Notes to IESBA Participants

The draft Questions & Answers (Q&As) in this paper were developed by the PIE Rollout Working Group to explain the key provisions in *Revisions to the Definitions of Listed Entity and Public Interest Entity in the Code* (PIE Final Pronouncement). In developing the questions for this draft, the Working Group has sought preliminary views from Accountancy Europe, the Hong Kong Institute of Certified Public Accountants (HKICPA), and Australia’s Accounting Professional & Ethical Standards Board (APESB).

The Working Group will revise these draft Q&As taking into account:

- Questions raised by participants at the May 2022 PIE Webinar
- Feedback received from the Board at its June 2022 meeting

Subject to the Board’s input, the Working Group plans to finalize the Q&As for release by August 2022. The Board will have the opportunity to undertake a fatal flaw review prior to finalization.

The Working Group intends to use the Q&As as a support tool for its upcoming regional and jurisdictional outreach. As the Working Group gathers more information from the outreach, it will consider the need to update the Q&As or develop a new set of Q&As to address specific circumstances.

Matter for IESBA Consideration

1. IESBA members are asked to provide feedback on the draft Q&As.

Paragraph 400.8

1. Paragraph 400.8 provides that some independence requirements and application material are applicable to the audits of public interest entities (PIEs) because of the significant public interest in their financial condition.

How does the “financial condition” of an entity differ from its “financial performance” or the “financial position”, on which auditors put more focus?

As highlighted in the Basis for Conclusions, *Revisions to the Definitions of Listed Entity and Public Interest Entity in the Code*, the IESBA had considered a number of other terms such as “financial performance”, “financial position”, “financial statements” and “balance sheet”. The IESBA is of the view that the public interest focus for the purposes of independence should be on the general financial health of an entity as reflected in the entity’s financial statements rather than technical terminology or compliance with technical pronouncements which is the focus of the auditors. In another word, the focus should be more broadly about how the financial failure or success of an entity would impact the public. To highlight this broader nature of the term “financial condition”, the IESBA has included the phrase “due to the potential impact of their financial well-being on stakeholders” in paragraph 400.8.
Whilst an entity’s financial statements that present its financial position and performance are important in assessing the entity’s financial condition as indicated in paragraph 400.10, the IESBA is of the view that using “financial statements” might place too much emphasis on the technical composition of the financial statements alone as opposed to their role in enhancing confidence in the overall financial well-being of an entity. The IESBA is also of the view that the phrase “public interest in the financial statements” might be perceived as restricted to the interest of investors only.

The focus on the broader term “financial condition” and financial health does not expand the responsibility of an auditor to beyond that specified in the auditing standards.

2. Should an entity be included as a PIE if there is significant public interest in its performance on environmental, social and governance (ESG) matters?

As the International Independence Standards (IIS) under Part 4A of the Code deal with the audits and reviews of financial statements, the overarching objective as set out in paragraphs 400.8 and 400.10 is focused on the financial health of an entity and not on other aspects of the entity such as its performance on ESG matters.

For instance, whilst there may be a high level of public interest in the environmental impact of the business or activities of certain categories of entities, such interest does not necessarily translate into public interest in those entities’ financial condition, i.e., their financial success or failure may not draw any significant public interest.

The IESBA recognizes the rapid growth in demand for sustainability reporting and assurance, prioritization by regulators on the development of new regulations governing this area as well as the development of global and regional standards. In response to this global movement, the IESBA established the Sustainability Working Group in Q1 2022 to conduct fact-finding and lay the groundwork for the IESBA’s standard-setting response in the sustainability area. The IESBA will continue to monitor the development of sustainability assurance and, if appropriate, consider the need to expand its overarching objective for additional independence requirements for PIEs.

The following are two other examples of public interest in other aspects of an entity:

**Example 1**

Whilst there might be significant public interest in charities if they have significant “public funding” or they deliver services and activities for the benefit of vulnerable communities, the public impact of their financial failures will vary from charity to charity. For instance, the public interest in the financial condition of a private foundation with only a few founding donors which primarily provides grants to other charities might not be significant as its financial failure would not have the same level of public interest as the financial failure of a major charity that runs programs that directly assists many vulnerable beneficiaries.

