

Ken Siong
IESBA Senior Technical Director
IFAC
6th Floor
529 Fifth Avenue
New York
10017 USA

11 May 2021

Dear Ken,

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

The Financial Reporting Council (FRC) welcomes the opportunity to comment on this exposure draft. As the UK's Competent Authority for Audit, our mandate includes the setting of auditing, assurance and ethical standards, as well as inspection of public interest entity audits and enforcement action against auditors. We also exercise an oversight function over the accountancy profession in the regulation of its members and take public interest misconduct cases where conduct falls below expected standards – for example, when practitioners fail to comply with the fundamental principles and requirements set out in the Code of Ethics. The FRC is also responsible for setting the UK Corporate Governance Code and its associated guidance.

General Comments

We support IESBA's aim to enhance the definitions of listed entities and public interest entities within the Code. The overarching aim of the proposed amendments is to enhance public confidence in the audit of financial statements for certain entities judged to have activities and characteristics that heighten public interest in their financial condition. The proposals also recognise that public interest is context driven, and that local standard setters are best placed to make the underlying judgement over which particular entities are subject to heightened public interest. We also welcome the use of considerations that focus on the attributes of an entity, rather than its functional activities, in determining whether it is a public interest entity. Indeed, you may already be aware that the UK government is currently consulting on proposals to extend the definition of a public interest entity, to include large private companies, and potentially other entities.

We also welcome the focus on defining public interest in the financial condition of certain entities. This reflects the changing regulatory climate in relation to financial audit, in the UK, where stakeholders and reports commissioned by government have emphasised that certain entities are subject to public interest considerations due to their activities or other attributes, and that the role of the statutory auditor is to maintain deserved confidence in the financial condition of such entities.

The FRC believes the proposed wording could be improved by explicitly stating that the underlying objective is to enhance public confidence in engagement performance through the auditor adopting additional safeguards which help maintain public perception of independence. In respect of the role of firms, we suggest that IESBA create a requirement to consider whether the public interest would be best served by the adoption of additional safeguards over independence for the audit of certain entities. This approach would be aligned to considerations over threats to independence from long association within the IESBA code, as well as firm-based considerations over the need for engagement quality control within the IAASB's Quality Management Standards.

Finally, the FRC supports the role envisioned in the Exposure Draft for local jurisdictions to refine the categories of public interest entities to reflect specific local legal, regulatory and other contextual considerations. However, we would encourage IESBA to consider drafting clauses allowing national standard setters to exclude certain categories of public interest entity to put considerations of public interest as the principal criterion to prevent unjustified exclusions of certain categories of public interest entities. We also believe it would be appropriate to include jurisdictional flexibility in the categorisation of public interest entities.

Specific comments

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?*

The FRC broadly supports the overarching objective set out in paragraphs 400.8 and 400.9 as set out in the Exposure Draft. In particular, we support the rationale set out in paragraph 18 of the consultation document, which explains that the aim of these changes is to enhance confidence in the audit of public interest entities by subjecting auditors to enhanced independence safeguards, and increase the confidence that stakeholders have in the independence of the auditor. However, as drafted, paragraph 400.9 does not articulate this as the mechanism by which enhanced confidence is to be achieved. We believed that the current drafting could be improved by explicitly stating that the objective is to be achieved through additional safeguards to mitigate threats to auditor independence.

We are also supportive of the use of 'financial condition' in paragraph 400.8 for the reasons set out in paragraph 21 in the explanatory notes. However, we note that paragraph 400.9 reverts to using 'financial statements', which potentially signals that an auditor's only pathway for enhancing confidence is in relation to the financial statements. We therefore suggest that consideration should be given to the language used in paragraph 400.9 and how this relates to public interest in the financial condition of companies.

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?*

The FRC supports the list of factors included in paragraph 400.8 for determining the level of public interest in an entity. The overall focus of the list is on the intrinsic attributes that lead to significant levels of public interest in an entity, rather than the activities that an entity may undertake. By doing so, it focuses on a principles-based approach to identify entities in which there is significant public interest. In our view, the factors that focus on size, replaceability, stakeholder interest and systemic importance of entities correctly locate public interest around the wider societal disbenefits that would arise from their financial failure. We do not believe

that there are other key factors that need to be added to the list. In particular, we would not support the inclusion of considerations of audit complexity, since public interest in an entity's financial condition is independent from the underlying complexity of the entity.

