Network Firm Examples

This document has been prepared by the staff of the International Ethics Standards Board for Accountants to illustrate the application of the network firm definition contained in the *Code of Ethics for Professional Accountants* (the Code). The Code contains ethical standards for professional accountants including independence requirements for professional accountants in public practice who perform assurance engagements. The definition of a network is relevant for independence purposes. A firm that is a member of a network (as defined in the Code) is required to be independent of the audit clients of other firms within the network.

The definition of network contained in the Code is:

A larger structure:

(a) That is aimed at co-operation; and

(b) That is clearly aimed at profit or cost sharing or shares common ownership, control or management, common quality control policies and procedures, common business strategy, the use of a common brand-name, or a significant part of professional resources.

The definition is identical to that contained in the EU 8th Directive. The Code also contains application guidance. The full text of the definition and guidance are included in Appendix A to this paper.

This paper analyzes some hypothetical associations to determine whether the particular association would be considered to be a network for independence purposes under the Code. Readers are cautioned that the determination of whether a particular association would be determined to be a network for independence purposes under the Code is a matter to be judged based on the particular facts and circumstances. The hypothetical examples contained in this paper are provided for illustrative purposes and are not intended to be, and cannot be, all inclusive. The examples are not a substitute for reading the full text of the Code and applying the guidance to the particular circumstances faced by an association.

In all of the examples presented below it is assumed that there are no unmentioned facts which would be relevant to the consideration as to whether the association would be considered a network.

Prepared by IESBA Staff

Facts	Analysis	Conclusion
A is an association of 120 firms, operating in 120 different countries, established to provide global services to clients. Each firm is a member of A International but is a separate and distinct legal entity. As a member of A International, each firm agrees to common quality control policies and procedures designed by A International and which are implemented and monitored throughout the association. Each firm uses the name A in marketing and promotional material and also when signing assurance reports. There are many common clients within the association.	A is a larger structure which is aimed at co-operation. The entities within the larger structure: • share common quality control policies and procedures which are designed, implemented and monitored throughout the larger structure; and • use a common brand name when the firms sign assurance reports. Either of these factors would be sufficient to make the association a network.	A is a network comprised of all the 120 firms.
B is an association of firms, operating in 120 different countries, established to provide global services to clients. Each firm is a separate and distinct legal entity. All of the firms are listed in the global directory of B. When performing assurance engagements, all firms use a common audit methodology which was developed by B. Each firm implements its own system of quality control policies and procedures and there is no shared monitoring across the association. All firms mention that they are a member of B association in marketing and promotional material. 80 firms use the name when signing assurance reports. There are numerous common clients between these 80 firms. The 40 other firms use a local name. There are no common clients between these 40 firms.	B is a larger structure which is aimed at co-operation. The 80 firms within the larger structure that use the name of B when signing assurance reports are a network. The other 40 firms, who use a local name when signing assurance reports are not part of a network. These 40 firms should, however carefully consider how their promotional material describes the membership in B to avoid the perception that they belong to a network.	B is a network comprised of the 80 firms that use the B name in the signing of assurance reports. The other 40 firms are not part of the network.

Facts	Analysis	Conclusion
C is an international association of firms formed to provide global services to clients. Each firm is a separate and distinct legal entity. Under the profit sharing arrangement, 30% of the profit of each firm is pooled and redistributed to individual firms based on a pre-defined formula.	C is a larger structure which is aimed at co-operation. The larger structure is clearly aimed at profit sharing.	C is a network.
D is a national association of firms formed to exchange ideas, information and expertise with the goal of improving the quality and profitability of the firms within the association. Each firm is a separate and distinct legal entity. The association conducts a number of educational programs each year covering matters such as changes in accounting standards. The association also distributes a monthly newsletter on matters of interest. All firms within the association are listed in a members' directory. Member firms use the directory to locate other members for matters such as referral of work or for identifying another firm with whom to partner for a specific piece of work.	D is a larger structure which is aimed at co-operation but it is not clearly aimed at profit or cost sharing and does not share common ownership, control or management, common quality control policies and procedures, a common business strategy, use of a common brand name or a significant part of professional resources.	D is not a network.
E is an association of firms in one country. Each firm is a separate and distinct legal entity. The firms use a common audit methodology and share a common technical department. Under the association agreement, all financial statements must be reviewed by the technical department before the audit report is issued. The advice from the technical department, either on review of the statements or through consultation during the audit, must be followed by the audit partner.	E is a larger structure aimed at co-operation. The use of a common audit methodology is not sufficient to conclude that the larger structure shares significant professional resources but there is also sharing of a technical department and the advice from this department is mandatory. This fact, coupled with the requirements for the technical department review of financial statements before release of the audit opinion, would indicate that the larger structure does share significant professional resources.	E is a network.

