

IESBA

International
Ethics Standards
Board for Accountants®

Proposed IESBA Definition of Public Interest Entity

Supplementary Guidance to Exposure Draft to Aid Local Body
Considerations Regarding Adoption and Implementation



MARCH 2021

Purpose



This staff publication provides additional explanation and information on the IESBA's proposed revisions to the definition of public interest entity (PIE) in the Exposure Draft, *Proposed Revisions to the Definitions of Listed Entity and Public Interest Entity in the Code* (PIE ED) and supplements some of the guidance material in the explanatory memorandum of the ED.

This publication has been developed to, amongst other things, assist local regulators, national standard setters or other relevant local bodies in considering and planning adoption of the revised PIE definition when finalized and issued by the IESBA. **The IESBA recognizes that there may be refinements to the proposals as a result of the comments received on exposure.**

Firms may also find this publication helpful in further understanding the requirement for them to determine whether to treat additional entities, or categories of entities, as PIEs in accordance with proposed paragraph R400.16.

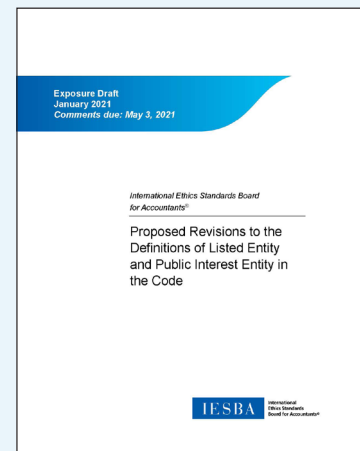
This staff-prepared publication does not amend or override the Code, the text of which alone is authoritative. Reading this publication is not a substitute for reading the Code. This guide is not meant to be exhaustive and reference to the Code itself should always be made. This publication does not constitute an authoritative or official pronouncement of the IESBA.

Introduction



In January 2021, the IESBA released the PIE ED which proposes amongst other things to:

- Introduce an overarching objective for additional independence requirements for audits of entities that are PIEs.
- Provide guidance on factors for consideration when determining the level of public interest in an entity.
- Expand the extant definition of PIE to a list of categories of entities that should be treated as PIEs, subject to refinement by the relevant local bodies responsible for ethics standard setting as part of the adoption and implementation process.
- Replace the term “listed entity” with one of the new PIE categories, “publicly traded entity.”
- Elevate the extant application material that encourages firms to determine whether to treat additional entities as PIEs to a requirement and include enhanced guidance on factors for consideration by firms.
- Require firms to disclose if an audit client has been treated as a PIE.



On January 29th, 2021 the IESBA released *Proposed Revisions to The Definitions of Listed Entity and Public Interest Entity In the Code*.

[Click the image to read more](#)

The IESBA's Proposed Approach



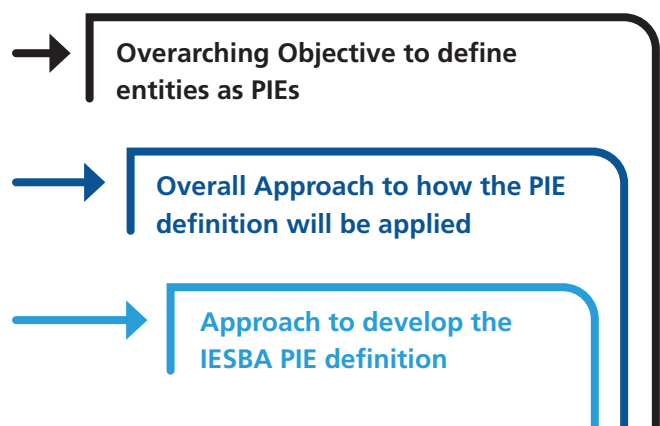
Overarching Objective

In considering how the definition of PIE should be enhanced, the IESBA took the view that it is important to first have clarity about the overarching objective of defining a class of entities for which the audits require additional independence requirements.

Such an objective would then form the basis of the overall approach and also provide a clear principle against which any proposals can be tested.

