

Entities of Significant Public Interest

Background

Existing Section 290.28 contains the following guidance on the application of the independence requirements to audits of entities of public interest:

“Certain entities may be of significant public interest because, as a result of their business, their size or their corporate status they have a wide range of stakeholders. Examples of such entities may include listed companies, credit institutions, insurance companies, and pension funds . . . Consideration should be given to the application of the framework in relation to the financial statement audit of listed entities to other financial statement audit clients that may be of significant public interest.”

Recognizing the need for more specific guidance and in light of the public interest associated with a wide range of entities, the IESBA proposed in the exposure draft to strengthen this guidance. The proposal extended the listed entity independence provisions to all entities of significant public interest. Such entities are described in proposed revised Section 290 as listed entities and certain other entities which, because of their business, size or number of employees have a large number and wide range of stakeholders.

As noted in the Explanatory Memorandum of the Exposure Draft, when developing guidance on which entities should be considered an entity of significant public interest, the Board reviewed the guidance of other jurisdictions. That review indicated that there were similarities in approach, for example, including listed entities within the definition of public interest entities and including certain other entities based on a size test. There were, however, significant differences in the application of a size test. Further, in some jurisdictions entities considered to be of significant public interest for independence purposes are defined by law or regulation. In considering this information, the Board concluded that it was impracticable to develop a single definition of an entity of significant public interest that would have global application and be suitable in all jurisdictions. Accordingly, in those jurisdictions where entities considered to be of significant public interest for independence purposes are defined by law or regulation, the IESBA concluded that this definition should be used in applying the requirements of proposed revised Section 290. In the absence of such a definition, the IESBA concluded that member bodies should determine the types of entities that are of significant public interest in their particular jurisdictions.

The IESBA stated in the Explanatory Memorandum the view that because of the significant public interest associated with listed entities, such entities should always be considered to be entities of significant public interest. Therefore, audits of such entities should always be subject to the enhanced safeguards contained in Section 290. Accordingly proposed revised Section 290 states that entities of significant public interest will always include listed entities.

For other entities, the exposure draft contains some flexibility for each jurisdiction to determine, based on the facts and circumstances, which entities should be considered to be entities of significant public interest in that particular jurisdiction. While there is a

presumption that regulated financial institutions will be considered to be entities of significant public interest, the Board recognizes that in some jurisdictions, it is possible that certain regulated financial institutions would not have a large number and a wide range of stakeholders and thus, the extent of public interest in those entities would not be significant. Conversely, some pension funds, government-agencies, government-controlled entities and not-for-profit entities may have a large number and wide range of stakeholders and should, therefore, be treated as entities of significant public interest. Accordingly, proposed revised Section 290 states that “depending on the facts and circumstances” entities of significant public interest will normally include regulated financial institutions, such as banks and insurance companies, and may include pension funds, government-agencies, government-controlled entities and not-for-profit entities.

In the absence of a legislative definition, member bodies will need to determine which entities, in addition to listed entities, will be treated as entities of significant public interest. Member bodies may find it useful to consult with those who regulate entities that might be considered to be entities of significant public interest to determine which particular entities should be categorized as such for independence purposes.

The proposal indicates that in the case of an audit client that is a non-listed entity of significant public interest, in certain circumstances, depending on the nature and structure of the client’s organization, it may not be necessary to apply the enhanced safeguards applicable to listed entities to all related entities of the client to maintain independence. The IESBA recognizes that in the case of certain entities of significant public interest, including many government-controlled entities which do not have a typical corporate structure, application of the enhanced safeguards to all related entities is overly broad and unnecessary to maintain independence.

Discussion

Comments Received

60 respondents commented specifically on the extension of the listed entity provisions to all entities of significant public interest (“ESPIs”) of whom the majority either agreed with the proposal or agreed in large part with the proposal with some suggestions for clarification.

Comments from those who supported the proposals include:

- We believe the rationale for the application of additional requirements for the audit of listed entities is that in such entities, there is a wider range of financial stakeholders than for most entities and that therefore safeguards needed to address perception issues take greater precedence. By their very nature, entities of significant public interest share the characteristic of a wide range of financial stakeholders so in principle we agree with the proposal. We also agree that it would be inappropriate for IFAC to seek to promulgate a detailed international definition and that this should be done by national regulators or, in their absence, member bodies: national differences will be too great for a detailed IFAC definition to apply sensibly (ICAEW);

- We agree to the proposed extension of the requirements for the auditor's independence for listed companies to other entities of significant public interest. In our opinion such an extension is reasonable since there are no good explanations for maintaining different independence provisions for auditors in listed companies and auditors in other companies with a large number and wide range of stakeholders; (DnR)
- We support the approach of the IESBA to rely on member bodies to determine the types of entities that are of significant public interest where there is no legal definition in place. The guidance that is provided by the IESBA in paragraph 290.23 is considered helpful and appropriate in this regard. (APB)

One respondent [Basel] disagreed with the view that it is impracticable to develop a single definition that would have global application and be suitable in all jurisdictions. The respondent pointed to the EU definition which defines entities of significant public interest.

