Definitions of Listed Entity and Public Interest Entity – Issues and Task Force Preliminary Views

PURPOSE OF THIS PAPER

1. This paper provides a summary of the Task Force's observations based on its information gathering to date and the Task Force's preliminary views.

2. During the March 2020 IESBA meeting, the Task Force Chair will present this paper in conjunction with a strawman draft of the proposed text in **Agenda Item 9-B**. The strawman draft is to illustrate how the Task Force's views might be incorporated in the Code and it is not intended that the Board provide drafting comments during the meeting. To the extent, however, that there is a broad consensus on the direction of travel, the Task Force would welcome any observations from Board members after the meeting on how the proposals might best be implemented.

3. The IESBA is asked to provide input to the following.

Matters for IESBA Consideration

1. IESBA members are asked to provide input on:

   (a) The Task Force's view on the overarching objective for the Code in imposing more stringent independence requirements for the audit of certain types of entities. In this regard, the Board is specifically invited to comment on the Task Force's first draft of such an objective as set out below (see paragraphs 14–19).

   (b) The Task Force's preferred approach to develop a revised categorization to replace the extant definition of "public interest entity," (PIE) including the suggestion of replacing the term "PIE" with "significant public interest entity" (SPIE) (see paragraphs 20-27, 30-41; for "SPIE", see paragraphs 40-41).

   (c) Other matters raised in this paper as appropriate, including views on the practicality of expanding the definition of audit client to include all related entities for any revised category of "PIE" in paragraph R400.20 of the Code (see paragraphs 40-41; for "related entities", see paragraphs 42-44).

   (d) The Task Force's next steps, including whether there is any further research that the Board considers would be helpful (see paragraphs 45-47).

BACKGROUND

A Brief History

4. Prior to the introduction of PIE, the Code used the term "listed entity" to differentiate those entities for which the audits should be subjected to more stringent independence requirements. Paragraph 290.28 of the 2005 Code explained that Section 290[1] contains additional matters that are relevant

[1] Section 290, *Independence – Audit and Review Engagements*

to the financial statement audit of "listed entities" because of the strong public interest in their financial statements.

5. As part of its Independence Project during mid to late 2000, the IESBA proposed to extend the independence requirements for audits of listed entities to audits of entities of significant public interest in recognition of the need for more specific guidance and in light of the public interest associated with a wide range of entities.

6. The PIE concept was established in the Code in March 2008 when the IESBA finalized revisions to the independence provisions in the former Section 290. In adopting this concept, the Board at the time did not specify any types of entities, such as banks or insurance undertakings, that should be treated as PIEs. Other than listed entities, therefore, the decision for determining what should be treated as a PIE was largely left to local regulators and authorities, although firms were also encouraged to consider whether an audit client should be treated as a PIE based on some guidance provided in the Code.

7. The definitions of PIE and listed entities have remained unchanged since the introduction of PIE into the Code in 2008.

8. Since then, there have been calls from some within the regulatory community, such as the International Association of Insurance Supervisors (IAIS) and the Basel Committee on Banking Supervision (Basel Committee), as well as the small and medium practices (SMP) community, the Public Interest Oversight Board (PIOB) and others to review the PIE definition in the Code to ensure the right entities or types of entities are being scoped in or scoped out. Some stakeholders have also queried the currency and clarity of the definition of "listed entity." See the project proposal for more information about the comments received.

9. Whilst this project was earmarked to commence only in Q2 2021, the IESBA agreed that it should be brought forward to provide clarity about the scope of entities that would be impacted by the proposed changes in both the Non-Assurance Services and Fees Exposure Drafts (EDs) released in January 2020. Both these projects are proposing additional independence requirements for PIE audits. The IESBA approved the project proposal on the definition of PIE and listed entity at its December 2019 meeting.