The list of factors could be improved by clarifying that size is a matter of context which relies on considering the entity within its operating environment and should not be regarded as an absolute measure.

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?*

The FRC supports the approach set out by IESBA in its proposals for defining a public interest entity. Significant international variation exists between different jurisdictions in terms of legislation, regulatory framework and market characteristics, and a single definition is unlikely to capture this variety. A broad approach to defining a public interest entity which considers the attributes that such an entity may possess as well as specific business activities is therefore welcome.

Since what constitutes the public interest in a particular regulatory environment is potentially context dependent, we are also broadly supportive of the envisioned role for local jurisdictions in refining the definition as part of the local adoption and implementation process. Local bodies will be best placed to determine thresholds and specific criteria which determine whether an entity should be treated as a public interest entity. We do however have some concerns that the latitude granted to local bodies to exclude particular categories could potentially undermine the purpose of the Code, which is to ensure a consistent approach across all jurisdictions. At worst, it could result in regulatory arbitrage between jurisdictions. If this element of the proposals is adopted, IESBA should ensure that a post-implementation review is conducted at an early stage to identify any unintended or negative consequences arising from this approach.

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

We support the proposals for the new term of publicly traded entity. The proposed definition encompasses trading in financial instruments issued by an entity which is not just limited to regulated exchanges, but also covers recognised exchanges and over-the-counter trading. The definition also scopes out those entities where in substance it is not possible to trade in the financial instruments issued by that entity, such as when listing is a structural requirement, or where the consent of another party is required to trade in those instruments. This aligns with the guidance provided by the FRC on what constitutes a listed entity for the purposes of our own Ethical Standard.

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

The FRC is in broad agreement with the remaining categories set out in the subparagraphs within R400.14. We note that these are broadly aligned with the current position within the FRC Ethical Standard. These make a distinction between public interest entities which are defined in law, and Other Entities of Public Interest (OEPIs) for which public interest considerations require safeguards to maintain public confidence in auditor independence which are similar to those in place for public interest entities.

In the UK, the determination of a PIE still follows the same categorisation as that used in the EU Audit Directive. These are:

- (a) An issuer with transferable securities listed on a UK regulated market;
- (b) A credit institution within the meaning of Article 4(1)(1) of Regulation (EU) No 575/2013 of the European Parliament and of the Council, which is a CRR firm within the meaning of Article 4(1)(2A) of that Regulation;
- (c) A person who would be an insurance undertaking as defined in Article 2(1) of Council Directive 91/674/EEC of 19 December 1991 of the European Parliament and of the Council on the annual accounts and consolidated accounts of insurance undertaking as that Article had effect immediately before exit day, were the United Kingdom a Member State; and
- (d) Other entities that a Member State may choose to designate as a PIE (although at the time of writing no other entities have been designated).

These categories are aligned with subparagraphs R400.14(a), R400.14(b), R400.14(c), and R400.14(f) respectively. The UK Government is currently consulting on extending the legal definition of PIE to include additional entities such as large private companies which are subject to additional statutory governance or reporting requirements.

Entities classified as 'Other Entities of Public Interest' include private sector pension schemes, subject to certain size criteria. This is broadly comparable with subparagraph R400.14(d), with additional criteria adopted to refine the definition to suit public interest considerations within the UK. Other entities within this category include other categories of listed entity, entities that are subject by law to additional governance requirements, and Lloyd's Syndicates. These additional categories reflect further consideration of where public interest lies, and auditors of these entities are subject to enhanced safeguards to maintain public confidence in engagement performance.

Whilst the definitions provided in these subparagraphs are necessarily high level, the role allocated to local bodies as well as the factors identified in paragraph 400.8 for identifying public interest entities provide the underlying framework for identifying public interest entities.

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.*

This is a dynamic area of policy making, with an ongoing debate over underlying accounting and the extent of regulatory oversight that these new entities will be subject to. We therefore believe that local bodies will currently be better placed to make the necessary judgements on whether entities raising capital in less conventional ways should be treated as PIEs. The list of factors set out in paragraph 400.8 should serve to capture less conventional forms of capital raising as public interest entities if they warrant treatment as such.