**Example 2**

For social media providers, there might be significant public interest in how they manage the collection, use and disposal of their users’ data that contain personal and sensitive information. However, whilst the financial success or failure of social media providers will impact their investors, there is only likely to be limited impact on their users given that the users are usually free to join and the providers are easily replaced by other similar providers.
Paragraph 400.9

3. Paragraph 400.9 provides a list of factors for consideration when evaluating the level of public interest in the financial condition of an entity. How could each of these factors be relevant in the evaluation?

As highlighted in the Basis for Conclusions, these factors should not be considered in isolation.

<table>
<thead>
<tr>
<th>Factor</th>
<th>Relevance</th>
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<tbody>
<tr>
<td>1. The nature of the business or activities, such as taking on financial obligations to the public as part of the entity’s primary business</td>
<td>This factor is drawn from the extant paragraph 400.8. Certain types of business or activities, such as those of banks, insurers and other financial institutions, are likely to draw more public interest in the entity's financial condition. On the other hand, public sector services or hospitality are less likely to attract significant public interest in an entity's financial condition. The term “public” encompasses not only individuals but also other entities.</td>
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<td>2. Whether the entity is subject to regulatory supervision designed to provide confidence that the entity will meet its financial obligations</td>
<td>This factor is linked to Factor #1. This factor relates to entities that are subject to financial or prudential regulatory supervision designed to give confidence that the entities will meet their financial obligations. Such regulation is often but not necessarily restricted to financial markets. The use of “regulatory supervision” refers to not only regulations but a process of supervision or supervisory regime. If an entity is subject to regulatory supervision that includes ensuring it meets its financial obligations, there is likely to be significant public interest in that entity's financial condition.</td>
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<td>3. Size of the entity</td>
<td>The size factor is drawn from the extant paragraph 400.8. It is of particular importance when a relevant local body is determining if there should be a size threshold to any of its categories of PIEs at the local level. The size dimension may be in amount of annual turnover or other aspects such as the number of investors or policy holders. Size as a factor can be viewed both from the perspective of excluding very small entities that might meet other factors, and from the perspective of considering very large entities that by sheer size alone might qualify to be regarded as of significant public interest. This latter aspect will often be linked to bullet #5.</td>
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4. The importance of the entity to the sector in which it operates including how easily replaceable it is in the event of financial failure

This factor includes consideration of how easily replaceable the entity is in the event of financial failure and hence whether such failure will cause significant disruption to the supply of goods or services on which the public may depend.

This factor captures a characteristic that is common to a number of public utility entities and financial market infrastructure entities.

For instance, companies that sell electricity to retail customers are unlikely to play an integral part in the energy sector. The financial failure of such a company is unlikely to create significant disruption as its customers would be able to sign up with another company and receive similar services.

5. Number and nature of stakeholders including investors, customers, creditors and employees

This factor is drawn from the extant paragraph 400.8. It relates to the direct impact on an entity’s stakeholders. This factor is relevant to entities such as private entities.

The greater the number of stakeholders and the broader the range of stakeholders an entity has, the more likely there will be significant public interest in the financial condition of that entity.

This factor calls for consideration of not only the number of stakeholders, but also their nature. For instance, the level of public interest may not be high if the investors are mostly sophisticated investors who are investing for their own accounts.

Another example is a private company with large number of employees. A relevant local body might determine that such entities should be treated as PIEs.

6. The potential systemic impact on other sectors and the economy as a whole in the event of financial failure of the entity

This factor relates to the indirect impact that the entity might have on the economy.

If an entity’s financial failure were to have a significant impact on the economy in which it operates, this would indicate that it is of significant public interest.

Many entities of systemic impact would be expected to be captured under some of the mandatory PIE categories such as banks and insurers.