Objectives of Project

10. The objectives of the project are two-fold:

    (a) To review, in coordination with the International Auditing and Assurance Standards Board (IAASB), the definitions of the terms "listed entity" and "PIE" in the Code with a view to revising them as necessary so that they remain relevant and fit for purpose; and

    (b) In doing so, to:

        (i) Establish agreement between the IESBA and IAASB on a common revised definition of the term "listed entity" that would be operable for both Boards' standards; and

        (ii) Develop a pathway that would achieve convergence between the concepts underpinning the definition of a PIE in the Code and the description of an "Entity of significant public interest" (ESPI) in the IAASB standards to the greatest extent possible.

February 2020 PIOB List of Public Interest Issues

11. In its February 2020 list of public interest issues on the IESBA work streams, the PIOB welcomed this project, noting that it is crucial to determine the categories of entities (e.g. financial institutions, listed companies, significant utility companies), which should be subject to stricter provisions in the Code as the PIE definition affects other IESBA projects such as NAS and Fees. The PIOB also encouraged the IESBA to coordinate with the IAASB to ensure consistent application of the two sets of standards.

INFORMATION GATHERING ACTIVITIES TO DATE

12. In developing its preliminary views set out in this paper, the Task Force:

- Reviewed the development of the current PIE definition by the Board as part of its Independence project between 2006 – 2008, including the Board's rationale.
- Completed a scan of the use of the terms "PIE" and "listed entity" in the extant Code as well as the recently released NAS and Fees EDs.
- Conducted a review of the definition of PIE and other equivalent terms used in a number of jurisdictions, including the EU, United Kingdom, South Africa, Hong Kong, Singapore, Australia and New Zealand.
- Has commenced a review of the definitions of listed entities or equivalent terms used by jurisdictions.
- Has discussed with the IAASB correspondent members the use of the terms "listed entity" and ESPI in the IAASB standards, including the most recent developments with regards to the proposal not to extend the engagement quality review (EQR) requirements to "ESPIs" in the ISQM 1 Exposure Draft (ED).[2]

13. Refer to **Agenda Item 9-C** for some of the additional background information reviewed by the Task Force as of February 2020.

OVERARCHING OBJECTIVE FOR MORE STRINGENT INDEPENDENCE REQUIREMENTS

14. In considering if, and how, the definition of PIE should be enhanced, the Task Force believes that it is important, at the outset, to have clarity about the objective for defining a class of entities for which the audits require more stringent independence requirements. This can then inform the approach and also provide a clear principle against which any proposals can be tested.

15. The Task Force noted, as mentioned above, that Section 290 of the 2005 Code (prior to the introduction of the concept of PIE to the Code) contained the following explanation about why there were additional independence matters in the Code that are relevant to the audit of listed entities:

> *Paragraph 290.28 (2005 Code)*
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> *The evaluation of the significance of any threats to independence and the safeguards necessary to reduce any threats to an acceptable level, takes into account the public interest.*

[2] Proposed International Standard on Quality Management (ISQM) 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*

> *Certain entities may be of significant public interest because, as a result of their business, their size or their corporate status they have a wide range of stakeholders. Examples of such entities may include listed companies, credit institutions, insurance companies, and pension funds.* ***Because of the strong public interest in the financial statements of listed entities, certain paragraphs in this section deal with additional matters that are relevant to the financial statement audit of listed entities****. (Emphasis added)*

16. In addition, a 2006 IESBA paper provides further insight into the rationale for additional independence requirements for audits of listed entities:

> *The rationale for applying differential requirements to listed entities is in terms of the perceived threats to independence, actual threats being addressed by the core requirements applicable to all audits. Listed entities have a much higher visibility and a wider range of stakeholders than privately owned entities, and it is more difficult to communicate on a direct basis to deal with perception concerns. The IFAC guidance has therefore required specific extra safeguards to be applied when auditing listed entities, to address the perception threats that would cause concern to a reasonable and informed third party… A rationale can be constructed for a degree of differentiation on the grounds that the public is in practice most interested in listed companies because there is a very widespread direct or indirect ownership interest in listed entities, which is a factor not typically present with other PIEs.*[3]

17. In the Task Force's view, there are types of entities (in addition to listed entities) for which there is significant and wide public interest in their financial condition and hence financial statements. It is important, therefore, that there is public confidence in those financial statements. A major contributor to that confidence is in turn confidence in the audit of such financial statements. Building on the observations above, the Task Force is of the view that additional and more stringent independence requirements (together with additional quality management measures specified in the IAASB's standards) would indeed serve to enhance the confidence in such audits.