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?*

The FRC supports paragraph 400.15 A1 on the grounds that relevant local bodies are best placed to discern which categories of entities are subject to heightened levels of public interest within their own jurisdictions. They are the most appropriate bodies to identify further criteria that will be relevant to that jurisdiction, and so enable the broad categories in paragraph R400.14 to be refined further with reference to local law and regulation. The FRC, therefore, considers that paragraph 400.15 A1 would be improved by cross-referencing the factors identified in paragraph 400.8 that indicate the extent of public interest in an entity's financial condition to assist local bodies in making those judgements.

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?*

The FRC supports the proposed outreach and educational support to relevant local bodies. IESBA's strategy should focus on ensuring that the objective underpinning the definition of a PIE is clearly articulated and widely understood. We believe that there should be a strong focus on the contextual principles that underpin the definition of a public interest entity, as well as the appropriate refinements for the definition which should be made within a particular jurisdiction.

As noted in our response to Question 3, a post-implementation review should also be undertaken at the earliest opportunity to understand how the proposed role for relevant local bodies has been utilized, and to identify if any jurisdictions have scoped out any category of PIE without a justification based around the principles of public interest.

9. *Do you support the proposal to introduce a requirement for firms to determine if any additional entities should be treated as PIEs?*

Within the UK, enhanced confidence in corporate reporting by public interest entities is supported by:

- Additional corporate governance requirements and enhanced corporate reporting through application of the Corporate Governance Code;

- Additional requirements for auditors over independence and reporting mandated by regulation; and
- A supervision regime consisting of inspection of audits performed on these entities and enforcement action against audit firms when necessary.

Placing a requirement for firms to treat additional entities as public interest entities would result in only one element of this regime being in place. While the entity would be audited as a public interest entity, it would not be under any obligation to comply with the additional corporate governance and reporting requirements that flow from being so defined by regulation. Furthermore, regulation of the underlying audit in the UK would probably fall to a professional body rather than to the FRC as Competent Authority. Without these additional measures in place, a determination by a firm that an entity is a public interest entity is likely to cause confusion among stakeholders. It could also lead to a devaluation of the term, undermining the overarching aim to enhance confidence in the audit of such entities. For these reasons, determination of whether an entity is a public interest entity should be a matter for regulation.

We also note the potential for practical difficulties with respect to the additional requirements placed on auditors of public interest entities if the entity does not wish to be treated as such. If Those Charged with Governance do not ensure that an entity voluntarily conforms to the UK regulatory environment, the auditor possesses no levers with which to ensure that compliance if they believe that they should be treated as such.

Instead of requiring firms to identify additional entities as public interest entities, we believe that a more appropriate approach would be to require firms to assess whether the public interest would be served if they adopted the enhanced independence requirements for audits of public interest entities for the entity in question. The rationale behind the proposed changes to IESBA's code is to enhance confidence in the audit of certain entities by requiring auditors to adhere to additional safeguards over independence. Requiring firms to make such an assessment and to action safeguards as necessary would be consistent with the requirements of Section 540 of the IESBA code, which requires firms to assess and safeguard against potential risks to independence from familiarity and self-interest. It would also be aligned with the requirement placed by ISQM 1 on firms to perform engagement quality reviews for entities which the firm determines that an engagement quality review is an appropriate response to address identified risks to quality for entities which are neither listed or where engagement quality review is neither required by law or regulation.¹

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

We believe that firms should be required to consider whether the public interest would be served if they adopted enhanced safeguards over independence for entities which are not defined in law and regulation as PIEs. The proposed list of factors set out in paragraph 400.16 A1 provide a starting point for making these considerations. However, they potentially distract from the public interest criteria set out elsewhere in revisions to the Code. They focus on judgements made by others, and do not focus sufficiently on what might be the basis for enhanced public interest in an engagement or entity.

¹ IAASB, ISQM 1 *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*, paragraph 34 (f) (iii).

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

We support the proposal for firms to disclose if an audit client has been treated as a public interest entity. If the objective is to enhance public confidence in the financial condition of certain entities, public disclosure that a firm has treated an entity as a public interest entity and adopted additional safeguards will support that objective. We note that the Exposure Draft places responsibilities on both local bodies and firms to identify entities which should be treated as public interest entities. If this requirement is maintained, we consider it appropriate for firms to disclose whether the entity has been designated as a public interest entity either due to law and regulation, or through by the firm's own assessment.

