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

Dear Sirs:

Assirevi is the association of the Italian audit firms. Its member firms represent the vast majority of the audit firms licensed to audit companies listed on the Italian stock exchange and other public interest entities in Italy, under the supervision of CONSOB (Commissione Nazionale per le Società e la Borsa).

Assirevi promotes technical research in the field of auditing and accounting and publishes technical guidelines for the benefit of its members. It collaborates with CONSOB, the Italian accounting profession and other bodies in developing auditing and accounting standards.

Assirevi is pleased to submit its comments on the Exposure Draft “Proposed Revisions to the Definitions of Listed Entity and Public Interest Entity in the Code” issued by IESBA in January 2021.

Our detailed comments are set out in the attached document.

Should you wish to discuss our comments please do not hesitate to contact us.

Yours faithfully,

Gianmario Crescentino
Chairman

(Enclosure)
COMMENTS ON THE IESBA EXPOSURE DRAFT

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

(January 2021)

Assirevi appreciates the opportunity to contribute with the following comments to the above-mentioned Exposure Draft and the project described therein.

Firstly, our Association agrees with the need to review the definition of PIEs, which is crucial in determining the entities falling within the scope of certain provisions of the Code.

As already highlighted in our previous response to the IESBA Consultation Paper "Proposed Revisions to the Non-Assurance Services Provisions of the Code" (January 2020), following the enactment in the European Union of Directive 2014/56/EU and Regulation (EU) 537/2014 relating to the audit of financial statements issued by PIEs there is now a mismatch between the current Code and the European legislation. Therefore, we agree it is certainly appropriate to intervene to reduce difficulties and uncertainties for auditors who have to comply with both sets of rules – which are not always coordinated among them.

In this respect, Assirevi concurs on the effectiveness of the approach proposed in the Exposure Draft to define PIEs along the following two levels of regulatory intervention: 

"(a) Role of Code - Development of a longer and broader list of high-level categories of entities as PIEs in the Code;
(b) Role of Local Bodies - Refinement of the IESBA’s final revisions by the relevant local bodies (such as regulators or oversight bodies, national standard setters and professional accountancy bodies) through tightening definitions, setting size criteria and adding new types of entities or exempting particular entities”.

In relation to the proposals concerning these two levels, however, we believe that some adjustments would be needed, as indicated in our responses to questions 2, 3, 4 and 15 below.

On the contrary, the Association strongly disagrees with the approach proposed by the IESBA through the introduction of a third level for the definition of PIEs, namely: "(c) Role of Firms - Determination by firms whether to treat any additional entities, or certain categories of entities, as PIEs”.

This approach, which leaves to the auditor the choice of entities to be included in the category of PIEs in addition to those already listed by the Code or local legislation, seems inappropriate in our opinion for several reasons:

(i) the definition of the perimeter of PIEs involves a relevant element of public interest; accordingly, only national or international legislators have a thorough and fully comprehensive vision of the appropriate choices to be made in this respect, in light of the regulatory strategies that they pursue. The legislators can then decide to delegate and empower the competent Authorities to proceed to the identification, on their behalf, of different types of entities to be included in the list of PIEs. Additionally, the qualification of an entity as a PIE in relation to the public interest involved necessarily requires an objective evaluation, which can only be appropriately carried out by legislators and regulators. Otherwise, introducing elements of subjectivity in determining the perimeter of PIEs would raise uncertainties which are not compatible with the purpose of the Code to safeguard the public interest;
the auditor would be required to take a decision (with unavoidable elements of discretion) as to which category each audited entity should be included in. In fact, the Exposure Draft does not seem to require the auditor to use his professional judgment as to whether, in certain circumstances, the safeguards to independence should be strengthened by applying the provisions contained in the Code for PIEs. The requirement is rather to classify an audited entity as a PIE, which would give the auditor the role of a legislator and/or a regulator, even more so in the absence of any involvement of the audited entity and its governance bodies. It is reasonable to expect inevitable discussions with the audited entity, which may dissent from the auditor's view on the existence of elements leading to the qualification of the entity as a PIE. Such a situation could lead to potential conflict areas due to subjective interpretations, with could result in threatening, in our opinion, the very same independence that the proposal in the Exposure Draft is intended to strengthen. Indeed, the assessment of the elements that might lead to qualifying an entity as a PIE could, at most, be carried out by the audited entity, which has the full information framework necessary to reach a conclusion in this respect.

it is also reasonable to expect that such an approach may result in inconsistent behaviors, as entities with similar characteristics may well be assessed differently from time to time by the relevant auditors;

the discretionary and highly subjective nature of the auditor’s assessment could be questioned ex post as a result of any subsequent events or additional facts.