The proposed overarching objective (see paragraphs 400.8 and 400.9) means that when refining the IESBA definition and determining which entities should be categorized as PIEs in the local code, it is important for relevant local bodies to assess the *public interest in the financial condition* of an entity (i.e. how its financial success or failure may impact the public) and not the public interest in

other aspects of that entity such as the quality of the products or services it provides, the manner in which it delivers those products or services, or the nature of the data the entity holds.





Example 1

Whilst there might be a significant level of public interest in the provision of services by a public hospital given its role within a jurisdiction’s health services infrastructure, whether that public hospital should be categorized as a PIE in the local code will depend on the public interest in its financial condition. In this regard, the financial condition of a public hospital might not attract significant public interest if the government is committed to providing sufficient funding to enable it to continue the provision of its services.

Example 2

Whilst there might be significant public interest in charities if they have significant “public funding” or they deliver services and activities for the benefit of vulnerable communities, the public impact of their financial failures will vary from charity to charity. For instance, the public interest in the financial condition of a private foundation with only a few founding donors which primarily provides grants to other charities might not be significant as its financial failure would not have the same level of public interest as the financial failure of a major charity that runs programs that directly assist vulnerable beneficiaries.

Example 3

For social media providers, there might be significant public interest in how they manage the collection, use and disposal of their users’ data that contain personal and sensitive information. However, whilst the financial success or failure of social media providers will impact their investors, there is only likely to be limited impact on their users given that the providers are usually free to join and they are easily replaced by other similar providers.

Broad Approach to How the Code will be Applied

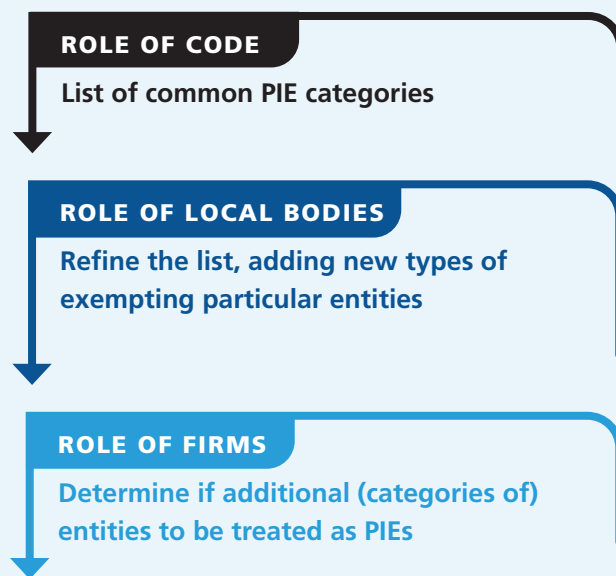
The IESBA’s proposed approach to revising the definition of PIE is a broad approach which uses a longer and more broadly defined list of categories. This is contrasted with the more limited approach adopted by the extant Code which only has a narrow list of entities to which local bodies can add.

This broad approach comprises 3 key elements:

- The development of a longer and broader list of high-level categories of entities as PIEs in the IESBA Code;
- Refinement of the IESBA definition by relevant local bodies by tightening definitions, setting size criterion and adding new types of entities or exempting particular entities; and
- Determination by firms if any additional entities should be treated as PIEs.

Broad Approach

A longer and more broadly defined list which local regulators and authorities can modify by following definitions, setting size criteria and adding new types of PIEs or exempting particular entities.



Under this approach, relevant local bodies will play a pivotal role towards ensuring that the list of PIE categories applicable in the local setting is fit for purpose. To achieve this, relevant local bodies are expected to refine the IESBA definition as part of the local adoption and implementation process, taking into account, amongst other things, the overarching objective and the list of factors set out in paragraph 400.8 (see discussion below).

As highlighted in the PIE ED, the IESBA’s rationale for relying on local bodies to refine the definition is that local regulators, national standard setters or other relevant bodies have the responsibility, and are also best placed, to assess and determine which entities or types of entities should be treated as PIEs for the purposes of additional independence requirements. A number of countries, such as European Union member states, the UK, Australia and South Africa, have already developed their own definitions of PIE for the purposes of additional independence requirements.