**Paragraph R400.17(a)**

4. Are all “listed entities” under the extant Code scoped in as publicly traded entities (PTEs) without an exception?

The concept of “listed entity” is incorporated into the definition of PTE in the Code.
The phrase “including through listing on a stock exchange” is intended to include not only primary stock exchanges but also other exchanges such as second-tier exchanges when used for trading by the public.

The glossary also includes “listed entity as defined by relevant securities law or regulation” as an example of a PTE. As such, any entities that are listed entities as defined in their local jurisdictions will also be scoped in as PIEs as long as these entities also meet the criteria set out in the PTE definition and are not otherwise refined by the local bodies.

5. What are some examples of “financial instruments” in the definition of PTE?

In determining not to define the term “financial instruments” or rely on the IASB’s definition set out in International Accounting Standard (IAS) 32, Financial Instruments: Presentation, the IESBA concluded that the term should be broadly interpreted subject to local refinement.

The term covers not only “shares, stock or debt” (as currently used in the extant definition of “listed entity”) but also other types of instruments such as bonds, warrants and hybrid securities. It is also sufficiently broad to cover any future developments in corporate fundraising.

6. What does the phrase “traded through a publicly accessible market mechanism” mean? What are the examples of entities that are determined to be included in, or excluded from, the PTEs in consideration of this phrase?

The phrase “traded through a publicly accessible market mechanism” means that the trading of an entity’s financial instruments is through a trading platform or system that is available to the public. Such mechanism can be either a primary or second-tier stock exchange or over-the-counter platform. However, it is not intended to capture entities for which the only way to trade their financial instruments is through privately negotiated agreements or for those entities whose listing on the market mechanism is only for tax or regulatory compliance. This means that, for instance, an entity whose listed debt securities are offered to only institutional investors would not be scoped in as a PTE. On the other hand, an entity whose financial instruments are traded through an over-the-counter platform by the public, even with a low volume of trade, is without refinement by a local body, a PTE.

Similar to the definition of the mandatory categories under paragraph R400.17 (b)-(c), the definition of PTE is high-level and will scope in a broad range of entities without refinement at the local level. Any further refinement should be conducted by the relevant local bodies as appropriate depending on their specific contexts, such as by reference to specific regulated or other exchanges. For example, some jurisdictions might determine that entities trading via certain specific second-tier markets or over-the-counter platforms are not considered to be PTEs under paragraph R400.17(a) as the financial condition of these entities do not attract significant public interest and thus refine R400.17(a) in their jurisdiction accordingly.

Questions 7-10 below explain if certain entities under a broad set of circumstances would be scoped in as PTEs under the Code’s definition without any further refinement by the relevant local bodies. The IESBA acknowledges that local bodies will need to gain an understanding of the different types of financial instruments including the mechanism employed and their availability when determining if certain entities should be scoped in as PTEs at the local level. In this regard, the PIE Rollout Working Group plans to carry out a number of jurisdictional and regional outreaches. As part of these outreaches, the Working Group will work with local bodies on addressing their local-specific issues and on how to more clearly define the mandatory categories. These issues may include whether certain debt
instruments have an appropriate market mechanism and whether a financial instrument is “trading”. See also the response to Q.11 for more discussion on the anticipated role of the local bodies.

7. Do PTEs encompass all entities whose financial instruments are traded on any platforms such as primary stock exchanges, second-tier markets, over-the-counter trading platforms?

The definition of PTE in the Code will include any entities whose financial instruments are publicly traded on any platforms whether it be the primary stock exchanges or over-the-counter platforms. As part of its adoption and implementation process, a local body might determine that only entities that are trading their financial instruments in the primary stock exchange or other specified trading platforms attract significant public interest in those entities’ financial condition and should be scoped in as PTEs.

8. Does the definition of PTE include entities whose stocks or debt instruments are traded in the unregulated markets of a jurisdiction?

