

AICPA ANSWERS THE QUESTION:**When is an Association of CPA Firms a “Network” Subject to Additional Independence Requirements?****FROM THE DECATUR NEWS:**

“The accounting firm of Jones, Barney & Co., 100 South Main St., has joined the Flemington Network, an affiliation of more than 90 independent CPA firms serving closely-held businesses in the US. By joining the network, the firm has access to the national resources of Flemington, the nation’s 12th largest accounting and consulting firm in the country. Jones’ managing partner, Mark Altomare, said, ‘Our membership in the Flemington Network allows us to provide the same level of service as a national firm while maintaining the presence of a local firm.’”

This fictional account illustrates the ongoing trend of accounting firms participating in associations with other firms. Membership in an association, which can be national or international in scope, enables a firm to satisfy client demands for cross-border and other professional services that exceed its normal geographical boundaries and service offerings without merging with or acquiring another firm, or adding offices or personnel. Other benefits include: access to the association’s technical and training resources, knowledge-sharing, and inter-association referrals of work.

John L. Carey, former AICPA president and eloquent spokesman on accounting ethics, once wrote, “As society becomes more complex, so do its ideas of proper human behavior, and the professions in their ethical codes will inevitably reflect this growing complexity.” Participation in membership associations certainly adds complexity to practice. So after lengthy deliberations and issuing an exposure draft, the AICPA Professional Ethics Executive Committee (PEEC or the Committee) released a new independence standard in the AICPA *Code of Professional Conduct* (the Code) that addresses practice in certain types of membership associations, i.e., those that the Committee deems to be “networks.” The significance of operating as a network firm in a network (now defined terms in the Code) is this: among other things, a network firm must maintain independence not only of its own financial statement audit and review clients, but also with respect to the audit and review clients of other network firms in the network. An excerpt from the new standard (Interpretation 101-17, *Networks and Network Firms*), follows:

A network firm is required to be independent of financial statement audit and review clients of the other network

firms if the use of the audit or review report for the client is not restricted as defined by professional standards. For all other attest clients, consideration should be given to any threats the firm knows or has reason to believe may be created by network firm interests and relationships. If those threats are not at an acceptable level, safeguards should be applied to eliminate the threats or reduce them to an acceptable level. The independence requirements apply to any entity within the network that meets the definition of a network firm (ET section 92 par. 29).

Note: The *Conceptual Framework for AICPA Independence Standards* (ET§100.01) provides guidance on evaluating threats and (if needed) applying safeguards to resolve independence matters.

The following table highlights the characteristics that render an association of accounting firms a “network” and a firm a “network firm.” These generally relate to public perception of the relationship between the firms in the association, the degree of autonomy the firms have in the relationship with the association, and whether the firms have a significant stake in the risks and rewards of their participation in the association.

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WHAT MAKES AN ASSOCIATION A “NETWORK”?

Two basic criteria make an association a network. They are:

- (1) Firms and other entities in the association (“member firms”) cooperate with other member firms to enhance their capabilities to provide professional services, **and**
- (2) At least one of the following criteria are met:

Common Brand Name/Initials	<ul style="list-style-type: none"> • Member firms or entities controlled by member firms share a common brand name or common initials as part of their firm name. <p>A firm that does not use a common brand name as part of its firm name but refers to its membership in the association in its stationery or promotional materials should carefully consider how it describes that membership and take steps to avoid the perception that it belongs to a network. For example, the firm could state that it is “an independently owned and operated member firm of XYZ Association.”</p>
Common Control	<ul style="list-style-type: none"> • Member firms are under common control (as defined by US GAAP) with other member firms through ownership, management, contractual, or other means. <p>Exception: Associations may have certain membership requirements, which would not necessarily indicate that members are under common control.</p>
Profits or Costs	<ul style="list-style-type: none"> • Member firms share profits or costs. <p>Exception: Sharing the following costs do not, by themselves, create a network; (i) immaterial costs; (ii) costs related to operating the association; (iii) costs related to the development of audit methodologies, manuals, and training courses; (iv) costs arising from an arrangement between the firm and an otherwise unrelated entity to jointly provide a service or develop a product.</p>
Common Business Strategy	<ul style="list-style-type: none"> • Member firms share a common business strategy, which involves ongoing collaboration among the firms. Member firms are responsible for implementing the association’s strategy and are held accountable for performance pursuant to that strategy. <p>Exception: A member firm is not considered to be a network firm merely because it cooperates with another entity to market professional services or respond jointly to a request for a proposal to provide a professional service.</p>
Significant Professional Resources	<ul style="list-style-type: none"> • Member firms share a significant part of professional resources, including: <ul style="list-style-type: none"> - 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; - training courses and facilities. <p>Examples: Not Significant</p> <ol style="list-style-type: none"> 1. Member firms do not share a significant amount of human resources or significant client information (e.g., client data, billing, and time records) and can make independent decisions regarding technical matters, audit methodology, training, etc. 2. The shared professional resources are limited to a common audit methodology, audit manuals, training courses, or facilities, and do not include a significant amount of human resources or client or market information. 3. Firms occasionally use other member firms’ personnel to assist with an engagement. <p>Example: Significant</p> <p>Shared professional resources involve the exchange of client information or personnel, e.g., staff are drawn from a shared pool, or a common technical department is created within the association to provide participating member firms with technical advice that the firms are required to follow.</p>
Sharing Common Quality Control Policies and Procedures	<ul style="list-style-type: none"> • Member firms are required to follow common quality control policies and procedures, which are monitored by the association.

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Note: If none of the above criteria are met and a member firm solely refers work to or receives referrals from other member firms in an association, that would neither render the association a network nor the firm a network firm.

Effective Date

This interpretation and two related definitions will be effective for engagements covering periods beginning on or after July 1, 2011. The PEEC has also issued implementation guidance (see Resources below).

Resources

Interpretation 101-17, Networks and Network Firms
http://www.aicpa.org/Research/Standards/CodeofConduct/Pages/et_101.aspx#10117

ET§92.21, Network
 ET§92.22, Network Firm
http://www.aicpa.org/Research/Standards/CodeofConduct/Pages/et_92.aspx

Implementation Guidance
<http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/Ethics%20Division%20Network%20Firm%20Implementation%20Guidance.docx>



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Cathy Allen, founder of **Audit Conduct**, LLC, helps CPA firms strengthen their quality controls over independence and ethics by developing courses and practice tools, delivering customized training, consulting on specific matters, and assisting with compliance issues. A former senior staff member of the AICPA Professional Ethics Division and Director of Independence for two of the ‘big four’ accounting firms, she also provides litigation support on matters involving the professional conduct of accountants.