ACCOUNTANCY EUROPE.

Mr. Ken Siong
IESBA Senior Technical Director
International Ethics Standard Board
for Accountants

Sent by email:
KenSiong@ethicsboard.org

Brussels, 4 May 2021

Subject: Proposed Revisions to the Definitions of Listed Entity and Public Interest Entity in the Code

Dear Mr Ken Siong,

Accountancy Europe is pleased to provide you with its comments on the IESBA Proposed Revisions to the Definitions of Listed Entity and Public Interest Entity in the Code.

We agree with the objectives of the PIE project to review the definitions of the terms "listed entity" and "PIE" in the Code so that they remain fit for purpose, and an agreement between the IESBA and the IAASB is established on a common revised definition of the term "listed entity". While doing these the main goal should be to provide clarity and to avoid further fragmentation in the application of both Boards' standards.

Auditors are working in the public interest which is best served by high quality audits. Performing an audit in an independent manner contributes to this. However, it will be misleading to take an approach which assumes stricter independence rules mean higher audit quality.

We do not agree with the broad approach proposed by the IESBA. The Code should define a minimum list of PIE categories as a baseline and other entities can be designated as PIE depending on the local circumstances. The role of local standard-setting bodies will only be more relevant when this refinement is not done by laws and regulations. This is not the case in the European Union (EU).

There is no benefit in establishing a requirement for firms to determine if any additional entities should be treated as PIEs. This will only lead to confusion and practical difficulties as explained further in our detailed responses.

Finally, expanding the PIE definition in the Code should not systematically lead to creating additional requirements in the IAASB standards.

We also invite the IESBA to make an impact assessment related to a potential expansion of PIE definition on the recent significant revisions of the Code (i.e., NAS and Fee related proposals). These

bring additional requirements for PIE auditors and stakeholders provided their comments to these proposals considering the PIE definition in the extant Code.

We thank you for the opportunity to comment on this very important piece. For further information on this letter, please contact Harun Saki at harun@accountancyeurope.eu or Hilde Blomme at hilde@accountancyeurope.eu.

Sincerely,

Myles Thompson
President

Olivier Boutellis-Taft
Chief Executive

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Accountancy Europe unites 50 professional organisations from 35 countries that represent close to **1 million** professional accountants, auditors and advisors. They make numbers work for people. Accountancy Europe translates their daily experience to inform the public policy debate in Europe and beyond.

Accountancy Europe is in the EU Transparency Register (No 4713568401-18).

ANNEX - REQUEST FOR SPECIFIC COMMENTS

Overarching Objective

> 1. *Do you support the overarching objective set out in proposed paragraphs 400.8 and 400.9 as the objective for defining entities as PIEs for which the audits are subject to additional requirements under the Code?*

Yes, we agree with the overarching objective to enhance confidence in the financial statements of PIEs through enhancing confidence in their audits. Even though not specified in the extant Code, this objective has been the main reason for setting additional requirements for PIE auditors throughout Part 4-A of the Code.

However, independence rules are only one of the many factors for enhancing confidence and achieving high-quality audits for both PIEs and non-PIEs. It will be misleading to focus too much on PIE auditor's independence. Therefore, we are doubtful about the benefit of reiterating this objective in Part 4-A of the Code.

> 2. *Do you agree with the proposed list of factors set out in paragraph 400.8 for determining the level of public interest in an entity? Accepting that this is a non-exhaustive list, are there key factors which you believe should be added?*

Yes, we agree with the proposed list and would like to highlight that EU legislation specifies the nature of the business, the size and the number of employees as indicative factors to consider when designating additional entities as PIE (see also our response to Question-3).

However, there is a need to clarify the meaning of the term "financial condition" and what is meant by "taking on financial obligations to the public" in the Code as they are explained in the Explanatory Memorandum.

Approach to Revising the PIE Definition

> 3. *Do you support the broad approach adopted by the IESBA in developing its proposals for the PIE definition, including:*
>
>   - *Replacing the extant PIE definition with a list of high-level categories of PIEs?*
>   - *Refinement of the IESBA definition by the relevant local bodies as part of the adoption and implementation process?*

No, we do not support this approach. The Code should define a minimum list of PIE categories as a foundation to which local jurisdictions can add others depending on the local circumstances. The categories in the Code should include only systemically important entities: listed entities, banks and insurance companies (please see our response to Question 5 for more details).