Regulated markets are markets that are overseen by the relevant regulators to protect the public interest in those markets and operate in accordance with certain regulations. The financial instruments traded through these markets are generally available to the public. On the other hand, unregulated markets are not regulated by a specific regulator and the offerings are private and restricted to certain investors.

The key factor for consideration is whether the financial instruments trading in a particular market are available to the public. If an entity whose stocks or debt instruments are traded in an unregulated market where those instruments are not available to the public for trading, the entity would not be a PTE in accordance with the Code’s definition.

9. There are entities that register debt offerings on an exchange (often not a regulated exchange) to qualify for exemption from certain taxes. Are these entities scoped in as PTEs under the Code’s definition?

The term “publicly traded” is used instead of “publicly listed” as some financial instruments might only be listed and are not intended to be traded. Such situations can arise for example within groups where the relevant instruments are held entirely intra-group. The IESBA is also aware of the issue of shares in small “start-up” or new venture entities which are subscribed for by the public because of the tax breaks provided and where any exit will be only through a disposal managed by the professional advisers promoting the entity. The IESBA is of the view that entities whose financial instruments are only listed or issued to the public with no trading do not necessarily attract significant public interest in their financial condition.

10. State and local governments might finance their capital needs such as the development of schools, roads and hospitals through the issuance of long-term debt, primarily tax-exempt municipal bonds. These bonds can often be traded in over-the-counter trading markets. Would these public entities be scoped in as PTEs under the Code’s definition?

If the municipal bonds are redeemable and are trading through a publicly accessible market mechanism, the issuing public sector entity would, without refinement by a local body, be scoped in as a PTE under the Code’s definition.

Some relevant local bodies may determine to refine the PIE definition to scope out issuers of municipal bonds or other entities that may be otherwise scoped in as PIEs under the definition of PTE in the Code.
Paragraphs R400.17 (d) and 400.18 A1

11. Local bodies responsible for adopting the Code play a significant role under the Code’s revised PIE definition framework. It is anticipated that those bodies will refine the definition taking into account the local contexts to ensure the right entities are scoped in as PIEs in their local Code.

What if a local body adopted the Code’s list of mandatory PIE categories without more explicitly refining the categories?

The IESBA Code is adopted and implemented by relevant local bodies across jurisdictions and applies to professional accountants in those jurisdictions. In developing the revised PIE definition, the IESBA recognized that the relevant local bodies have the responsibility, and are also best placed, to assess more specifically which entities should be scoped in as PIEs in their jurisdiction. Accordingly, the IESBA formed the view that it would be appropriate under these circumstances that the Code should deviate from its normal practice and allow local bodies to more clearly define what entities should be included as PIEs under each of the three mandatory categories under paragraph R400.17(a)-(c) as well as to include additional entities as PIEs in their jurisdictions under paragraph R400.17(d).

After considering the views of all relevant stakeholders including regulators and the profession as well as taking into account the local contexts, a relevant local body might conclude that the right entities would be scoped in as PIEs if it adopts the Code’s mandatory PIE categories without any revisions in its jurisdiction.

However, if a local body adopts the list of mandatory categories in paragraph R400.17 without conducting the necessary stakeholder engagement and assessment, it is likely that its local PIE definition would scope in entities that do not have significant public interest in their financial condition. To address this risk, the IESBA included application material (paragraphs 400.18 A1 and 400.18 A2) that highlights the anticipated role of the local bodies under the IESBA’s revised PIE definition framework. In addition, the PIE Rollout Working Group will carry out a range of rollout activities including regional and jurisdictional outreaches.

12. What if a local body’s definition of publicly traded entity only includes entities trading from its primary market but does not include entities trading on other publicly trading platforms?

Paragraph 400.18 A1 clarifies that the mandatory categories set out in paragraph R400.17(a)-(c) are broadly defined and that the Code provides for the relevant local bodies to more explicitly define these categories. The paragraph also provides examples on how such bodies may refine the categories such as “Making reference to specific public markets for trading securities”.

