

TECHNICAL STAFF PAPER

Subject: Consultation Paper: Proposed Definition of *Public Interest Entity for the Code* – Summary and Analysis of Key Issues.

Purpose

The purpose of this paper is to provide:

- A summary of respondents comments raised in response to APESB's *Consultation Paper Proposed Definition of Public Interest Entity for the Code (CP 01/11)*; and
- Technical staff views and recommendations.

A summary of the respondents' comments and Technical staff views/recommendations on the issues raised in the Consultation Paper is given below.

1. Respondents' Comments

(i) APESB's proposed definition of "*Public Interest Entity*" for APES 110.

Respondents are invited to comment on APESB proposed amendment to paragraph 290.26 to strengthen the requirement and to include the reference to "public issuers of debt and equity instruments" in the definition of Public Interest Entity (PIE).

Analysis of Respondents' Comments

BDO, PricewaterhouseCoopers (PwC), Ernst and Young (EY), the Auditing and Assurance Standards Board (AUASB), the Joint Accounting Bodies (JAB) and Australasian Council of Auditors-General (ACAG) are generally supportive of the amendments made to paragraph 290.26. KPMG, PwC and Australian Public Policy Committee (APPC) support the addition of 'public issuers of debt and equity instruments' in paragraph 290.26 but also suggested that further guidance should be developed. Deloitte is supportive of the addition of "public issuers of debt and equity instruments".

KPMG, Grant Thornton (GT) and Pitcher Partners (PP) do not agree with the use of 'shall' and suggested that the words 'are encouraged' to be retained. KPMG suggested that the use of "shall" will require a far-ranging assessment of potential entities by Firms using internally developed guidelines which may lead to high variable outcomes as what is a PIE between different Firms. This issue was also raised by Deloitte. Both PwC and Deloitte are concerned about international consistency and proposed that minimal wording change to the IESBA Code is desired. APPC's Independence Task Force (ITF) did not reach consensus view on the proposed change from 'are encouraged' to 'shall' in paragraph 290.26. APPC and GT raised the issue that this change may impose additional documentation requirements. EY, KPMG and APPC seek consideration of the costs and benefits of the current PIE definition. APPC and GT questioned the non-prescriptive

language that is currently present in paragraph 290.26 (e.g. “may include”) which may create ambiguity to paragraph 290.26 if “shall” is used.

AUASB and JAB proposed that the word ‘and’ between the two limbs of paragraph 290.25(a) and 290.25(b) should be replaced with ‘or’ and both noted that the singular form of ‘Public Interest Entity’ should be used in the definitions and paragraph 290.25.

JAB sought APESB’s confirmation on whether ‘number and range of stakeholders’ in paragraph 290.26 is the primary consideration and if yes, then APESB should provide guidance on ‘number and range of stakeholders’ in order to identify an entity as a PIE.

ASIC suggested that firms should not only ‘consider’ but should be mandated to treat certain entities that hold assets in a fiduciary capacity for a broad group of users as PIE’s (same as Publicly Accountable Entity). Furthermore, they maintain their view that the definition of PIE should be aligned to the term Publicly Accountable Entity in AASB 1053.

JAB recommended that ‘member bodies’ should be removed from paragraph 290.26 as in the Australian context this paragraph would not apply to Professional Bodies. This issue was also raised by EY.

Technical staff views are:

Paragraph 290.25

1. Technical Staff agree with the recommendation by AUASB and JAB to adopt the singular form of the definition of Public Interest Entity. This singular form is generally consistent with APESB’s approach to definitions.
2. Technical Staff agree with the recommendation by AUASB and JAB to change “and” to “or” between the two limbs of paragraph 290.25(a) and 290.25(b). The IESBA’s intention in the new Code was to expand the entities to which the stricter auditor independence requirements applied to from Listed Entities to Public Interest Entities. Accordingly it is logical that these two limbs are joined by a “or” rather than “and”.

Paragraph 290.26

1. The majority of the respondents are generally supportive of the amendment to paragraph 290.26 in respect of the addition of ‘public issuers of debt and equity instruments’.
2. The change to assertive language from ‘encouraged to’ to ‘shall’ and the removal of “may” (as marked up in Appendix 1) strengthens the requirement for Firms to consider whether additional entities are PIE’s.
3. Technical staff agree with the JAB’s recommendation to remove ‘member bodies’ from paragraph 290.26 in the Australian context.
4. Amend “pension” to “regulated superannuation” to address the Australian context.