In line with this approach, the definition of PIE in the European Union (EU) legislation is as follows:

- entities whose transferable securities are admitted to trading on a regulated market of any Member State
- credit institutions
- insurance undertakings

- 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

Additional designation (which can be considered as refinement) mentioned in the last bullet point is made by national legislation. For more details, please see our publication: *Definition of Public Interest Entities in Europe*.

Furthermore, the approach proposed by IESBA would scope in entities whose financial condition would not be of public interest, especially in jurisdictions where the regulations do not specify a PIE definition and lead to unnecessary complexity. Unless the definition applies only to entities for whom the IESBA determines that differences in auditor behaviour are warranted (e.g., the provisions of the IESBA Code relating to NAS and fees), expanding the PIE definition may also discourage smaller audit firms from auditing PIEs by forcing them to comply with additional and disproportionate rules of independence.

Also, this approach deviates from normal standard setting by the IESBA which is setting minimum requirements which can be extended. This reversed approach would cause confusion and could potentially undermine trust in the profession. If the scope of the Code, which is adhered to by many audit firms, becomes significantly at variance with local legislation, there will be a lot of confusion globally for both audit firms and the users of financial statements. This will be even more confusing if national definitions and the Code's definitions introduce different requirements for the auditor.

PIE Definition

4. *Do you support the proposals for the new term "publicly traded entity" as set out in subparagraph R400.14(a) and the Glossary, replacing the term "listed entity"? Please provide explanatory comments on the definition and its description in this ED.*

Yes, we believe that the new term of "publicly traded entity" can replace "listed entity" in the Code. However, the proposed definition of "publicly traded entity" should be revised to clarify that it encompasses entities whose shares, stock or debt are quoted or listed on a recognized stock exchange or equivalent.

In addition, we would like to emphasize that such replacement should not lead to any inconsistency between the Code and the IAASB standards. Therefore, IESBA should not pursue the replacement unless it is also agreed and adopted by the IAASB.

5. *Do you agree with the proposals for the remaining PIE categories set out in subparagraphs R400.14 (b) to (f)?*

Only partly. We believe that the subparagraphs (b) and (c) should be included in the list of PIE categories.

We disagree with the inclusion of the entities whose function is to provide post-employment benefits (subparagraph d) and those whose main function is to act as a collective investment vehicle (subparagraph e) under PIE categories. Their inclusion would certainly be counterproductive as it jeopardises the purpose of focusing on the entities with actual public interest. At local level, depending on their characteristics such as the number of investors or participants, size, local circumstances, some entities in these two categories could be added to the PIE list by laws and regulations or by local authorities.

In most jurisdictions, entities within the scope of subparagraphs (b) to (e) are subject to regulation and supervision to promote investor protection. The existence of an independent audit, although essential, is only one element of the investor protection. Including these broad categories in the Code's PIE definition would lead to a risk that efforts are not focused on entities with a significant public interest. This is especially true for entities in subparagraphs (d) and (e) which are very often small size, local entities with a limited number of investors.

> 6. *Please provide your views on whether, bearing in mind the overarching objective, entities raising funds through less conventional forms of capital raising such as an initial coin offering (ICO) should be captured as a further PIE category in the IESBA Code. Please provide your views on how these could be defined for the purposes of the Code recognizing that local bodies would be expected to further refine the definition as appropriate.*

Less conventional forms of capital raising such as an initial coin offering (ICO) are usually more complex instruments but may be attractive for investors with higher risk appetite. These should be closely monitored by supervisory authorities to ensure the sound functioning of markets and investor protection.

We note that there is not a direct link between the level of risk taken by some investors and the existence of public interest. Mitigating the risk for investors should be a question of market regulation not of the independence rules for auditors. Stricter independence rules can never be a proxy for appropriate market supervision and transparent information to investors.