18. The Task Force has therefore prepared a first draft of the overall objective as set out below:

> *400.8 Some of the requirements and application material set out in this Part are applicable only to the audit of financial statements in which there is a significant public interest. The purpose of these additional requirements and application material is to enhance confidence in such financial statements through enhancing confidence in the audit of those financial statements.*

19. The Task Force also noted that:

- There might be some circumstances that would not permit increased confidence in the entity's audit to either be feasible or achieve the increased confidence in the financial statements. For instance, laws and regulations might not require an audit of the financial statements in the first place, the necessary levels of corporate governance might be absent, or the financial reporting framework itself might not be robust. Under these circumstances, additional independence requirements could impose an undue cost on the entities without achieving the objective of enhanced confidence in the financial statements.

[3] IESBA Agenda Paper 3-C, Independence Public Interest Entities, February 2006

- There may not necessarily be significant public interest in an entity's financial statements even if there is significant public interest in that entity for other reasons – such as determining the quality of the services it provides.
- Clearly if the objective is to enhance confidence in an entity's financial statements, the definition of PIE would be applicable for Part 4A[4] rather than Part 4B[5] of the Code.

TASK FORCE PRELIMINARY VIEW

Proposed Approach

20. From the Task Force's initial review of the definitions of PIE or other equivalent terms used by a number of jurisdictions, the Task Force observed that:
    - National standards (or relevant regulations or legislation) fall into one of the following four categories with respect to the use of the term "PIE":
        - Uses the term "PIE" with essentially the same definition as the IESBA Code (e.g. HKICPA Code in Hong Kong, MIA Code in Malaysia, and ICAEW Code and ICAS Code in the UK)
        - Uses the term "PIE" with a similar definition as the IESBA Code but with additional entities (e.g. IRBA Code in South Africa, APESB Code in Australia, ISCA Code in Singapore)
        - Uses the term "PIE" with different definition to the IESBA Code (e.g. EU Audit Directive, NZAuASB Code in New Zealand)
        - Does not use the term "PIE" (e.g. CPA Canada Independence Rules in Canada)
    - A number of jurisdictions define entities by reference to specific legislation which governs their activities (for example, banks or insurance companies) and/or have differing size thresholds.
    - The implementation of the term "PIE" as defined in the EU Directive 2006/43/EC[6] (the Audit Directive) by the EU member states further highlights the difficulty of establishing a ***concise*** definition that can be universally adopted at the global level. The Task Force noted that the first three of the four categories of PIEs in the Audit Directive's definition are further defined by other EU Directives. For the second category of the EU definition, which is credit

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4 Part 4A, *Independence for Audit and Review Engagements*

5 Part 4B, *Independence for Assurance Engagements other than Audit and Review Engagements*

6 Article 2.13 of the EU Directive 2006/43/EC, amended by Directive 2014/56/EU, broadly sets out four categories of entity that fall within the meaning of a PIE:

(a) entities governed by the law of a Member State whose transferable securities are admitted to trading on a regulated market of any Member State within the meaning of point 14 of Article 4(1) of Directive 2004/39/EC;

(b) credit institutions as defined in point 1 of Article 3(1) of Directive 2013/36/EU of the European Parliament and of the Council ([17]), other than those referred to in Article 2 of that Directive;

(c) insurance undertakings within the meaning of Article 2(1) of Directive 91/674/EEC; or

(d) entities designated by Member States as public-interest entities, for instance undertakings that are of significant public relevance because of the nature of their business, their size or the number of their employees

institutions, it is defined by point 1 of Article 3(1) of Directive 2013/36/EU excluding those entities listed in Article 2 of that Directive. Further, whilst some member states have elected to only include the minimal types of entities required (i.e., the first three categories), other member states have designated additional entities as PIEs in accordance with the fourth category, ranging from pension funds and investment companies to state-owned entities.