In this regard, it should also be noted that the set of independence rules applicable to the audit of PIEs in the European legal system (and consequently in the legal systems of the EU Member States – including Italy) is very complex and onerous, not only for the auditor but also for the entity being audited. We refer in particular to the provisions concerning the appointment of the auditor, the duration of the audit engagement, the appointment of the Audit Committee, the prohibition to provide certain non-audit services and the determination of the fee cap. As a consequence, it is easy to imagine significant implementation issues due to an inconsistent and uncoordinated application of the set of rules provided for PIEs by the Code, compared with those indicated by the European and national lawmakers.

Finally, we would like to remind to the Board that the 2014 reform that led to the above-mentioned European legislation on PIEs has expressly included in this category "entities [...] whose transferable securities are admitted to trading on a regulated market", "credit institutions" and "insurance undertakings".

At an Italian level, an ad hoc category was created in 2016 (namely, “Entities subject to an intermediate discipline” – “ESRI”)

1 Pursuant to Article 19-bis of Legislative Decree no. 39/2010, the following categories fall within the definition of ESRIs: “a) companies issuing financial instruments which, even if not listed on regulated markets, are widely distributed among the public; b) companies managing regulated markets; c) companies managing clearing and guarantee systems; d) companies managing centralised financial instruments; e) securities brokerage companies; f) asset management companies and the relevant Italian mutual funds managed by them; f-bis) Italian mutual funds managed by EU management companies, EU and non-EU AIFMs; g) investment companies with variable capital and investment companies with fixed capital; h) payment institutions referred to in Directive 2009/64/EC; i) electronic money institutions; l) financial intermediaries referred to in Article 107 of the Consolidated Banking Act".
proposals to reform the areas of audit and corporate governance – including a new definition of PIEs. In this definition, the UK Government is proposing to include entities such as (i) “AIM companies with market capitalization exceeding £200m”, (ii) “Lloyd’s Syndicates” and (iii) “large third sector entities”. The Government also seeks suggestions as to other entities to be added to the PIE category, but does not provide any mechanism for audit firms to identify the entities to be included in such definition.

The abovementioned experiences confirm, once again, that in the current context it is for the legislators (and, at the most, the regulators) to appropriately determine the extent of the perimeter for the definition of PIEs. This is further confirmed by the guidelines for the appointment of statutory auditors or audit firms by public interest entities recently published by the Committee of European Auditing Oversight Bodies on March 16th, 2021. In fact, as stated in such guidelines, “entities are defined as PIEs from the moment they fulfill the criteria of a listed company, a credit institution or an insurance undertaking as set out in EU law. In addition, Member States may designate other entities as PIEs under national legislation. Such entities are to be considered PIEs when fulfilling the criteria set by the respective Member State”. Indeed, from a European Union perspective the identification of entities which have to be qualified as PIEs is always left to the European or national legislator, without any mechanism similar to the ‘third level’ proposed in the Exposure Draft.

In summary, Assirevi supports in principle the intent of the IESBA to broaden the definition of PIEs, as it shares the “overarching objective” indicated in the Exposure Draft, according to which “there are types of entities for which there is significant public interest in their financial condition and hence their 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; and confidence in such audits will be enhanced by additional independence requirements” (see p. 8).

However, the Association expresses its disagreement with the approach set out with respect to the “third level” referred to above, considering that the overarching objective stated by the Board can be fully satisfied through an extension of the definition of PIEs by the IESBA and a possible integration/clarification of this category by the supranational or national legislators or regulators.

If the aim of the IESBA is to strengthen the safeguards to auditor independence in those territories where there is a weaker regulatory response by local lawmakers or regulators, it would then be desirable for the proposal to clarify that the provision regarding the third level of definition of a PIE is limited to those cases where there are no specific local provisions in this regard.

In any event, Assirevi believes that the overarching objective stated by the Board can easily be achieved through the mere use of professional judgment by the auditor to determine whether, in certain circumstances, it may be appropriate to strengthen the existing independence safeguards by applying the provisions for PIEs reflected in the Code. This would not entail any request of the auditor to qualify an audited entity as a PIE – and would therefore avoid the unintended consequences referred to above, which could impact the otherwise reasonable intentions of the Board.

All this having been said, the following pages of this letter include our specific comments to certain questions included in the explanatory memorandum to the Exposure Draft.

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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?**

As already stated in our introductory comments, Assirevi supports in principle the overarching objective of extending the definition of PIEs, although it does not agree with the approach envisaged with the third level of definition (“Role of Firms”).