Further, the IESBA recognized that any categories it seeks to include in a global principles-based Code will inevitably be quite broad and could therefore scope in entities in respect of which the public interest is not significant. Also, in some jurisdictions there will be categories of entities that should be added as PIEs because of the level of public interest in their financial condition or well-being but which would not be suitable as PIEs for all jurisdictions at the global level.

Under the IESBA’s broad approach, firms are also required to determine if any additional entities or categories of entities should be treated as PIEs. It is important to note that firms can only add additional audit clients as PIEs and cannot treat any audit clients as non-PIE entities if those entities are required to be treated as PIEs for the purposes of the Code.

Approach to Develop the Five Specific PIE Categories

Proposed paragraph R400.14 sets out the list of PIE categories as follows:

(a)	A publicly traded entity
(b)	An entity one of whose main functions is to take deposits from the public
(c)	An entity one of whose main functions is to provide insurance to the public
(d)	An entity whose function is to provide post-employment benefits
(e)	An entity whose function is to act as a collective investment vehicle and which issues redeemable financial instruments to the public
(f)	An entity specified as such by law or regulation to meet the objective set in paragraph 400.9

5 specific categories



The IESBA considered a number of other categories during the development of the definition. However, it concluded that whilst those other categories may have applicability in specific jurisdictions, none of them were likely to be of global relevance.

In looking at existing PIE definitions used in various jurisdictions, the IESBA noted that they were often defined by reference to local legislation governing, for example, entities carrying on banking or insurance businesses. As the IESBA Code is intended for global application, the IESBA is not able to follow a similar course. Hence, the categories in the proposed definition are broadly based and described in such way as to avoid the use of terms that are more jurisdiction specific.

In addition, the IESBA recognized that in attaching no size criterion to the various categories in the definition, it was potentially scoping in some very small entities that would not objectively be considered to be PIEs. However, the IESBA did not believe it would be practicable to define size thresholds that would be capable of global application. Proposed paragraph 400.15 A1 therefore makes clear that the IESBA list does not give any recognition to size. Instead, the Code provides for the relevant local bodies to further refine these categories, including the exclusion of entities that should not be treated as PIEs. If these categories were adopted by the relevant local bodies as they are without any refinement, they will likely scope in entities that do not have significant public interest.

IESBA Approach to developing the 5 specific categories (R400.14 (a)-(e))

INCLUDE →

- Categories that are likely to be adopted by most jurisdictions
- Categories suited for a global list because of the nature of their main functions

EXCLUDE →

- Categories that would only be included by local bodies because they are very large

Refining the IESBA Definition of PIE



When considering how to refine the IESBA's definition of PIE in proposed paragraph R400.14 for local adoption, a relevant local body should ask, with respect to:

1. The Code's PIE Categories (Subparagraphs R400.14(a) to (e))
 - How might each of the five specific categories be further refined so that the right entities are scoped in or out as the case may be? This could be by reference to local law or regulation—for example, defining what is a bank or on which markets/trading platforms securities are regarded as being publicly traded, as well as possibly setting size criterion.
2. Entities Defined by Law or Regulation as PIEs (Subparagraph R400.14 (f))
 - Which entities have been specified by law or regulation as PIEs having regard to the objective in paragraph R400.9? However, if an entity was defined by local law or regulation as PIE but for reasons unrelated to the objective set out in paragraph 400.9

(see paragraph 400.14 A1), that entity should not be treated as a PIE under subparagraph R400.14(f).

3. Additional Categories

- Are there any additional categories of entities that should be included as PIEs?

To address the above three questions, the IESBA expects that the relevant local body will, amongst other matters:

- Be guided by the overarching objective (see proposed paragraphs 400.8 and 400.9) for defining entities as PIEs in the Code.
- Consider the list of factors set out in proposed paragraph 400.8 for determining the level of public interest.
- Consider whether the entities concerned can fulfill the requirements imposed for PIEs, for example being subject to some form of corporate governance that will permit those charged with governance to assume the role envisaged for them by the Code.