The definition of the new term “publicly traded entity” in the glossary includes an entity that issues financial instruments that are traded through a publicly accessible market mechanism. However, a relevant local body might refine the category of publicly traded entity in its local code to only include entities with financial instruments trading in the jurisdiction’s primary market. Accordingly, a firm in that jurisdiction is required to only treat those entities trading from its primary market as PTEs in accordance with paragraph R400.18.

13. What if a local professional body or national standard setter do not have the authority to revise its local PIE definition as the term is defined by legislation?

The IESBA recognizes that the standard setting framework varies from jurisdiction to jurisdiction. For instance, the local professional bodies or national standard setters may not have the authority
to make any refinement to the PIE definition as the term is defined by legislation that was designed operationalize a range of public policies, not only on auditor's independence but also on issues such as responsibilities of those charged with governance (TCWG) and audit committees. In these instances, the IESBA acknowledges that it may be difficult for the local professional bodies or national standard setters to successfully persuade its legislators to revise its local PIE definition. Whether the local bodies could adopt the revised PIE definition in these jurisdictions and what options might be available will depend on the circumstances. As part of its outreaches to promote adoption of the revised PIE definition, the PIE Rollout Working Group will provide assistance to local bodies in identifying possible ways forward to ensure the right entities are scoped in under the revised PIE definition.

14. What if a local body has not yet adopted the PIE revisions when they become effective on December 15, 2024?

The PIE revisions will become effective for the audits of financial statements for periods beginning on or after December 15, 2024. If a relevant local body has not yet adopted the PIE revisions by that date, the local extant PIE definition will continue to apply to the professional accountants in that jurisdiction.

15. What if a jurisdiction has an extant PIE definition that is different to the revised PIE definition set out in paragraph R400.17 and the local body does not intend to make any revision to its extant definition?

Paragraph 400.18 A1 clarifies that the mandatory categories set out in paragraph R400.17(a)-(c) are broadly defined and that the Code provides for the relevant local bodies to more explicitly define these categories.

A local body may determine that its extant definition of PIEs already includes all the mandatory categories of PIEs and that no further revision to its extant categories is necessary to adopt the IESBA's revised PIE definition. However, it is noted that to fully adopt the revised PIE definition, a local body must not exclude any one of the mandatory categories set out in paragraph R400.17(a)-(c).

Paragraph 400.18 A2

16. What additional information or factors that a local body may take into account when considering whether to include pension funds or collective investment vehicles (CIVs) as potential PIE categories in its local Code?

The IESBA concluded that the two categories relating to post-employment benefits (PEBs) such as pension funds and CIVs as proposed in the Exposure Draft (ED), Proposed Revisions to the Definitions of Listed Entity and Public Interest Entity in the Code, should not be retained as mandatory PIE categories of the Code.

In reaching this conclusion, the IESBA planned to conduct a holistic review of PEBs and CIVs and their relationships with trustees, managers and advisors, including a review of the definition of related entity in the Code. Further, the IESBA acknowledged that these categories may be included in some local codes and has, therefore, included both pension funds and CIVs as examples in paragraph 400.18 A2.

In addition to the factors set out in paragraph 400.9, the following is additional information for consideration by local bodies when consider if pension funds or CIVs should be included in their
local PIE definitions:

- Whilst pension funds and CIVs can have significant impact on the public in the event of financial failures, many of them only have few investors or stakeholders and there is little public interest in the financial condition of these smaller schemes.
- Some CIVs may already be listed and trading in public exchanges.
- Some CIVs may not be open to the public and are available for trading only by institutional investors.
- In some jurisdictions, increased independence requirements would make these pension plans more expensive and thus result in some employers abandoning the plans altogether.
- Government-operated pension schemes may not pose any significant risks to the public.
- In jurisdictions where the pension scheme accounts only show the scheme's assets (and not its liabilities) and are therefore effectively stewardship accounts, rather than indicating the financial condition of the scheme, there may not be much public interest in the scheme accounts.

As mentioned above, the IESBA planned to conduct a holistic review on pension funds and CIVs which is due to commence in 2023.