- Some jurisdictions that adopt the IESBA's definition of PIE, such as Australia and South Africa, have elevated the application material (Paragraph 400.8[7] of the IESBA Code) that encourages firms to determine whether to treat additional entities, or certain categories of entities, as PIEs to a requirement.

21. As a recent example of a regulator adding entities to be treated as PIEs, the UK Financial Reporting Council (FRC) announced in late January 2020 that a new category, "other entity of public interest' (OEPI), has been included in its Glossary of Terms. Under its revised Ethical Standard as of December 2019, the statutory audit of an entity that meets the definition of OEPI is subject to certain independence requirements with respect to the provision of non-audit/additional services. An OEPI is defined as "An entity, which does not meet the definition of a Public Interest Entity, but nevertheless is of significant public interest to stakeholders." OEPIs include Alternative Investment Market (AIM) entities (which are not listed entities under the EU definition as AIM is not a 'regulated market' as defined), Lloyd's syndicates, large private sector pension schemes and large private companies that meet certain legal criteria and thresholds.

22. Based on its observations to date, the Task Force has reached the preliminary view that it would be difficult, if not impossible, to develop a single definition of PIE at a global level that can be consistently applied by all jurisdictions without significant modification and further refinement at a local level. The Task Force noted that the IESBA reached a similar conclusion as part of its Independence project in mid-2000.

23. The Task Force is therefore of the view that there are essentially only two approaches that the IESBA could take in revising the definition of PIE in the Code:

Approach 1	A short and narrow list of categories, similar to the current definition of PIE in the Code, to which local regulators and authorities may continue to add.
Approach 2	A longer and more broadly defined list which local regulators and authorities can modify by tightening definitions, setting size criteria and adding or exempting particular types of entities.

24. The Task Force preferred **Approach 2** as it considered that it would be difficult to further refine the current PIE definition under Approach 1, particularly given the principles-based nature of the Code. Approach 1 is also unlikely to meet the expectations of those who would wish the Code's definition to encompass a broader range of PIEs.

25. The Task Force is further of the view that local regulators and authorities have the responsibility, and are also best placed, to assess and determine which entities or types of entities should be treated as PIE for the purposes of additional independence requirements. Indeed, as illustrated in

[7] Section 400, *Applying the Conceptual Framework to Independence for Audit and Review Engagements*, paragraph 400.8

earlier comments, many have already done so by taking into consideration issues, concerns and nuances specific to the local environment and how these impact the public interest in their jurisdictions.

26. In following Approach 2, the Task Force is also conscious that any categories it seeks to include will, being principles based, inevitably be quite broad and could therefore scope in entities where the public interest is not significant. The Task Force therefore believes it is appropriate in these circumstances that the Code should deviate from its normal practice and allow local law and regulation to prevail where it tightens those broad categories to exclude entities that the Code would otherwise include. The Task Force also believes that any list should strike an appropriate balance by including those types of entities for which there is a general acceptance for treatment as a PIE, but not including all possible such entities.

27. The Task Force has therefore developed the following initial list of categories based on its review of the various national standards and observations received which led to the initiation of this project (See R400.13 in **Agenda Item 9-B**):

    (a) An entity whose shares, stock or debts are publicly traded

    (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 that pools money from the public to purchase shares, stock and debts

    (f) An entity specified as such by law or regulation

Listed Entities

28. As highlighted in the project proposal:

    - Some stakeholders have questioned the meaning of the term “recognized stock exchange” in the definition of “listed entity.”[8] IESBA Staff has also received questions as to whether that term is intended to be the same as, or broader than, the concept of a “regulated market” in the definition of a PIE in the EU Audit Directive. It was suggested that some might perceive a difference as in practice exchanges exist that have a lower level of regulation compared with larger or more established securities exchanges.