List of Factors for Consideration

When considering the list of factors in proposed paragraph 400.8, it is important to note that the list is not exhaustive and there may be other relevant factors to consider in the specific jurisdiction. Further, each factor on its own may not be sufficient to determine if a category of entities should be added.

1 **Nature of Business and Activities**

The nature of the activities, such as taking on financial obligations to the public as part of an entity's primary business

- In relation to this factor, the IESBA intends the term “public” to encompass not only individuals but also other entities.
- The two most obvious examples of entities in these categories are banks and insurers. However, depending on the jurisdiction, there may be other examples of entities which, as part of their business model, take on significant financial obligations to the public.
- The IESBA expects that local jurisdictions might also exclude certain entities even if the nature of the primary business or activities might give rise to some level of public interest in their financial condition. For example, the IESBA noted that some local codes exclude entities such as credit unions or certain mutual insurance concerns.

2 **Regulatory Supervision**

Whether the entity is subject to regulatory supervision designed to provide confidence that the entity will meet its financial obligations

- This factor relates to entities that are subject to financial or prudential regulatory supervision designed to give confidence that the entities will meet their financial obligations. Such regulation is primarily but not necessarily restricted to financial markets. If an entity is subject to regulatory supervision that includes ensuring it meets its financial obligations, there is likely to be significant public interest in that entity's financial condition.

3 **Size**

Size of the entity

- Size as a factor can be viewed both from the perspective of excluding very small entities that might meet other factors, and from the perspective of considering very large entities that by sheer size alone might qualify to be regarded as of significant public interest. This latter aspect will often be linked to bullet #5.
- This is one of the key factors that should be taken into consideration as, under the IESBA's approach for developing its list of PIEs, smaller entities within each of the categories in proposed paragraph R400.14 will be scoped in irrespective of whether they are deemed to have significant public interest in their jurisdictions.
- For instance, under CPA Canada's Independence Standards – Harmonized Rule of Professional Conduct that addresses independence requirements (Rule 204),¹ the definition of “listed entity” excludes those entities which have, in respect of a particular fiscal year, market capitalization and total assets that are each less than \$10,000,000. Another example is that under South Africa's IRBA Code of Professional Conduct for Registered Auditors, entities are presumed to have satisfied the conditions of a PIE if they are insurers “registered under the Long-term Insurance Act 1998, (Act No. 52 of 1998) and the Short-term Insurance Act 1998, (Act No.53. of 1998) excluding micro lenders.”

1. The extent to which Rule 204 is adopted by individual Canadian provincial bodies and CPA Bermuda is determined by those bodies.

4 Importance to Sector

The importance of the entity to the sector in which it operates including how easily replaceable it is in the event of financial failure

- This factor relates to entities that are an integral part of a sector such as the energy sector or capital markets. The harder it is to replace an entity to provide the relevant products or services if it were to suffer financial failure, the greater the likelihood that it will have a higher level of public interest.
- This factor is particularly relevant to entities such as public utility entities and financial market infrastructure entities.
- For instance, companies that sell electricity plans to retail customers are unlikely to play an integral part in the energy sector. The financial failure of such a company is unlikely to create significant disruption as its customers would be able to sign up with another company and receive similar services.

5 Number and Nature of Stakeholders

Number and nature of stakeholders including investors, customers, creditors and employees

- The greater the number of stakeholders and the broader the range of stakeholders an entity has, the more likely there will be significant public interest in the financial condition of that entity.
- This factor calls for consideration of not only the number of stakeholders, but also their nature. For instance, the level of public interest may not be high if the investors are mostly sophisticated investors who are investing for their own accounts.
- Another example is local credit unions that take deposits from the public but may only have relatively small numbers of customers. A relevant local body might determine that such entities should be excluded from being treated as PIEs.

