May 3, 2021

Comments to IESBA’s Exposure Draft “Proposed Revisions to the Definitions of Listed Entity and Public Interest Entity in the Code”

The Nordic Federation of Public Accountants (NRF) is pleased to respond to the IESBA’s Exposure Draft on Proposed Revisions to the Definitions of Listed Entity and Public Interest Entity in the Code.

General comments

The definitions of listed entity and public interest entity (PIE) are rather key to auditors and audit firms. Not only are there enhanced independence regulations related to such entities. Due to the collaboration between the IESBA and the IAASB on these matters, the scope of these definitions also impacts the performance of both quality controls and audit engagements. It is therefore essential that these definitions remain relevant and fit for purpose. Hence, we believe this is a very important project for the IESBA.

One of the overarching objectives with any kind of regulation is to obtain consistent application. We agree with the IESBA that establishing concise definitions that can be universally adopted at a global level is probably unrealistic. At the same time, we have concerns about the proposed broad approach. We are not convinced that it is appropriate for the Code and we question how much convergence the approach will actually achieve on a global level.
According to the explanatory memorandum, when the current PIE concept was adopted in early 2000, “IESBA concluded that other than for listed entities, determining which entities should be treated as PIEs should be largely left to local regulators or other authorities, although firms were also encouraged to consider whether additional entities should be treated as PIEs.” In our view, this narrow approach is still appropriate and fit for purpose, which is why we suggest that it should be maintained. However, we propose that the minimum level should be expanded to not only include listed entities, but also banks and insurance companies.

Yours sincerely,

Helene Agélii
Secretary General and CEO
Nordic Federation of Public Accountants

About NRF

NRF is a separate legal institution, founded in 1932, acting on behalf of and under the direction of the recognized audit and accounting institutes in the Nordic region (DnR in Norway, FAR in Sweden, FLE in Iceland, FSR – danske revisorer in Denmark and Suomen Tilintarkastajat ry – in Finland).
DETAILED 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?

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?

We support the concept of providing clarity about the objective of defining entities for which the audits require additional independence requirements. However, we are not convinced that the proposed objective is clear enough.

In our view, the proposed broad approach, including the relationship between 400.8 and 400.9 and the requirements in especially R400.14, is very complex. It seems as if the PIEs listed in R400.14 and the “public interest entities, reflecting significant public interest entities in the financial condition of these entities” referred to in 400.8 and on which the enhanced independence requirements in the Code should be applied, are not the same entities. In other words, the Code is referring to two types of PIEs, but it is only the latter one that is of importance when complying with the Code.

Also, the list of factors in 400.8 is very confusing and it is unclear how it should be applied and by whom.

According to the explanatory memorandum: “paragraph 400.8 is only application material which sets up the context for the overarching objective in paragraph 400.9 and the list of PIE categories in paragraph R400.14”. Entities that reflect significant public interest are entities defined as such by local bodies having refined the categories of entities listed in R400.14. They are also entities that are outside the scope of PIEs listed in R400.14, but entities that the firms believe should be treated as PIEs according to R400.16. Trying to deal with both limitations and additions to a requirement in the same paragraph is confusing.

Since the enhanced independence requirements in the Code is only intended to be applied on the entities covered in 400.8, it is unclear why this paragraph is only application material, while the content in R400.14, that is not intended to define those entities on which the enhanced independence requirements should be applied, is a requirement.

With regard to firms complying with the requirement in R400.16, they are supposed to also consider additional factors to those listed in 400.8. This makes us question the value of having this general list of factors.

We do not support adding any further factors to list. Rather we suggest that the IESBA reconsider the necessity and clarity with having this list, including the placement of the list with regard to how it is intended to be applied and by whom.
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 broad approach.

The broad approach, with the fundamental interdependences between the role of the Code, the local bodies and the firms, is rather unusual, and we question its appropriateness in the Code. Not only does this model deviate from the bottom-up approach that is used throughout the current Code, it is also too uncertain if, and how, it will work in practice.

Besides “publicly traded entities” (which we comment on below), we can appreciate that the different categories included in R400.14, generally speaking, could be described as PIEs. However, even though the expanded list of PIE categories is presented as a requirement for the firms, the list is not intended to be applied as such in its entirety.