17. What are other types of categories that might be considered by a relevant local body?

The IESBA had considered a number of other categories when developing the ED but determined that they are not suitable for a global code. These categories include:

- Charities.
- Financial market infrastructures.
- Large private companies.
- Private equity funds.
- Public utilities.
- Public sector entities.
- Stock and commodity exchanges.
- Systemically significant entities.

The IESBA observed that a number of jurisdictions have already included some of the above and other categories as PIEs for the purposes of additional independence requirements. The IESBA plans to release a jurisdictional PIE definition database by Q4, 2022 as a reference for the local bodies.

**Paragraph 400.19 A1**

18. One of the factors in paragraph 400.19 A1 is an entity's “corporate governance arrangements, for example, whether those charged with governance are distinct from the owners or managements”. How would this factor affect a firm’s determination about whether to treat an entity as a PIE for the purposes of Part 4A of the Code?

Paragraph 400.19 A1 encourages firms to determine whether to treat other entities as PIEs for the purposes of Part 4A of the Code. The paragraph also provides a list of factors for consideration by firms including an entity's "corporate governance arrangements, for example, whether those
An entity’s corporate governance arrangements may be a relevant factor for consideration as the application of additional independence requirements for PIEs to an entity may be misleading or give the wrong perception about the maturity and quality of the entity’s management if the entity lacks appropriate corporate governance arrangements such as a robust corporate governance board.

19. If a firm determines to treat an additional entity as a PIE in accordance with paragraph 400.19 A1, does that firm have to apply all independence requirements for PIEs with regards to the audit of that entity such as those of the revised non-assurance services (NAS) and Fees provisions requiring action from TCWG?

If a firm determines to treat an additional entity as a PIE in accordance with paragraph 400.19 A1, the firm should apply all the independence requirements for PIEs including those relating to communications with TCWG under the revised NAS and Fees provisions. Hence, it is important that a firm carefully considers whether it is warranted to treat such an entity as a PIE. Similarly, the transparency requirement in paragraph R400.20 assumes that all the independence requirements for PIEs have been applied to the audit of the financial statements of such an entity. Notwithstanding paragraph 400.19 A1, a firm may apply additional independence requirements in order to address threats to its independence relating to the audit of an entity’s financial statements. In this regard, the ISQM 1\(^1\) also provides that “In some cases, the matters addressed by the firm in its system of quality management may be more specific than, or additional to, the provisions of relevant ethical requirements.”\(^2\)

**Paragraphs R400.20 and R400.21**

20. What are some of the factors that a firm should take into consideration when determining what is an “appropriate” form of public disclosure?

The IESBA did not specify or provide any examples of the appropriate form of public disclosure in the PIE revisions as the IAASB is yet to consider the issue as part of its narrow scope maintenance of standards project.

As highlighted in the Basis for Conclusions, the IESBA will consider if and what, further actions might be warranted once the IAASB has concluded its deliberations on whether the auditor’s report is a suitable location for such disclosure and, if so, how this may be accomplished. The IESBA will provide more guidance on the appropriate form of disclosure in due course.

21. Paragraph R400.21 provides an exception to the transparency requirement in paragraph R400.20 if the disclosure will result in disclosing confidential future plans of an entity.

If disclosing the fact that additional independence requirements for PIEs have been applied to the audit of an entity will risk disclosing the entity’s plan to go public or its merger and acquisition plan, will this serve as an exception to the transparency requirement?

The IESBA acknowledged the importance of the fundamental principle of confidentiality and the

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1. ISQM 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements or Other Assurance or Related Services Engagements*
2. ISQM 1, paragraph A63
challenges that firms may face if disclosure in paragraph R400.20 would lead to disclosure of material confidential plans about the entity. Accordingly, the IESBA included paragraph R400.21 as an exception to the transparency requirement.

If a disclosure by a firm under paragraph R400.20 will result in disclosing an entity’s plan to go public or its merger and acquisition plan that has not been made known to the public, the exception in paragraph R400.21 may apply.