6 Systemic Impact

The nature of the activities, such as taking on financial obligations to the public as part of an entity's primary business

- Irrespective of the other factors, if an entity's financial failure were to have a significant impact on the economic system in which it operates, this would indicate that it is of significant public interest.
- Whilst many entities of systemic impact would be expected to be part of the financial systems and therefore captured under some of the other categories of the PIE definition such as publicly traded entity, the IESBA is of the view that there may be other entities in a local jurisdiction that will have such impact.

A relevant local body might determine that only certain types of entities within each IESBA PIE category should be treated as PIEs under paragraph R400.14 or determine to exclude specific entities. For instance, a relevant local body might determine to exclude some state-owned entities that would otherwise be encompassed by the IESBA definition, such as a state-owned bank.

Other Categories for Consideration

In addition to refining the list of PIE categories set out in paragraph R400.14, a relevant local body may also consider including other categories of entities as additional categories of PIEs in its local code, taking into consideration the local context.

Examples of local codes that already include an expanded list of PIEs:

- [Australia](#)
- [New Zealand](#)
- [Singapore](#)
- [South Africa](#)

The following is a list of those categories that the IESBA has determined not to have sufficient public interest to be categorized as PIEs in a global code. Whilst these may not be suitable PIE categories for the Code, relevant local bodies might determine to include some of them as PIEs in their local codes. Some jurisdictions have already included some of these categories as PIEs in their local codes. The IESBA also noted that some of the entities in these categories may already fall within one of the other PIE categories (e.g., an entity would be a publicly traded entity if they issued debt instruments that are transferable and publicly traded).

Charities



Charities cover a broad range of sectors such as social and welfare, education, sports, health, arts and religion. In this regard, it may be argued that the level of public interest in these entities varies depending on the nature of their operations and services. For instance, the public interest in the financial condition of a major welfare organization on which its beneficiaries are highly dependent may be different to that of a local sporting club that is also registered as a charity.

Charities also vary in size – in terms of donations, the number and types of donors and beneficiaries, as well as number of employees. For instance, some of the largest private foundations in the world may have only a small number of donors (often the founders) and distribute their money to grantees (often other charities) instead of directly for the benefit of members of the public. The level of public interest in such private foundations' financial condition might therefore be lower than that in those charitable organizations which run programs that directly benefit large numbers of the public and receive donations from a broad spectrum of society.

There is also a public interest in ensuring that as far as possible a charity's monies are spent on its charitable objectives and not on administration. To meet this public interest, the audit requirements for charities are often less stringent than those for similar sized commercial enterprises. In this regard, the IESBA recognizes that application of the PIE requirements of the Code may have cost implications.

The IESBA therefore determined that the public interest in the financial condition of a charity will vary considerably depending on factors such as size, nature of services and number of stakeholders. Accordingly, the IESBA did not consider it appropriate to include charities as a separate category of PIE in a global code.

Nonetheless, this may well be a category which can selectively be added by local jurisdictions. For example, the Singapore's [ISCA Code](#) provides that the audit of large charities and large institutions of a public character are subject to the same independence requirements applicable to listed entities if they meet certain size thresholds as defined by the relevant laws and regulations. Similarly, New Zealand's [XRB Code](#) also includes not-for-profit entities of a certain size as PIEs. Finally, whilst charities are not listed as a category of PIE in its local Code, Australia's APESB has recently published an [Independence Guide](#) that includes an illustrative example of a significant charity as an entity that firms might determine to treat as a PIE.

Public Utilities



A public utility is an entity that provides essential services to the public such as electricity, gas, water and postal services.

Whilst there may be significant public interest in the continuing operations of a public utility entity because of

the essential nature of the services it provides, the level of public interest in the financial condition of such entity will depend on a number of factors. Such factors may include the source and sustainability of its funding and whether in the event of financial failure, the provision of its services can be readily replaced by other service providers.

In this respect, the IESBA also acknowledges that the term “public utility” might encompass a range of entities involved in the overall supply chain of services to the public. So, for example, in the case of the supply of electricity, the generation, transmission and customer relationship/ distribution might be undertaken by separate entities, some of which might be more easily replaced than others.