We have strong concerns as to what signals this approach sends. Having requirements that are not intended to be applied as such, dilutes their importance. We do support the IESBA exploring this area and providing guidance, but we believe this approach should be dealt with outside of the Code.

In order for this broad approach to work, the explanatory memorandum states that the local bodies need to actively refine the scope. Putting such critical expectations on a part, whose actions or non-actions – as opposed to professional accountants and accounting firms – are outside of the Code’s remit, provides for very uncertain outcomes in terms of achieving convergence on a global level. For example, the consequences and outcomes will vary quite a lot between jurisdictions where the local bodies decide to actively refine the scope and where they do not. In jurisdictions where there does not exist any legal definitions, it would seem as if the broadly scoped categories in R400.14 would have to be applied in its entirety by the firms, even though that was never the intent.

Also, when the local bodies refine the broad scope in R400.14, they should base their decisions on the list of factors in 400.8 that reflect the level/extent of public interest in the entity. Only such PIEs, that reflect significant public interest in the financial condition of these entities should then be included in the final scope.

In addition to having an expanded list of PIE categories in R400.14 and an expectation on local bodies to refine this list, the firms should be required to consider further entities as being treated as PIEs. When doing so, the firms should not only consider the factors stated in 400.8 but also additional factors listed in 400.16 A1. The rationale for this model is difficult to comprehend and we doubt that this approach will lead to sufficient convergence on a global to justify such a complex model. With regard to the role of the firms, we also refer to our response to question 9.
NRF’s proposed alternative
Instead of moving ahead with this approach, we propose that the IESBA maintains the current narrow approach when defining PIEs. However, we agree that the current definition that only include listed entities is too narrow to reflect PIEs even on a minimum level. In our view, also banks and insurance companies should be included. Having already concluded that achieving a concise definition on a global level is unrealistic, we still believe that any inconsistent application of these two terms will still be less than applying the proposed broad approach.

In addition to including such a minimum level of certain entities, the PIE-definition should also include an explicit reference to legal definitions of PIEs (in an audit and independence context) and entities that local bodies have determined should be defined as PIEs, i.e., the role of local bodies should only be to add, and not to limit, the scope of the definition.

We believe that this narrow approach of defining PIEs is clearer, easier to apply, and better reflects what is reasonable to expect from a global Code that primarily should be used as a self-regulatory tool for the accountancy profession.

Comments to specific paragraphs
If IESBA’s proposed broad approach should be applied, we still question some of the drafting related to this approach. For example, according to R400.15 a firm “shall have regard to law or regulation…”. This almost sounds as if compliance to law and regulation is optional for the firms.

Paragraph 400.15 A1 is intended to regulate the role of the local bodies in relation to the requirement in R400.14. As such, we think it should rather be application material to that paragraph than to R400.15.

Also, paragraph 400.15 A1 states that “The Code therefore provides for those bodies responsible for setting ethics standards for professional accountants to refine these categories by, for example, making reference to local law and regulation governing certain types of entities.” We wonder how this relates to legal or regulatory definitions in a jurisdiction. For example, does it mean that unless the local body actively states that a legal definition should be applied although it does not cover all categories/entities included in R400.14, the broader requirement in R400.14 should by default be applied for those categories/entities that fall outside the legal definition?

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 entities”?
Please provide explanatory comments on the definition and its description in this ED.

According to the explanatory memorandum “the term is intended to scope in more entities” than those that are covered by the current term. We would like to understand the rationale behind that conclusion, especially since we believe that by adding more entities on which
strict independence requirements should be applied, the higher the risk of diluting the value of the independence requirements that ought to be applied on all audit and review engagements, including on non-PIEs.

We question whether the proposed term "publicly traded entities" and its scope will be clearer and easier to apply than "listed entities". We would therefore prefer maintaining the current scope, preferably by also keeping the term “listed entities”. This term is generally used and understood. It is also the term used in the ISAs. IESBA should not pursue the replacement unless it is also agreed and adopted by the IAASB.

To our understanding, there is no satisfactory evidence that a broadened scope is necessary. Also, considering the proposed broad approach, where the local bodies are expected to refine the entities included in this term/category, we are concerned that this will lead to inconsistencies between jurisdictions, which will only confuse the stakeholders.