Several of the respondents who disagreed with the proposal commented that this could lead to inconsistent application because of differing interpretation from jurisdiction to jurisdiction. Some also commented that this could be particularly problematic for ESPIs that cross jurisdictions:

- Also the phrase “large number and wide range of stakeholders” as well as “stakeholders” should be defined. The ambiguity and lack of clarity in these terms will lead to inconsistent interpretation and ultimately application of the definition and related requirements throughout international member organizations; (Grant Thornton)

The proposals state that a listed entity would always be considered to be an ESPI. Some respondents commented that no support was provided for this statement in the ED, either in the proposed revised Section 290 or in the Explanatory Memorandum. In addition, three respondents expressed the view that in some jurisdictions there are many small listed entities and therefore smaller listed entities may not have a large number or wide range of stakeholders. In addition it was noted that such entities may not have the level of sophistication is necessary to comply with reporting requirements without assistance from their auditing firm.

Respondents noted that while the ED states that SPIEs are entities that “because of their size or number of employees, have a large number and wide range of stakeholders” the examples provided would not necessarily meet this overall characteristic. Respondents expressed concern that irrespective of this overall characteristic some may inappropriately interpret this as meaning that the nature of the business itself would be sufficient to determine whether an entity should be considered a SPIE. These respondents suggested that greater emphasis be give to either the size of the entity or the fact that it has a wide range of stakeholders.

Nine respondents expressed the view that additional guidance should be provided as to the characteristics of SPIEs. These respondents expressed concern that the examples

provided could be too easily seen as tantamount to rules to apply despite the qualifying language. It was suggested that additional guidance be provided in the following areas:

- Who are the entity's stakeholders, including what is meant by a "stakeholder";
- The size of the entity (measured in terms such as total assets, total revenue, market capitalization and/or the number of stakeholders);
- The degree of reliance placed by the stakeholders on the audited financial statements; and
- The potential impact on the stakeholders of an audit failure caused by a lack of auditor independence.

Three respondents suggested that it might be useful if the Code was aligned with the International Accounting Standards Board definition contained in the exposure draft of IFRS for Small and Medium sized entities. (The ED provides a simplified set of accounting principles that are appropriate for smaller and medium –sized entities that do not have public accountability). The IFRS ED defines an entity as having public accountability if:

(a) it files, or it is in the process of filing, its financial statements with a securities commission or other regulatory organization for the purpose of issuing any class of instruments in a public market; or (b) it holds assets in a fiduciary capacity for a broad group of outsiders, such as a bank, insurance entity, securities broker/dealer, pension fund, mutual fund or investment banking entity"

Five respondents disagreed with the proposal but did not suggest an alternative. One of these respondents expressed concern that the proposal was too broad and is likely to lead to a further decline in the number of small audit practitioners, reducing choice and quality for those entities requiring or requesting an audit.

The Appendix to this Agenda Paper contains a chart summarizing views expressed. A detailed cut and paste of all comments received on this matter is contained in Agenda Paper 3-G.

Alternatives Considered

The Task Force is of view that despite the large number of respondents who expressed explicit support for these proposals, in light of the large volume of comments expressing concern with the proposals, or concern with how the proposals could be interpreted, it is appropriate to clarify the intent of the Board.

Flexibility for listed entities

The Task Force considered the suggestion that there should be some flexibility as to whether all listed entities would be considered to be SPIEs. The Task Force believes that it is not appropriate to provide this flexibility. The Task Force notes that the existing Code does not provide for such flexibility. The Task Force also notes that a significant amount of the concern is likely related to the elimination of the flexibility for alternatives to partner rotation (see Agenda Paper 3-H). Accordingly the Task Force is of the view that in light of the recommendation regarding partner rotation it is appropriate that listed

entities, regardless of size, will always be considered to be SPIEs and therefore subject to the more stringent requirements contained in the proposals.

Emphasize Size

The Task Force considered whether emphasising the size of the entity or providing more guidance on the size of the entity would be sufficient to address the concerns expressed and would be capable of appropriate consistent application. The Task Force concluded that, in light of the concern expressed, providing greater emphasis on the size of the entity would not address the concern that the examples provided could be viewed as tantamount to a rule. The Task Force also noted that, as discussed by the Board when developing the proposal, it was not possible to provide specific quantitative guidelines that would be appropriate for global application. The Task Force noted that during the development of the proposals the Board had reviewed requirements in European jurisdictions which had established a size test. The review had revealed that there were significant differences in the sized tests used.

IAS Definition

The Task Force considered whether adopting the IAS definition of an entity with public accountability enterprise would address concerns expressed. The Task Force was of the view that the second category (it holds assets in a fiduciary capacity for a broad group of outsiders, such as a bank, insurance entity, securities broker/dealer, pension fund, mutual fund or investment banking entity) might not address the concern that the nature of the business itself, irrespective of size, would categorize an entity as an entity of significant public interest.