For these reasons, the IESBA determined this was not a suitable category to try to define at a global level, but might clearly need to be considered within specific jurisdictions.

Public Sector Entities



Similar to the rationale relating to public utility entities, whilst there may be significant public interest in the continuing operations of a public sector entity, the level of public interest in the financial condition of such entity will depend on a number of factors. In addition, some public sector entities in certain jurisdictions are audited by other arms of government rather than by professional accountants.

Accordingly, the IESBA is of the view that public sector entities should not be included as a separate PIE category in a global code.

Large Private Companies



The IESBA is of the view that what is “large” will vary from jurisdiction to jurisdiction and it would be impossible to set an appropriate monetary limit which would be of global application. Whether there is sufficient public interest in the financial condition of a particular private company or types of private companies will also depend on other factors such as those included in the proposed paragraph 400.8.

Accordingly, the IESBA is of the view that large private companies, including any companies that were once publicly traded companies, should not be included as a separate PIE category in a global code. Instead, the inclusion of any private companies or categories of private companies should be considered only at the local level. For instance, some jurisdictions might determine that any private companies that are required to file certain types of financial statements should be added as a category of PIE.

The IESBA noted that under the UK Financial Reporting Council’s (FRC’s) revised Ethical Standard as of December 2019, the statutory audit of an entity that meets the definition of “other entity of public interest” (OEPI) is subject to certain independence requirements with respect to the provision of non-audit/additional services. Under the UK FRC’s revised Glossary of Terms, large private companies that meet certain thresholds and criteria are deemed to be OEPIs. The IESBA further notes that such entities have also been subject to enhanced corporate governance requirements.

Private Equity Funds



Private equity funds generally receive investments from institutional investors and do not attract funds from the public directly.

Similar to the rationale for large private companies, the IESBA is of the view that whether there is sufficient public interest in the financial condition of a private equity fund will depend on other factors such as those included in the proposed paragraph 400.8. Accordingly, the IESBA is of the view that private equity funds should not be included as a separate PIE category in a global code.

Financial Market Infrastructures, Stock and Commodity Exchanges



In the [Principles for Financial Market Infrastructures \(PFMI\)](#) of the Committee on Payment and Settlement Systems of the International Organization of Securities Commissions (IOSCO), financial market infrastructure (FMI) is defined as:

A multilateral system among participating institutions, including the operator of the system, used for the purposes of clearing, settling, or recording payments, securities, derivatives, or other financial transactions.

FMI play a significant role within the financial system and are considered to be systemically important. Safe and efficient FMIs are essential for a stable and well-functioning financial system. This means they require sound design and high standards of operational and financial resilience. FMIs can be structured in a variety of forms, including associations of financial institutions, nonbank clearing corporations, and specialized banking organizations. They may also be owned and operated by central banks or by the private sector and can be either for-profit or not-for-profit. FMIs may include payment systems, central securities depositories, securities settlement systems, central counterparties and trade repositories.

Similarly, stock and commodity exchanges play an important role within the financial system and the wider economy by providing the infrastructure, facilities and regulatory environment that allow businesses, industries and governments to raise capital, and investors to buy and sell various types of financial instruments. Many stock exchanges today are listed entities themselves and are therefore already classified as PIEs under the extant Code's definition.

The IESBA is of the view that the FMIs, stock and commodity exchanges should not be added as a PIE category in a global code for the following reasons:

- Whilst the health of FMIs, stock and commodity exchanges is clearly important to the proper functioning of financial markets, given their typically large size, lack of substitutability in the markets they serve, and strong connections with banks and other financial institutions, the IESBA is of the view that the public interest in these entities relates more to their operations (including compliance with all necessary legal requirements) than their financial condition.
- The legal structure of such entities varies considerably between jurisdictions. For instance, as noted many stock exchanges are now listed entities in their own right and would therefore be treated as PIEs for that reason. Some, in contrast, are still mutual

organizations owned by their members that effectively support it from a financial perspective. Payment organizations are similar. For example, in the UK, the payments services provider Pay.UK is effectively sponsored by the Bank of England and the major banks – the fact therefore that it is currently showing negative reserves in its financial statements is of little or no consequence to the public who depend on its operations.