Moreover, Assirevi believes that the approach suggested for the first two levels (“Role of Code” and "Role of Local Bodies”) would inevitably lead to a very fragmented and inconsistent framework of independence rules.

In fact, different sets of rules would apply depending on whether a specific entity is defined as a PIE by both the Code and the Local Bodies, or solely by the Code. In addition, should a “third level” also apply the further question would arise as to which framework of rules is applicable to entities qualified as PIEs only by the auditor. On this, see also our responses to questions 9 and 10 below.

Also, it cannot be overlooked that the expansion of the category of PIEs proposed by the IESBA would also entail amendments to the existing auditing standards and, consequently, an extension of many rules – which today only apply to listed companies – to a wider range of entities. In this regard, the application of the first and second level of definition inevitably implies already a significant expansion of the entities to which auditing standards currently applicable only to listed entities would also apply. The use of the third level in the qualification of an entity as a PIE would then determine a further extension of the entities subject to those auditing standards.

Also from this perspective, inconsistencies among companies with similar characteristics may therefore arise – not only with respect to the applicable independence rules, but also with respect to the auditing standards and procedures to be applied. In this regard, see also our response to question 15 below.

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?**

Assirevi agrees that the factors contained in paragraph 400.8 are relevant elements for the identification of entities as PIEs.

However, these criteria merely identify defining principles while leaving wide margins of discretion in determining the entities to be identified as PIEs – as clearly highlighted in the following examples:

- "Size of the entity."
- *The importance of the entity to the sector in which it operates including how easily replaceable it is in the event of financial failure.*
- *Number and nature of stakeholders including investors, customers, creditors and of employees.*
- *The potential systemic impact on other sectors and the economy as a whole in the event of financial failure of the entity*. 
Therefore, in the view of Assirevi, the criteria set out in paragraph 400.8 of the Code are acceptable as a matter of principle, but should be used exclusively as guidelines for the legislators and regulators in making their choices and identifying the entities to be included in the category of PIEs.

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?

Although Assirevi agrees in principle with the objective of introducing a common PIE definition at the international level, it believes that critical application issues may arise as a result of the "approach adopted by the IESBA in developing its proposals for the PIE definition".

In fact – and as already mentioned in our response to question 2 above – it is our view that the current wording identifying PIE categories under paragraph R400.14 is too generic, as it refers to a wide range of entities that cannot always be determined ex ante with sufficient certainty.

Some more detailed considerations may help to better explain our view.

As an example, with reference to (b) ("An entity one of whose main functions is to take deposits from the public") and (c) ("An entity one of whose main functions is to provide insurance to the public"), it is not always easy to determine when the activities mentioned therein actually represent the "main function" of the relevant entity. Such an assessment would end up being guided by an unavoidable margin of discretion and could result in an inconsistent application in practice. Furthermore, following such an approach, entities which "take deposits from the public" or "provide insurance to the public" on a secondary level - with respect to the alleged principal function - would be excluded from the definition of a PIE. To date, at the European level, banking and insurance companies do qualify as PIEs regardless of whether they carry out these activities on a primary, secondary or exclusive basis. Therefore, it cannot be excluded that the wording proposed by the IESBA for this category of entities may lead to different interpretations in different national legal systems.

In the same perspective, the identification of the entities listed under sub-paragraph (d) of proposed paragraph R. 400.14 ("An entity whose function is to provide post-employment benefits") does not appear straightforward and could lead to inconsistent applications depending on the specificities of national systems.

As already mentioned in the introduction to this document, it is worth highlighting that the inclusion of an entity in the PIE category determines significant impacts not only in terms of auditor independence rules, but also, more generally, with regard to the provisions related to the performance of the audit: see in this regard our response to question 15 below. Moreover, it is worth reminding that over the years PIEs have also been subject to regulatory provisions pertaining not only to the mere area of statutory audits. As an example, under EU regulation PIEs are requested to report on non-financial information.

It is therefore the view of Assirevi that the objective underpinning the proposal to amend the Code should be pursued setting out very clearly defined categories of PIEs to which the rules of the Code of Ethics should apply. This would avoid the uncertainties
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and the lack of consistency that would result from the introduction of too broadly defined criteria, as explained above. Alternatively, if the Board wishes to maintain the proposed approach based on very broad definitions, it should then only set guidelines for the authorities in each jurisdiction, which would have full authority to classify an entity as a PIE or not. Consequently, entities defined as PIES at the individual country level would be subject to the independence rules of the country involved as well as to those identified in the Code of Ethics for this category of subjects.

Finally, it is necessary to consider how entities falling into one or more of the PIE categories set by the Code should be treated in case the specific legislation of the country of origin does not define them as such.