Additional Guidance on Criteria

The Task Force is of the view that the preferred approach is to provide additional guidance on the characteristics which would be considered in determining whether an entity (other than a listed entity or an entity that has been deemed to be of significant public interest by a regulator) is to be considered a SPIE for independence purposes.

Narrow Definition

The Task Force noted that much of the concern expressed related to the clarity of whether or not an entity would be considered to be an entity of significant public interest. The Task Force noted that an alternative which would address this concern would be to define entities of significant public interest very narrowly as listed entities and any entities which have been designated by a regulator to be an entity of significant public interest. The Task Force notes that such, other than for listed entities, this would leave the determination of whether an entity is of significant public interest to the relevant regulators in each jurisdiction.

If a broader definition is to be adopted who makes the determination?

The Task Force also considered who should make the determination of which entities are SPIEs. The Task Force noted that this determination could either be made by the firm with agreement by the client, by a member body or the client (audit committee). In considering which approach was preferable the Task Force considered the following advantages and disadvantages:

- Determination by firm advantages:
 - This approach would be consistent with the approach taken in IAASB's International Standard on Quality Control 1 which requires an engagement quality control review on all audits of listed entities and also requires the firm to establish criteria that it will consider when determining which engagements other than audits of financial statements of listed entities are to be subject to an engagement quality control review. The nature of the engagement including the extent to which it involves a matter of public interest is provided as a criterion (ISQC 1 ¶62);
 - This approach would lead to more consistent application for non-listed SPIEs which are cross-border, provided the same firm audits all parts of the SPIE;
 - The approach would also lead to more consistent application across a specific network; and
 - It is consistent with the overall framework approach regarding the assessment of threats to independence and application of appropriate safeguards to address the threats.
- Determination by member bodies advantages:
 - This approach would lead to more consistent application in a particular jurisdiction as entities would be treated equally and a change of auditor could not lead to a change in SPIE status; and
 - This approach could be seen as being more objective because firms would not be determining whether the more stringent requirements are to be applied to a particular entity.

Recommendation

After consideration of the alternatives the Task Force has developed two alternative definitions for the consideration of the Board – a narrow definition which would provide greater clarity as to what was and what was not an entity of significant public interest and a broader definition.

Narrow definition

Under this approach entities of significant public interest would comprise:

1. All listed entities; and
2. Entities which have been designated by a regulator to be subject to the same independence requirements as those applicable to a listed entity.

The Task Force is of the view that the advantage of this approach is that the line is clearly drawn. However the Task Force recognizes that such a definition would leave the

decision as to whether the more stringent listed entity requirements should apply to a non-listed entity to the individual regulators.

Broader definition

Under this approach entities of significant public interest would comprise:

1. All listed entities;
2. Entities which have been designated by a regulator to be subject to the same independence requirements as those applicable to a listed entity; and
3. Other entities, as determined by the firm, that have public accountability to a large number or wide range of stakeholders. Factors which the firm would consider in making the determination would include:
 - a. Size relative to the economy
 - b. Social significance in a particular jurisdiction
 - c. Whether the entity holds assets in a fiduciary capacity

Under both alternatives the illustrative examples contained the exposure draft (regulated financial institutions, such as banks and insurance companies, and may include pension funds, government-agencies, government-controlled entities and not-for-profit entities) would be deleted.

Action requested

Members are asked to consider the alternatives provided by the Task Force and provide feedback.

Appendix 1
Summary of Comments Received

	Member Bodies	Firms	Regulators	Gov't Orgs	Others
Agree with proposal to extend definition	JICPA, ICPAS, NRF, FSR, ICAS, ICAEW, DnR, NIVRA, IDW, CSOEC, KICPA, ACCA, ICAIndia, ICAP, MIA	Mazars	CEBS	ACAG	FEE, AC, APB, IRBA, CARB, PAOC
Agree with extension but must be clear that only larger entities would be considered to be SPIEs	CGA, ICANZ	KPMG, PwC			EFAA, CGA Alberta
Agree with extension but classification should be based on criteria	FAP	Mazars, DTT, BDO			Wolf, CoCPA, OCPA, MaCPA, SMP
Agree with extension but should be more emphasis on impact of entity and who is involved therewith	SAICA				
Credit unions should always be SPIEs			CEBS		
Some alignment with the IFRS Exposure Draft would be useful	HKICPA	E&Y, Grant Thornton,			SMP
Not all listed entities should be treated as SPIEs	CMA, CICA, FACPE				
Disagree that it is not possible to develop a global definition				Basel	
Disagree with extension	CNCC, Australia, FACPE				Hogan Hansen, SCAA

	Member Bodies	Firms	Regulators	Gov't Orgs	Others
Should not have differential requirements					CAGNZ
The examples should be deleted	AICPA	BDO			
Government entities should be excluded					APESB
In the absence of a legislated definition an appropriate government entity should define a SPIE				GAO	
The firm should determine based on the criteria whether an entity is a SPIE		DTT			
Member body should be required to consult with regulator in establishing the definition					NASBA