Role of Local Bodies

> 7. *Do you support proposed paragraph 400.15 A1 which explains the high-level nature of the list of PIE categories and the role of the relevant local bodies?*

The Code should set out the minimum baseline allowing local bodies to add other categories based on local circumstances. We are concerned about the approach now proposed by IESBA as the ability of local standard setters to scope out entirely a certain category can be very limited or non-existent, especially when the PIE definition is set by law like in the EU.

The IESBA should make it clear that the role of local standard-setting bodies will only be relevant in jurisdictions where the definition of PIE is not clearly stipulated in laws and regulations. In EU member states, the PIE definition is well-established by legislation and therefore, ethics standard setters (which we understand would be the relevant local body) often may not be able to assume a determining role in this.

Finally, some of our members believe that certain entities within the PIE categories proposed to be specified in the Code may be excluded by local regulations or standard setters if the nature or size of their business do not amount to significant public interest.

> 8. *Please provide any feedback to the IESBA's proposed outreach and education support to relevant local bodies. In particular, what content and perspectives do you believe would be helpful from outreach and education perspectives?*

The key feature of any outreach and education support should be clarity of the objective for defining entities as PIEs and what the appropriate implications might be in a particular jurisdiction given local factors.

The IESBA should also keep sight of whether jurisdictions have sought to scope out any categories of PIE without appropriate justification.

Role of Firms

> 9. *Do you support the proposal to introduce a requirement for firms to determine if any additional entities should be treated as PIEs?*
> 10. *Please provide any comments to the proposed list of factors for consideration by firms in paragraph 400.16 A1.*

No, we do not support the introduction of this requirement and believe it should remain in the application material as an encouragement to firms. Auditors already consider internal and external factors and determine if they need to apply stricter rules of independence in a specific engagement.

Such a requirement might negatively impact the three-way relation between the lawmaker, the audit firm and the regulator, especially in regions like the European Union where the lawmaker has set a robust PIE definition. Determination of additional entities as PIE by audit firms might be interpreted as questioning the capability of the lawmaker. Also, this may lead to inconsistency if a firm determines an entity as a PIE, but another firm does not do the same for another entity of a similar nature.

Similarly, the regulator will be put in a very difficult situation, being expected to confirm that audit firms abide by the requirement, but at the same time not wanting to be in a position to judge their lawmaker. Hence there will be a risk of legislators and regulators choosing not to adopt the IESBA Code.

Treating a non-PIE entity as a PIE by audit firms may only be relevant in two cases: when those charged with governance of an audited entity request to be treated as a PIE and when an entity is in the process of becoming a PIE. In other cases, we believe that the overall application of the conceptual framework and the requirements under Part 4-A of the Code will enable the auditor to achieve the objectives related to independence.

Although we disagree with the elevation of the extant application material that encourages firms to determine whether to treat additional entities as PIEs to a requirement, we would like to present the following remarks on the factors listed in paragraph 400.16 A1:

- Bullet 1: if laws and regulations specify an entity as not being a PIE, there should not be any expectation from the audit firm.
- Bullet 2: it may be relevant to treat a non-PIE entity as a PIE by audit firms when an entity is in the process of becoming a PIE. However, we do not agree to consider this for entities that are "likely to become" PIE in the future.
- Bullet 3: there is potential for inconsistency when predecessor and successor firms reach different conclusions. Also, there are practical challenges for an auditor to find out the reasoning of the predecessor firm and thus to judge the appropriateness of its conclusion.
- Bullet 5: when those charged with governance of an audited entity requests to be treated as a PIE, we are not sure if there may be valid reasons for the auditor not to do so.
- Bullet 6: we do not see a clear link between the entity's corporate governance arrangements and existence of public interest related to its financial condition.

Transparency Requirement for Firms

> 11. *Do you support the proposal for firms to disclose if they treated an audit client as a PIE?*

No, we do not support a requirement for firms to determine and disclose if any additional entities are treated as PIE in terms of independence rules for auditors.

Transparency is only useful if it provides useful information for stakeholders. In most jurisdictions, being a PIE creates obligations not only for the auditors but also, and foremost, for the entities. Applying and disclosing independence principles relevant to PIEs to a non-PIE audit will lead to confusion and raise many questions. Stakeholders will have difficulty in understanding what triggered this determination and how an entity can be treated as a PIE just for auditor's independence purposes.