Should the Exposure draft be amended to reflect our suggestions in respect of firms – i.e., that they are required to consider the need for enhanced independence safeguards for entities or types of engagement which fall outside the strict regulatory definition of a public interest entity – then we support additional reporting setting out what those enhanced safeguards were.

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 support additional disclosures within the auditor's report, whilst noting that that the form and content of the auditor's report should be a matter for the auditing standards. Disclosure of the impact on the auditor is an aid to both transparency and confidence and supports the overarching objective of the proposed amendments. An important consideration in determining the form of such a disclosure is whether the inclusion of additional material in the auditor's report meets the auditor's objectives in ISA 700 to form an opinion on the financial statements, and to express clearly that opinion. In particular, the inclusion of additional material in the auditor's report must enhance the clarity of the opinion, and any disclosure should support that aim

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?*

The FRC agrees with the conclusion reached by IESBA to not review paragraph R400.20 with respect to the definition of 'audit client' and to review the issue through a separate future workstream (though we do note that the use of the term client is unhelpful, and is something that many stakeholders disagree with, believing the audited entity not to be the beneficial client). The issues posed by certain corporate structures clearly merit further research to understand the consequences of extending the whole universe of related entities for listed entities to apply to all public interest entities. This is likely to reflect local circumstances and may require a role of local bodies to refine the meaning of 'audit client'. For example, within the UK, the FRC published additional application guidance following the introduction of the 'Other Entities of Public Interest' category to clarify the application of the term to entities held within portfolio companies or by central government bodies.

The FRC also agrees with IESBA's conclusion not to propose any amendments to Part 4B of the Code. We agree that the degree of public interest in an assurance engagement other than

an audit or review engagement is contingent upon the subject matter of that assurance engagement, and that not all such assurance engagements will therefore engage public interest.

14. Do you support the proposed effective date of December 15, 2024?

We support the proposed effective date on the grounds that certain jurisdictions may require additional time and support to introduce the changes in their regulatory environment.

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.

The FRC supports the overarching objective set out in paragraphs 400.8 and 400.9 for establishing differential requirements for different entities. We would also encourage that IESBA and IAASB align their definitions to ensure consistency between the auditing and ethical standards. We would note that there is an important conceptual difference between the ethical standards – which place requirements on the auditor to both protect against threats to independence and maintain public confidence in that independence – and the auditing standards which place requirements on the planning, performance, communication and reporting on the audit of financial statements. In the same way that ethical safeguards over auditor independence should be driven by context, the requirements for the appropriate performance of a financial statement audit should be also have regard to the underlying circumstances of the entity being audited. The nature and extent of public interest in that entity's financial statements will be one element that helps determine the shape of that audit response.

- (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.

The FRC encourages the IAASB to consider whether differential requirements should be applied more broadly to other categories of entities. If there is enhanced public interest in the audit of certain entities, then the auditor's response should also extend to the performance of the audit as well as the actions taken to ensure independence.

- (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?

As stated in our response to Question 12, we agree that it may be appropriate to disclose within the auditor's report that the firm has treated an entity as a public interest entity (subject to meeting the objectives of ISA 700). If the objective is to enhance public confidence in the audit of certain entities, then that objective will be met by disclosing this to users in the context of the auditor's report. The FRC also considers that disclosure should distinguish between those cases where:

- 1) the entity is determined to be a public interest entity through law and regulation, or
- 2) the firm has adopted additional safeguards to maintain public confidence because public interest considerations have led them to treat the entity as a public interest entity even though it is not so defined by law and regulation.

The FRC considers that the appropriate location for this disclosure within the auditor's report to be within the Basis of Opinion paragraph, which sets out the ethical framework which provides the basis for the auditor's independence. This should ensure sufficient balance between transparency and keeping the disclosure to a reasonable length.

If you have any questions relating to this response, please contact James Ferris j.ferris@frc.org.uk or Peter Kitson p.kitson@frc.org.uk.

Yours sincerely,



Mark Babington
Executive Director, Regulatory Standards
DDI: 020 7492 2323
Email: m.babington@frc.org.uk