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"?**

Assirevi understands the need to clarify the perimeter of companies subject to the PIE rules – a need underlying the proposal from the IESBA to replace the term “listed entities” with the term "publicly traded entity".

According to Assirevi, however, the definition of "publicly traded entity" should include only those entities active on a "regulated market", in line with the provisions of EU legislation.

Entities active on a "recognized stock exchange" are normally subject to different and less strict rules compared to those applicable to companies admitted to a "regulated stock exchange". This choice, adopted in most jurisdictions, aims at creating an alternative to the admission to trading of financial instruments on regulated markets, allowing for less onerous requirements and less complex rules when these instruments are listed on unregulated markets.

Consequently, Assirevi believes it would not be appropriate to consider entities listed on "recognized stock exchanges" in the same way as those whose securities are traded on "regulated stock exchanges", which would happen by simply replacing the term “listed entities” with the term "publicly traded entity". Indeed, this would mean not taking into account the significant differences existing among the rules governing those markets, as specifically enacted by local legislators.

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?**

On this point, please see our response to question 3 above.

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.**

In light of the strong interconnection between the two questions above, we believe it is appropriate to address them jointly.

As mentioned above, Assirevi does not agree with the proposal to include in the Code a "requirement for firms to determine if any additional entities should be treated as PIES".
The reasons underpinning the view of Assirevi, which is contrary to leaving to auditors the choice to determine whether specific entities should be defined as PIEs or not, have already been explained above. In addition, a number of additional issues that appear to be critical in this respect is described below.

In light of our specific experience at the national level, the current perimeter of entities for which "reinforced" independence requirements apply is already very broad. Nor does it seem easy to identify concrete examples of additional entities which should be added to the categories of PIEs already identified under the local regulatory framework and proposed by paragraph R400.14 of the Code. Italy, in fact, applies the PIE perimeter as defined by the European legislator, further supplemented by the ESRI\(^2\) entities – expressly introduced by the Italian law and substantially similar to PIEs with regard to the application of auditor independence rules.

Also in light of the above, it is the view of Assirevi that the introduction of proposed paragraph R400.16 would not be necessary. In fact, the "overarching objective for additional independence requirements for the auditors of PIEs" could be achieved, even in those jurisdictions where the local legislation does not provide sufficient coverage on this subject, by simply requiring the auditor to apply his professional judgment in determining whether, in certain circumstances, it is appropriate to strengthen the independence safeguards by voluntarily applying to an entity the provisions of the Code regarding PIEs. On the other hand, and for the reasons outlined above, it does not seem appropriate to require an auditor to qualify an audited entity as a PIE, given that such qualification would trigger all the consequences mentioned above – which are not limited to the application by the auditor of the reinforced independence requirements provided by the Code for PIEs.

Assirevi therefore does not agree with the introduction of proposed paragraph R400.16. However, if the intent of IESBA with the introduction of this "third level" of classification is to strengthen the protection of auditor independence in those territories whose national legal or regulatory framework in this area appears to be particularly weak, it should then be clarified that an intervention by the auditor to qualify an entity as a PIE would only be required in those very specific circumstances.

Among the factors justifying the negative view of Assirevi on the so-called “third level” of definition of a PIE, the issues related to inconsistencies in the execution of the audit resulting from different choices made by the auditor in qualifying an entity as a PIE also play a role. For example, the case of two auditors of the same group who come to a different conclusion as to whether the parent company should be regarded as a PIE or not would inevitably lead to an inconsistent application of two different sets of independence rules to the same group.

In addition, it is our view that even if the Code allowed for an extension of the rules on independence for PIEs to entities other than those listed by the Code or local authorities, this extension should in the first instance be decided by the audited entity rather than the auditor. The former – rather than the latter – has indeed the complete set of information required to determine whether the conditions to consider the entity as a PIE are met. Therefore, the criterion set out in bullet 5 of proposed paragraph 400.16 A1 of the Code could at most be the only addition to the categories of PIEs defined by the Code and local authorities.

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\(^2\) For details of the entities belonging to this category, see note 1 above.
Also when it comes to the appointment of the auditor, critical issues could arise due to the discretion given to the auditor to treat as a PIE an entity that is not considered as such by the Code or by the Local Bodies. For example, in case two auditors participating to an audit tender were to reach a different conclusion as to whether the company should be treated as a PIE or not, such an entity might be inclined to appoint the auditor that does not regard it as a PIE. This would in fact imply the application of a less stringent independence regime to the audit engagement, which in turn would result into less onerous consequences for the audited entity. In such a scenario, the very same purpose of the proposed amendment to the Code would be undermined.