We encourage the IESBA to undertake an impact assessment in order to understand the potential impacts the proposed broadened scope would have on, for example, the audit market (market concentration issues) and operational challenges related to limited staff.

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

We refer to our response to question 3.

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.

We do not support adding ICOs as a further PIE category in the Code. We refer to our response to question 3.

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?

We do not support providing the local bodies such a critical role for this model to work, especially since the behavior and actions of the local bodies cannot be governed by the Code. In our view local bodies should only be able to add entities to definitions provided by the Code and not limit the scope set out in a requirement.
Also, if this approach is designed to respond to stakeholders’ requests that the IESBA should provide guidance to legislators and regulators on how to define PIEs on a jurisdictional level, we suggest that such guidance should be provided outside of the Code.

It is unclear to us if the relevant local body would be the national standard setter, the professional accountancy organization or the oversight board. In many jurisdictions there might be more than one body that can be defined as the relevant local body.

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.

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?

We do not support this proposal.

In our view it is unclear what the rationale behind the proposal is. To our understanding such concerns have not been raised regarding the current approach that makes it necessary to replace the encouragement for the firms to determine if any additional entities should be treated as PIEs, with a requirement.

Also, we question the use of the reasonable and third party test in this context. It is not part of the current regulation and we cannot see why elevating the current encouragement to a requirement would justify the need to use this test. Normally, the reasonable and third party test is used to add a more objective perspective to the decision-making process. Applying the test within this context gives the impression that the firms should second-guess whether the already broad categories of entities covered in R400.14 are broad enough and whether the relevant local bodies are able to make the correct judgment calls when refining the scope. In our view this is a role that is not suitable for the firms.

10. Please provide any comments to the proposed list of factors for consideration by firms in paragraph 400.16 A1.

We think this “building block approach” to factors for consideration is a bit complicated. Taking into account that one purpose with this project was to come up with a clear objective for defining PIEs (400.8 and 400.9), it is a bit confusing that the three components of the broad approach; the Code, the local bodies and the firms - all have different factors to consider.
With regard to the specific list in 400.16 A1, we are concerned about potential consequences, for example the risk of audit firm shopping and disagreements in hindsight with regulators/oversight boards about the “correct” decisions in this regard.

Transparency Requirement for Firms

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

Even though we do support transparency when it provides useful information for stakeholders, we are concerned whether the benefits with disclosing this kind of information outweighs any negative consequences.

In our view, there is a high risk that such a disclosure foremost will cause confusion, for example in a situation where the firm has determined to treat the entity as a PIE, even though the entity is excluded from the legal or regulatory PIE-definition in that particular jurisdiction. Another example of confusion is when the same audit client is treated as a PIE by one auditor but not by another.

Trying to eliminate any confusion by adding further information to the disclosure statement would disproportionately prolong the auditor report. On balance and from a cost-benefit perspective, we therefore question the value of such a disclosure.

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.

We refer to our response to question 11 with regard to the value of such a disclosure. Having said that, we cannot see that such a statement could be placed anywhere else than in the auditor’s report.

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 both these conclusions.

14. Do you support the proposed effective date of December 15, 2024?
It is very difficult to provide any views on a reasonable effective date since it is so strongly linked to the final outcome of this project, especially with regard to the approach taken, including the future roles of the local bodies and the firms. Determining an effective date depends of course also on the number of entities to which the enhanced regulations would need to be applied, taking into account especially the revisions of the Code related to non-assurance services and fees.

Before determining an effective date, we recommend the IESBA to do some outreach as a basis for an impact assessment, in order to understand the amount of entities that would be included in a future scope and hence audit engagements that would be affected by the final version.

**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 establish 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.

In order to provide clarity and consistency, we believe that the IESBA and the IAASB should align their terminology to the extent possible.

However, as already mentioned in our response to question 1, we support the concept of providing an overarching objective but we have strong concerns about the clarity of the actual proposal in 400.8 and 400.9 in relation to R 400.14 – R 400.16.

(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.

We support further exploring the proposed case-by-case approach.

(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?

Please, see our response to questions 11 and 12.