

IESBA "Public Interest Entity" and "Listed Entity" Definitions (part 2)

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At its June 2020 virtual meeting, the International Ethics Standards Board for Accountants (IESBA or the Board) continued its deliberations on two key definitions in the *International Code of Ethics for Professional Accountant (including International Independence Standards)* - *Public Interest Entity (PIE)* and *Listed Entity*. A [previous article](#) provided highlights of Agenda Item 8A, "[Definition of Listed Entity and Public Interest Entity - Issues and Task Force Views](#)". This article provides a summary of the Board's discussion of the latest proposals, which took place virtually on June 11, 2020.

Broadly, the project seeks to re-assess the definitions of PIE and Listed Entity for purposes of identifying a class of entities to which more restrictive auditor independence requirements would apply. For example: stricter independence requirements generally apply to nonassurance services (NAS), fees and partner rotation (long association). Proposals to further tighten rules in these areas (except partner rotation, which was significantly revised in 2017), are currently pending and will be the subject of future articles.

Overarching Objective

As noted in [Agenda Item 8B of the June 2020 meeting materials](#) (preliminary draft revisions), the PIE definition seeks to identify entities whose financial statement audits should be subject to more stringent independence standards, reflecting significant public interest in the financial condition of these entities. The *extent of public interest* would depend on factors such as:

1. nature of the business, such as taking on financial obligations to the public as part of the entity's primary business
2. size of the entity
3. importance of the entity to the markets in which it operates
4. number and nature of stakeholders (e.g., investors, customers, creditors and employees)
5. potential systemic impact on other entities and the economy as a whole in the event of financial failure

Board Feedback

Most of the comments on this aspect of the proposal related to inclusion and/or placement of the fifth item regarding systemic impact of the entity on other entities and the economy, including that item 5:

- is more of a principle than a factor;
- subsumes some or all the other items; and
- should be elevated or placed elsewhere.

The task force will consider the Board’s feedback but task force Chair Michael Ashley countered that he sees a distinction between items 1 – 4 and item 5, as a bank may be important to its stakeholders but *not* systemically impactful to the markets and/or economy. He also noted that an entity need not be large to be systemically important, e.g., it is a key player in the market.

Board members’ comments included:

- uncertainty as to meaning of the term “financial obligations” in item 1
- emphasizing the increased interest in, relevance and importance of audits focused on sustainability reporting (i.e., environment, social and corporate governance or “ESG” reporting)
- whether to broaden the overarching objective for PIEs to include all assurance engagements
- whether to add other stakeholders such as taxpayers, donors or beneficiaries to item 4
- whether the factors would capture large non-governmental organizations (NGOs), which are funded to address crisis situations
- whether the factors would capture stock exchanges and other market operators that are important to the financial markets (e.g., re-insurance firms)

Due to differing views about including the fifth item (systemic impact), Chair Ashley requested a straw poll of the Board to determine whether the task force has captured the appropriate factors. The poll provided unanimous support for the proposed factors.

Listed Entity

The task force's latest proposed definition for Listed Entity is: *"An entity whose shares, stock or debt are publicly traded"*.

This discussion began around entities that are in the process of becoming publicly traded. Chair Ashley noted that identifying the point at which Listed Entity status is attained is challenging given the length and variation of the processes used around the world to achieve a listing. He noted one approach may be to provide factors that firms would consider in making the determination.

Board Feedback

Board members raised questions and/or concerns about whether:

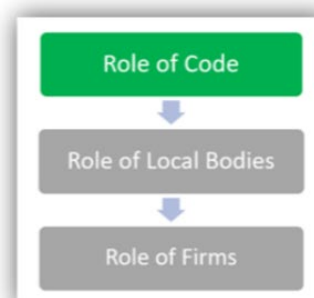
- “listed and/or publicly traded” should replace “publicly traded” to address situations in which an entity is listed but not (yet) publicly traded
- the term “securities” rather than “shares, stock or debt” should be used as it is broader and more inclusive (using the IESBA Code’s definition of “financial interest” was suggested)
- both initial public offerings and secondary offerings would be included
- the term “traded” is ambiguous and should say “available for trading” instead
- regulatory approval may be an appropriate gauge for when entities in the process of becoming publicly traded attain Listed Entity status

Preliminary Global List of PIE Categories

List of PIE Categories

33. At the March 2020 virtual meeting, the Task Force presented 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:

- An entity whose shares, stock or debts are publicly traded
- An entity one of whose main functions is to take deposits from the public
- An entity one of whose main functions is to provide insurance to the public
- An entity whose function is to provide post-employment benefits
- An entity that pools money from the public to purchase shares, stock and debts
- An entity specified as such by law or regulation



Agenda Item 8A (excerpt above) provides the latest proposed list of PIE categories that would appear in the Code. In compiling the list, the task force sought to *include* categories accepted in most countries and *exclude* those accepted in only a very few. The task force stated that they would expect local regulators and standard-setters to tailor the scope of the final list to identify PIEs in their own jurisdictions, for example, by adding or excluding entities based on size or significance. First, Chair Ashley asked the Board to comment on whether the task force should exclude any of the proposed PIE categories.

Board Feedback

Feedback on this question and the preliminary list of PIE categories included the following:

- item (d) - entities whose function is to provide post-employment benefits:
 - whether item (d) includes the plan only or also the entity that sponsors the plan
 - suggest clarifying that the entity’s *primary* business is to provide post-employment benefits
 - suggest placing the focus on public funds
- whether to apply a more principles-based approach

- items (a) and (e) - consider comments made about the language used in the Listed Entity definition (i.e., stock, shares vs. securities) in these items
- whether to distinguish between direct and indirect impact on the public
- whether the list would capture stock exchanges that are not publicly traded
- whether too much emphasis is placed on financial institutions and not enough on other market operators

Chair Ashley noted that the task force expects regulators to include the entities in these categories unless they decide to exempt certain entities due to size. In the case of private companies sponsoring employee benefit plans, he would expect only very large private companies to be treated as PIEs.