Finally, the Exposure Draft does not clearly explain the scope of the independence rules applicable to PIEs falling into this category as a result of a choice made by the auditor.

In the view of Assirevi, in the undesired event that the IESBA wishes to proceed with the introduction of the so-called “third level” for the definition of PIEs, it would then be necessary to clarify that only the independence requirements set forth in the Code for PIEs are to be considered applicable to the entities regarded as such by the auditor – with the exclusion of the other provisions that local regulations, such as the European rules, impose on the auditors of PIEs as locally defined. Otherwise, the auditor (as well as the entity being audited) would end up being subject to significantly onerous rules in the absence of the required legal prerequisites. In fact, as discussed above, the set of independence rules applicable to the audit of a PIE in the European legal system is very complex and onerous not only for the auditor, but also for the audited entity, given the restrictions on (i) the assignment and the duration of the audit, (ii) the rules established for Audit Committees, (iii) the prohibition to provide certain non-audit services and (iv) the fee cap on permitted non-audit services. In addition, as already mentioned, local laws in Italy also identify the category of ESRI, governed by rules on auditor independence similar to those applicable to PIEs. In this context, it is likely that implementation issues would arise in presence of an inconsistent application of the set of rules on EIPs under the Code and those provided by European and national regulations.

Finally, in the undesired event that the IESBA wishes to proceed with the introduction of proposed paragraphs R400.16 and 400.16 A1, Assirevi would appreciate some clarifications on the disclosure obligations provided for in proposed paragraph 400.17. It would in fact be appropriate to clarify that such public disclosure shall be made either:

(i) in the audit opinion; or, alternatively,

(ii) in the Transparency Report pursuant to Article 13 of EU Regulation 537/2014 which, in the European legal system, is already identified as the document in which, among other aspects, the PIE clients of each audit firm should be listed.

The inclusion of such a public disclosure in the terms discussed above could in fact help to clarify, also for the benefit of the users of the financial statements, the background of the independence rules that have been applied as a result of paragraph R400.16.
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?

With regard to items (a) and (b) above, Assirevi notes that in the current version of the auditing standards adopted in Italy following the implementation of the ISAs (“ISA Italia”) there are already specific requirements being set out for certain categories of entities in addition to listed entities. Namely, these requirements relate to (i) the assignment of the EQCR (ISA Italia 220), (ii) communications on independence to those charge with governance (ISA Italia 260) and key matters of the audit (the so-called Key Audit Matters or “KAM” – ISA Italia 701), all of which are applicable to all PIEs, as defined by local regulations following the implementation of the European legislation.

Therefore, the overarching objective of having different rules for certain categories of entities is not considered in itself a critical matter. As a result, Assirevi does not have particular comments with respect to combining IESBA and IAASB sources in order to introduce separate requirements for certain entities.

This, however, can only apply on the fundamental assumption that the auditor is not required to determine the entities subject to such differential requirements. In line with the current framework, this task should belong to national or supranational legislators and/or regulators.

In this regard, it should also be noted that the voluntary application of certain requirements under the ISA Italia standards to entities other than listed entities or PIEs is not allowed in Italy. This aims to safeguarding the uniformity and comparability of the financial reporting of entities belonging to the same category, as well as to avoid confusion among users on the level of assurance being provided.

The qualification of an entity as a PIE by the auditor would therefore in any event require a previous assessment by the local regulator as to the possibility to extend on a voluntary basis to entities not covered by a regulatory requirement a set of audit rules concerning, for example, the audit opinion.

In the event that PIEs are in the future subject to the rules currently provided for listed entities only, two different scenarios could arise at the Italian level:

- if proposed paragraphs R400.16, 400.16 A1 and R400.17 are not included in the Code, there would be no impact on the ISA Italia standards, as the definition of PIEs under the Code would already be in line with the corresponding definition currently established at the regulatory level (and already considered in the ISA Italia standards);
• if, on the contrary, paragraphs R400.16, 400.16 A1 and R400.17 are to be included in the Code, the structure of certain ISA Italia standards and some choices of localization made in the past should be re-evaluated, as the ISAs would then reflect a definition of PIEs potentially wider than that currently included in the ISA Italia standards.

In light of the various scenarios described above, Assirevi believes that keeping the reference in the ISAs to specific rules only for listed entities – and leaving the choice to provide for the extension of such rules to other PIEs at the national level – would be the desired solution, as this would allow for greater flexibility.

Finally, with regard to point 15(c) please refer to the considerations set out in our response to questions 9 and 10 above in relation to proposed paragraph R. 400.17.