Custodians



A custodian either of assets or of cash is an entity (often a financial institution) which maintains assets (which may include cash) on behalf of third-party clients. Custodians can take many different forms – from those simply providing such services to those that also provide linked advisory or investment management services. In addition, they may act as sub-custodians for other custodians. Where title to investments is held electronically, a central securities depository such as the Depository Trust Company or the various Euroclear subsidiaries in the European markets also in effect acts as the ultimate custodian. Generally, such third-party assets, including cash, held by a custodian do not feature as part of the custodian’s own financial statements, although some operational cash balances may be shown on the balance sheet offset by an equivalent liability to the client.

The third-party clients on whose behalf the assets are maintained may be other custodians, members of the public (for example, individuals with broker-dealer accounts) or mutual funds (generally run by investment managers).

Whilst there is clearly a public interest in ensuring the proper maintenance and integrity of the systems used to control and report on the client assets held by a custodian, the role of the auditor of the custodian’s financial statements may vary. In addition, in many jurisdictions, regulation requires segregation of custody assets in order to protect clients in the event of financial failure of the custodian.

Amongst other matters, the IESBA also noted that:

- At some level there is clearly a need for the financial statement auditor to consider if the custodian is complying with laws and regulations as regards its operations, However, the review and reporting to regulators of its client’s compliance with such laws and regulations are not necessarily the responsibility of the financial statement auditor.
- If the custodian’s client is itself subject to audit, then its auditor will often require the issuance of a controls report, such as under the International Auditing and Assurance Standards Board’s (IAASB’s) International Standard on Assurance Engagements (ISAE) 3402², to support the existence of the client’s assets. Similarly, such reports can be, but are not necessarily, issued by the custodian’s financial statement auditor. This can, in turn, impact what regulatory reports are required. For instance, in the US a qualified custodian is subject to a surprise examination of its custody systems by an auditor (which does not need to be the same firm that performs the audit of the financial statements), unless the investments are held on behalf of a pooled investment vehicle which itself has an appropriate audit.

Given the complexities, therefore, the IESBA felt that it was not appropriate to try to define a category to encompass those entities performing a custodian function where the role of their own financial statements and hence of the financial statement auditor was of significant public interest. Depending on the custodian arrangements in specific jurisdictions this would, however, be an aspect that might require further consideration.

2. International Standard on Assurance Engagements (ISAE) 3402, *Assurance Reports on Controls At a Service Organization*.

Systemically Significant Entities



The IESBA also considered whether, in addition to financial institutions that are systemically important, there are other systemically significant entities that should be included as a PIE category.

A systemically significant entity is an entity whose potential failure may cause serious harm to other industries and to the economy, or an entity that is “too big to fail.” The IESBA observed that aside from the large banks, it had as yet not been possible to achieve a global consensus on what other types of entities might be of systemic significance, although there had been some consideration of major insurance companies and hedge funds/asset managers as systemically significant entities.

The IESBA is, therefore, of the view that, whilst whether an individual entity has a systemic significance should play a part in the criteria used to determine if the entity is a PIE, the term is too subjective and requires too much local context to usefully include it as a separate category in a global code.

Role of Firms

Similar considerations to those above might also play a part in assisting firms to determine whether other entities should be treated as PIEs. For further information about the proposed new requirements for firms, refer to the PIE ED. These include the requirements to (1) determine if additional entities, or certain categories of entities, should be treated as PIEs (guidance is provided on additional factors for consideration) and (2) disclose if an entity has been treated as a PIE.

About the IESBA

The International Ethics Standards Board for Accountants ([IESBA](#)) is an independent global standard-setting board. The IESBA's mission is to serve the public interest by setting ethics standards, including auditor independence requirements, which seek to raise the bar for ethical conduct and practice for all professional accountants through a robust, globally operable *International Code of Ethics for Professional Accountants (including International Independence Standards)* (the Code).

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