    - Developments in capital markets around the world and newer forms of capital raising such as crowd funding—and how these are regulated—have raised questions about the need to update the definition of a listed entity in the Code for clarity and continued relevance.[9]

29. The Task Force is at an earlier stage of its information gathering on listed entities and has not yet developed any firm proposals for consideration by the IESBA. However, as for the definition of PIE, the Task Force notes that there are differing views as to what constitutes a “listed” entity. The EU,

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[8] See Summary of Responses (paragraph 32) to the survey of stakeholders for purposes of developing the IESBA Strategy and Work Plan, 2019-2023 (strategy survey).

[9] Calls to consider newer forms of capital raising like crowd funding were raised by a few respondents to the strategy survey (see Summary of Responses, paragraph 35).

for example, defines it by reference to whether the market is a "regulated market," which is itself determined by legislation intended to ensure transparent and fair trading of securities.

30. Based on its early review, the Task Force is considering the following:

    - Whether there will be more clarity if terms such as "publicly traded" (see above), "regulated market" or "public market" are used.
    - For some "lightly regulated" markets, where there may well be inherently more risks for investors by design, whether imposing additional auditor independence requirements will meet the overall objective of enhancing confidence in the financial statements.

31. The Task Force will also consider the impact of any proposed changes on the use of the same term by the IAASB in its standards, initially through input from the Task Force's IAASB correspondent members.

Role of the Firms

32. The Task Force agrees with the approach taken by the Accounting Professional & Ethical Standards Board (APESB) in Australia and the Independent Regulatory Board for Auditors (IRBA) in South Africa to elevate the application material in paragraph 400.8 of the IESBA Code that encourages firm to determine whether to treat additional entities, or certain categories of entities, as public interest entities to a requirement. The Task Force is of the view that firms should be required to determine if any additional entities should be treated as PIEs. This means that whilst local regulators and authorities can add or subtract entities to be included as PIEs, firms can only add more entities. In making such determination, firms should be reminded to apply the reasonable and informed third party test.

33. The Task Force envisages that some non-PIE entities might request that their audits be subject to the same independence requirements as PIEs in order to enhance confidence in their audits and, in turn, confidence in their financial statements. In considering such requests, the Task Force believes it would be appropriate to take into account factors such as whether the entities have the necessary governance arrangements to ensure the various independence requirements will work as envisaged and whether the entities' financial statements are subject to an appropriate level of accounting and financial reporting requirements.

Transparency

34. The Task Force appreciates that one effect of its proposals may be increased uncertainty as to whether an entity has been treated as a PIE, particularly if that has been determined by the firm rather than law or regulation. The Task Force is therefore of the view that it should be clear from the financial statements and/or audit report when the entity is a PIE. The Task Force will further consider this point with the IAASB, initially through input from the Task Force's IAASB correspondent members.

IAASB Use of the Term "ESPI"

35. As mentioned above, one of the objectives of the project is to develop a pathway that would achieve convergence between the concepts underpinning the definition of a PIE in the Code and the description of an ESPI in the IAASB standards to the greatest extent possible.

36. The term is currently used in IAASB Standards specifically in relation to requirements for:

    - Communication of certain matters to those charged with governance (TCWG) in an audit of financial statements in ISA 260 (Revised).[10]
    - Communication of key audit matters in the auditor's report in ISA 701.[11]

37. The description of ESPI in these provisions in ISAs 260 (Revised) and 701 is similar to the factors described in paragraph 400.8 of the Code for consideration by firms when determining if additional entities should be treated as PIEs.