Facts	Analysis	Conclusion
F is an association of firms formed to provide global services to clients. Each firm is a separate and distinct legal entity. The firms within the association share common quality control policies and procedures. These policies and procedures were designed by F and have been implemented across the association and are monitored across the association. There is annual communication across the association of the scope, extent and results of the monitoring process. Under the association agreement the monitoring of each firm is performed by a group of people from a central location. The monitoring group has the authority to make specific recommendations for action. The conditions of membership require firms to take the recommended action.	F is a larger structure aimed at co-operation. The larger structure shares common quality control policies and procedures.	F is a network.
G is an association of firms in one region. Each firm is a separate and distinct legal entity. A condition of membership of the association is that each firm will ensure its system of quality control for assurance and other related services engagements complies with International Standard on Quality Control 1 (ISQC1) issued by the International Auditing and Assurance Board.	G is a larger structure aimed at co-operation but does not share common quality control policies and procedures. The agreement to ensure firms' system of quality control complies with ISQC1 is not the same as sharing common quality control policies and procedures.	G is not a network.

Facts	Analysis	Conclusion
H is an association of firms in one country formed to exchange ideas, information and expertise with the goal of improving the quality and profitability of the firms within the association. Each firm is a separate and distinct legal entity. The association conducts a number of educational programs each year covering matters such as changes in accounting standards. The association also distributes a monthly newsletter on matters of interest. All firms within the association are listed in a members' directory. Member firms use the directory to locate other members for matters such as referral of work or for identifying another firm with whom to partner for a specific piece of work. Many firms within the association indicate on their stationery and promotional materials that they are a member of H association. None of the firms use the H name in signing of assurance reports.	H is a larger structure which is aimed at co-operation but it is not clearly aimed at profit or cost sharing and does not share common ownership, control or management, common quality control policies and procedures, a common business strategy, use of a common brand name or a significant part of professional resources. The reference by some firms to the membership of H association does not in itself create a network firm relationship. Such firms should however, be careful how they describe the relationship to avoid the perception that the association is a network.	H is not a network.
I is an association of 10 firms in one country formed to share expertise to develop audit manuals to comply with new auditing standards. Each firm pays 1/10 of the cost of a small group of experts who have responsibility to develop the audit manuals.	I is a larger structure which is aimed at co-operation but it is not clearly aimed at profit or cost sharing and does not share common ownership, control or management, common quality control policies and procedures, a common business strategy, use of a common brand name or a significant part of professional resources. The sharing of the costs associated with the development of the audit manuals does not in itself create a network relationship.	I is not a network.

Facts	Analysis	Conclusion
J is an association of 10 firms in one country formed to utilize economies of scale in delivery of IFRS training to staff on within the firms. Each firm pays 1/10 of the cost of the development of the courses which are then delivered to all staff within each of the 10 firms.	J is a larger structure which is aimed at co-operation but it is not clearly aimed at profit or cost sharing and does not share common ownership, control or management, common quality control policies and procedures, a common business strategy, use of a common brand name or a significant part of professional resources. The sharing of the costs associated with the development of the IFRS training courses does not in itself create a network relationship.	J is not a network.

Appendix
Extract from Code of Ethics

The full test of the Code can be downloaded from www.ifac.org

Networks and Network Firms

290.14 An entity that belongs to a network might be a firm, which is defined in this Code as a sole practitioner, partnership or corporation of professional accountants and an entity that controls or is controlled by such parties, or the entity might be another type of entity, such as a consulting practice or a professional law practice. The independence requirements in this section that apply to a network firm apply to any entity that meets the definition of a network firm irrespective of whether the entity itself meets the definition of a firm.

290.15 If a firm is considered to be a network firm, the firm is required to be independent of the financial statement audit clients of the other firms within the network. In addition, for assurance clients that are not financial statement audit clients, consideration should be given to any threats the firm has reason to believe may be created by financial interests in the client held by other entities in the network or by relationships between the client and other entities in the network.