Note: Agenda Item 8(A), pars. 40 to 47 describes the task force's consideration of PIE categories whose inclusion was questioned. They are:

- *Custodians*
- *Charities*
- *Public utility entities*
- *Public sector entities*
- *Large private companies*
- *Private equity funds*
- *Systemically significant entities*
- *Public accountability entities (e.g., fiduciary)*

According to the Agenda Item, the task force agreed to exclude all the above categories but has not yet reached consensus on custodians.

This next discussion centered on whether the list of PIE categories should include entities that perform custodial functions by holding customer cash or other assets. Chair Ashley acknowledged that national regulators do not typically identify these entities as PIEs, but as Agenda Item 8A notes, there is “*clearly a public interest in ensuring the proper maintenance and integrity of the systems used to control and report on the client assets held by a custodian*”. One challenge lies in defining custodians, due to variations in the way they operate (e.g., central depositories and small asset managers are both custodians). An additional consideration is that, while PIE requirements are aimed at audited financial statements, custodians hold third party assets, which should be segregated from the custodian's assets, and therefore are not audited by the custodian's auditor.

Board Feedback

Board comments on whether to include custodians in the list of PIE categories: included the following:

Views were mixed, with some concerned about the impact of an audit failure on the markets and others stating that the diversity of custodians make them ill-suited as a PIE category for use in a global Code.

Chair Ashley said that if custodians are included in the list of PIE categories, the task force will need to articulate the attributes more clearly.

Overall, the Board was not supportive of adding custodians to the list of PIE categories.

The next question was whether the task force should include any additional PIE categories in the list.

Board Feedback

Members noted that the list of PIE categories is appropriate within the proposed framework, which would allow regulatory bodies to tailor the list based on local jurisdictional needs.

Board Chair Stavros Thomadakis asked whether investment banks would be included as PIEs if they were not also banks. Board members were uncertain as to whether “pure” investment banks still existed and Chair Thomadakis agreed to research the issue.

One member agreed that local regulators should decide whether to treat public sector entities as PIEs.

Consultative Advisory Group (CAG) Chair Gaylen Hansen expressed a concern that a public utility experiencing an audit failure could take a significant amount of time (due to expertise, capital intensity and technology needed) to begin providing services to the public again. Chair Ashley noted that while the task force will consider that issue further, it is challenging to define the time factor at a global level and he would be inclined to look to local regulators to make that determination. He said the task force and IESBA staff plans to develop nonauthoritative guidance to help local regulators apply the revised PIE and Listed Entity definitions. In addition, the Board will need to carefully consider how long member bodies will need to adopt the revised definitions.

The Board’s feedback on the task force’s proposed approach included the following:

- Consider the risks associated with various entities and their complexity and the goal of having the Code adopted around the world
- Imposing PIE independence restrictions on employee benefit plans, charities and private equity firms is not helpful
- Align any revisions of these terms in the Code with the International Standards on Auditing

Chair Ashley clarified that the task force does not expect regulators would include all categories of PIE in their local regulations, e.g., some charities would include as PIEs, but that would be up to the local regulator. Size alone would not always be the determinant, e.g., a very large charity that takes no donations from the public would likely not be considered a PIE.

Role of Firms

The task force proposes raising current application material in the Code to a requirement (i.e., require firms to consider additional factors (beyond 400.8) to determine whether to treat additional entities as PIEs). One example: will the entity become a PIE in the next fiscal year? Also, an entity that is an owner-operated business with no governance body may not warrant

treatment as a PIE since governance requirements are integral to the enhanced independence requirements.

Other Items

The task force will continue to consider how to address related entities, which currently are defined more broadly for Listed Entities than for non-Listed Entities.

Both the Public Interest Oversight Board (PIOB) and CAG Chairs attending the meeting expressed support for the task force's approach.

Richard Fleck, Chair of the Board's Nonassurance Services (NAS) Task Force, updated the Board on commenters' responses to Question 4 of the [*Proposed Revisions to the Non-Assurance Services Provisions of the Code*](#), which related to the PIE project. Some commenters (8 or 9 out of 63 comment letters) do not think the Board should finalize the nonassurance services (NAS) proposal or [*Proposed Revisions to the Fee-Related Provisions of the Code*](#) until the PIE project has concluded and some asked for further discussion once the PIE and Listed Entity proposals are finalized. A primary concern of commenters related to smaller PIEs within their jurisdictions. Chair Fleck noted they will need to formulate a response to those requests. Chair Ashley mentioned that in 2008, the Board concluded that small listed entities should not be exempted; while regulators may exclude certain PIEs based on size, he questioned whether the Code should do so for the other PIE categories. Chair Thomadakis noted that it will be important to synchronize the effective dates for all three projects (i.e., PIE/Listed Entity, NAS and Fees).

Next Steps

The task force plans to meet with stakeholders, present its views and draft proposals to the International Auditing and Assurance Standards Board (IAASB) in July and the CAG and IESBA during their respective September 2020 meetings. The task force will also continue to monitor progress considering the impact of COVID-19 on stakeholders and the availability of resources and discuss with the IESBA in September 2020 whether it would be more appropriate to aim for a discussion paper instead of an Exposure Draft in December 2020.

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