There may be a merit in considering whether the fact that the audited entity is a PIE (in accordance with applicable rules and regulations) should be disclosed in auditor's report. The IAASB, in coordination with the IESBA, could explore the pros and cons of a such disclosure in auditor's report. this.

> 12. *Please share any views on possible mechanisms (including whether the auditor's report is an appropriate mechanism) to achieve such disclosure, including the advantages and disadvantages of each. Also see question 15(c) below.*

As noted in our response to question 11, the auditor's report would seem to be a logical place to disclose the auditor independence provisions that have been applied and what the implications are. Obviously, this will necessitate a process for revising ISA 700 series and there may be a gap between the effective dates of the revised Code and relevant ISAs.

Other Matters

> 13. *For the purposes of this project, do you support the IESBA's conclusions not to:*
>   a) *Review extant paragraph R400.20 with respect to extending the definition of "audit client" for listed entities to all PIEs and to review the issue through a separate future workstream?*
>   b) *Propose any amendments to Part 4B of the Code?*

Yes, we support the IESBA's conclusions to review the extant paragraph R400.20 through a separate future workstream.

> 14. *Do you support the proposed effective date of December 15, 2024?*

No, we do not support the proposed implementation date of 2024.The IESBA should consider a later effective date since for many jurisdictions there will be a significant increase in the number of PIEs. This will allow the time needed to introduce necessary adoptions in the local rules. Given the importance of increasing trust in audit and the public expectations on this issue, the IESBA could encourage early adoption in jurisdictions that are able to do so.

Matters for IAASB consideration

> 15. *To assist the IAASB in its deliberations, please provide your views on the following:*

a) *Do you support the overarching objective set out in proposed paragraphs 400.8 and 400.9 for use by both the IESBA and IAASB in establishing differential requirements for certain entities (i.e., to introduce requirements that apply only to audits of financial statements of these entities)? Please also provide your views on how this might be approached in relation to the ISAs and ISQMs.*

b) *The proposed case-by-case approach for determining whether differential requirements already established within the IAASB Standards should be applied only to listed entities or might be more broadly applied to other categories of PIEs.*

c) *Considering IESBA's proposals relating to transparency as addressed by questions 11 and 12 above, and the further work to be undertaken as part of the IAASB's Auditor Reporting PIR, do you*

believe it would be appropriate to disclose within the auditor's report that the firm has treated an entity as a PIE? If so, how might this be approached in the auditor's report?

We believe that the IESBA and the IAASB should align their terminologies to the extent possible. While doing this the main objective should be to provide clarity and to avoid confusion.

The status of PIE is usually defined by law or regulation in many countries, and it usually creates additional requirements for

- the entities themselves, such as the obligation to have an audit committee
- the auditor, such as the obligation to issue a written report to the audit committee
- for the supervisory authorities, such as the prohibition to delegate the inspection of PIE audit firms to professional organisations

Those differential requirements for auditors are relevant as long as they mirror differential requirements for the entity itself. We therefore believe that expanding the PIE definition only for the purposes of the Code should not systematically lead to creating additional requirements in the ISAs.

Transparency towards stakeholders is unquestionably inherent to the auditor's role and responsibilities, however transparency should not lead to confusion. The auditor's report already includes a dedicated part on the compliance with ethical and independence rules. Requiring additional disclosures would create or increase the expectation gap for stakeholders without providing them with more insight on the financial statements or the audit. They could expect that the entity has met all the obligations relevant for a PIEs.

Practical difficulties also would arise when there is a change of auditor and if the "so-called PIE" mentioned as such in the previous auditor's report is no longer treated as a PIE by the new auditor.

In addition, such disclosure could downplay the quality of non-PIE audits as if they were performed in accordance with a lower level of professional standards.

The differential requirements for listed entities in ISAs focus on enhancing transparency about aspects of the audit to those charged with governance and/or to intended users of the auditor's report. These requirements (and the requirement related to engagement quality reviews) do not directly affect the auditor's work effort in obtaining sufficient appropriate audit evidence to draw reasonable conclusions on which to base the auditor's opinion.