290.16 To enhance their ability to provide professional services, firms frequently form larger structures with other firms and entities. Whether these larger structures create a network depends upon the particular facts and circumstances and does not depend on whether the firms and entities are legally separate and distinct. For example, a larger structure may be aimed only at facilitating the referral of work, which in itself does not meet the criteria necessary to constitute a network. Alternatively, a larger structure might be such that it is aimed at co-operation and the firms share a common brand name, a common system of quality control, or significant professional resources and consequently is considered to be a network.

290.17 The judgment as to whether the larger structure is a network should be made in light of whether a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances, that the entities are associated in such a way that a network exists. This judgment should be applied consistently throughout the network.

290.18 Where the larger structure is aimed at co-operation and it is clearly aimed at profit or cost sharing among the entities within the structure, it is considered to be a network. However, the sharing of immaterial costs would not in itself create a network. In addition, if the sharing of costs is limited only to those costs related to the development of audit methodologies, manuals, or training courses, this would not in itself create a network. Further, an association between a firm and an otherwise unrelated entity to jointly provide a service or develop a product would not in itself create a network.

290.19 Where the larger structure is aimed at cooperation and the entities within the structure share common ownership, control or management, it is considered to be a network. This could be achieved by contract or other means.

290.20 Where the larger structure is aimed at co-operation and the entities within the structure share common quality control policies and procedures, it is considered to be a network.

For this purpose common quality control policies and procedures would be those designed, implemented and monitored across the larger structure.

290.21 Where the larger structure is aimed at co-operation and the entities within the structure share a common business strategy, it is considered to be a network. Sharing a common business strategy involves an agreement by the entities to achieve common strategic objectives. An entity is not considered to be a network firm merely because it co-operates with another entity solely to respond jointly to a request for a proposal for the provision of a professional service.

290.22 Where the larger structure is aimed at co-operation and the entities within the structure share the use of a common brand name, it is considered to be a network. A common brand name includes common initials or a common name. A firm is considered to be using a common brand name if it includes, for example, the common brand name as part of, or along with, its firm name, when a partner of the firm signs an assurance report.

290.23 Even though a firm does not belong to a network and does not use a common brand name as part of its firm name, it may give the appearance that it belongs to a network if it makes reference in its stationery or promotional materials to being a member of an association of firms. Accordingly, a firm should carefully consider how it describes any such memberships in order to avoid the perception that it belongs to a network.

290.24 If a firm sells a component of its practice, the sales agreement sometimes provides that, for a limited period of time, the component may continue to use the name of the firm, or an element of the name, even though it is no longer connected to the firm. In such circumstances, while the two entities may be practicing under a common name, the facts are such that they do not belong to a larger structure aimed at co-operation and are, therefore, not network firms. Those entities should carefully consider how to disclose that they are not network firms when presenting themselves to outside parties.

290.25 Where the larger structure is aimed at co-operation and the entities within the structure share a significant part of professional resources, it is considered to be a network. Professional resources include:

- Common systems that enable firms to exchange information such as client data, billing and time records;
- Partners and staff;
- Technical departments to consult on technical or industry specific issues, transactions or events for assurance engagements;
- Audit methodology or audit manuals; and
- Training courses and facilities.

290.26 The determination of whether the professional resources shared are significant, and therefore the firms are network firms, should be made based on the relevant facts and circumstances. Where the shared resources are limited to common audit methodology or audit manuals, with no exchange of personnel or client or market information, it is unlikely that the shared resources would be considered to be significant. The same applies to a common training endeavor. Where, however, the shared resources involve the exchange of people or information, such as where staff are drawn from a shared pool, or a common technical department is created within the larger structure to provide participating firms with technical advice that the firms are required to follow, a reasonable and informed third party is more likely to conclude that the shared resources are significant.

Definitions

Firm	(a) A sole practitioner, partnership or corporation of professional accountants; (a) An entity that controls such parties through ownership, management or other means; and (a) An entity controlled by such parties through ownership, management or other means.
Network firm	A firm or entity that belongs to a network.
Network[1]	A larger structure: ( ) That is aimed at co-operation, and (a) That is clearly aimed at profit or cost sharing or shares common ownership, control or management, common quality control policies and procedures, common business strategy, the use of a common brand-name, or a significant part of professional resources.

1 This definition is to be read in the context of the guidance provided in paragraphs 290.14-26.