38. With regards to the proposed use of the term "ESPI" in the ISQM 1 ED[12] as a factor for consideration by firms when determining if an EQR is necessary, the Task Force understands that the term is no longer included in the proposed text. The Task Force will, however, continue to liaise with the IAASB (with the Task Force's IAASB correspondent members in the first instance) on its development.

39. The Task Force aims to provide its preliminary view at the June 2020 IESBA meeting on a suggested pathway of convergence between the IESBA and IAASB terms, taking into consideration the development of the term "ESPI" in the IAASB's Quality Management projects.

SPIE vs PIE

40. The Task Force noted that the IESBA's 2016 ED on independence for audit, review and other assurance engagements (2016 Independence ED) used the term "entity of significant public interest" to denote the broader group of entities whose audit should be subject to more stringent independence requirements. However, the Board at the time ultimately determined to revise the term to "public interest entity" on the basis that a narrower definition has been adopted.

41. Upon reflection, the Task Force formed the view that the term "public interest entity" may send the wrong signal that PIE audits need to have more stringent independence requirements because only PIEs attract *any* level of public interest, which is not the case. The Task Force suggests that the term "significant public interest entity" (SPIE) may be more appropriate (see paragraph 400.8 in **Agenda Item 9-B**). The Task Force considers that this also has the benefit of distinguishing that term from the current use of the term PIE in the extant Code.

Related Entities

42. The Task Force noted that the Code contains only one reference of "listed entity" in the International Independence Standards that is separate from its treatment as a PIE. This reference, in paragraph R400.20, specifies which related entities are included in the definition of an audit client as follows:

    - When an audit client is a listed entity, reference to audit client will always include its related entities (upstream, downstream and sister entities)

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[10] International Standard on Auditing (ISA) 260 (Revised), *Communication with Those Charged with Governance*, paragraph A32

[11] ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*, paragraph A41

[12] Proposed ISQM 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*

- When an audit client is not a listed entity, references to an audit client includes those related entities over which the client has direct or indirect control (downstream only).
- When the audit team knows, or has reason to believe, that a relationship or circumstance involving any other related entity of the client is relevant to the evaluation of the firm's independence from the client, the audit team shall include that related entity when identifying, evaluating and addressing threats to independence.

43. To explain the rationale for not extending this requirement on non-listed entities that are PIEs, the explanatory memorandum to the 2016 Independence ED stated that:

> *…in the case of an audit client that is a non-listed entity of significant public interest, in certain circumstances, depending on the nature and structure of the client's organization, it may not be necessary to apply the enhanced safeguards applicable to listed entities to all related entities of the client to maintain independence. The IESBA also recognized that in the case of certain entities of significant public interest, including many government-controlled entities which do not have a typical corporate structure, application of the enhanced safeguard to all related entities is overly broad and unnecessary to maintain independence…*

44. As part of its review of the definitions of PIE and listed entity, the Task Force will also consider whether paragraph R400.20 should be revised to ensure it remains current and relevant. As part of its assessment, the Task Force will consider, amongst other things:

- The practicality of identifying, and obtaining the necessary data of, all related entities for non-listed entities (including banks, insurance companies and private equity companies) in a timely manner.
- The impact of additional independence requirements if the category of audit clients of which all related entities are included is expanded to PIE.
- Where provisions in the Code specify that, despite R400.20, they only apply to entities controlled by a listed entity.

NEXT STEPS

45. The Task Force Chair will be presenting the Task Force's preliminary views and seeking input from participants at the following upcoming meetings:

- March 2020 IESBA CAG meeting. The Task Force Chair will provide a report-back to the Board at its March 2020 meeting.
- April 2020 Forum of Firms meeting, Deep Dive Session.
- May 2020 National Standard Setters meeting.

46. The Task Force also intends to seek input from key regulators in Q2 2020.

47. The Task Force anticipates presenting a further draft of the proposed text for the IESBA's review at June 2020 IESBA meeting.