(ii) APESB's preliminary views on entities that will generally be captured by the definition of Public Interest Entity

Respondents are invited to comment on APESB's preliminary view that Public Interest Entities in the Australian context will include

- **Listed Entities;**
- **Disclosing Entities;**
- **Co-operatives that issue debenture to the public, Authorised Deposit-taking Institutions that are subject to APS 510 issued by APRA);**
- **General Insurance Companies (that are subject to GPS 510 issued by APRA);**
- **Life Insurance Companies (that are subject to LPS 510 issued by APRA); and**
- **Australian Government and State, Territory and Local Governments which have tier 1 reporting requirements as defined by AASB 1053.**

Analysis of Respondents' Comments

General

A number of respondents suggested that it is up to the regulators to go through a consultation process to determine PIE's in the Australian context. Some respondents commented that the regulators should decide which entities should be PIEs. However, ASIC have stated in their submission.

'The Board appears to assume that ASIC is able to create a regulatory or legislative requirement as to the entities that are Public Interest Entities for the purposes of the second limb of the definition in paragraph 290.25 of the Code. Neither ASIC or the AASB has such an ability.

Accordingly, we believe that it is the role of the APESB to specify the entities that are Public Interest Entities for the purposes of applying the Code."

EY proposed that all entities in section (ii) of the consultation paper should go through a threshold test (including Listed Entities) which assesses the number of shareholders who are unrelated public persons and their financial stakes in the entity. A number of other respondents concur with the view expressed by EY and suggested that the entities should go through a threshold test and be evaluated on a case by case basis.

ASIC agrees with the preliminary list of entities provided in the consultation paper. ASIC further suggested that the entities in the list should be expanded to include unlisted registered Managed Investment Schemes (MIS) and regulated superannuation funds. ASIC further noted that these entities should be deemed to be PIEs. Inclusion of Superannuation Funds was also raised by JAB, Deloitte and EY.

APPC, Deloitte and JAB noted that it was unclear whether the preliminary list of entities proposed by APESB was a mandatory list under paragraph 290.25 or guidance to assist members to interpret paragraph 290.26. They requested further guidance on this issue. APPC and Deloitte requested further guidance under paragraph 290.26 with regard to size, number and range of stakeholders, financial turnover, number of employees etc that might influence the determination of a PIE. APPC further commented that category based definitions are inappropriate and consideration should be given to determine specific characteristics of an entity to determine whether it might be treated as a PIE.

Listed Entities

Deloitte and PwC agreed with APESB's view that all Listed Entities are Public Interest Entities. PwC expressed the view that the definition of Listed Entities in APES 110 also extends to Australian audit clients that are listed overseas.

EY suggested that Entities proposed by APESB in the consultation paper (excluding Listed Entities) should be subjected to a threshold test based on the financial stake of an unrelated security holder in the entity. They have suggested the following example:

“An example, and by no means is this the only way of defining a threshold, is that here are minimum shareholder numbers required for listed entities (approx 300), and perhaps that is a useful threshold to consider by saying that a PIE should have no less than, say, 300, unrelated public persons who have a personal financial stake. In addition a threshold could be set on the total of that financial interest for each potential PIE, e.g. the total financial stake or amount due to non related members of the public exceeds, say, \$1,000 million. We believe both threshold tests need to be met.”

BDO, KPMG, GT, AUASB, JAB, PP, APPC and ACAG did not comment on Listed Entities specifically.

Disclosing Entities

KPMG commented that some Disclosing Entities do not satisfy the 'large number and wide range of stakeholders' test in paragraph 290.26 as there are too few security holders.

PwC noted that some Disclosing Entities are not PIE's under paragraph 290.25 and considered it appropriate to further apply paragraph 290.26 taking into consideration the public interest element and the number of Enhanced Disclosure Security holders.

Deloitte considered the list of entities in section (ii) of the consultation paper to be only subject to the test in paragraph 290.26 which requires the 'size, nature and range of stakeholders' for each entity to be taken into consideration.

GT suggested a size test should be adopted as some small Disclosing Entities have minimal public interest and therefore should not be a PIE.

PP agreed that although some Disclosing Entities satisfied the test in paragraph 290.25(b) these entities should also be subject to an economic significance and size test.

EY suggested that the threshold test for financial stakes (refer above) should be applied to Disclosing Entities that are not listed.

ASIC is of the view that Disclosing Entities should be deemed to be PIEs.

JAB suggested a case by case approach and urged APESB to clarify on whether APESB's view expressed in section (ii) is determinative or guidance only. APPC also requested further guidance on this issue.

Co-operates that issues debenture to the public

KPMG commented that some co-operatives that issues debenture to the public do not satisfy paragraph 290.26 for 'large number and wide range of stakeholders'.

PwC noted that the determinative factor of whether a Co-operates that issue debenture to the public is a PIE depends on the number of people holding the debentures, the nature of the holders of the debenture, the nature of the holders of the debentures (e.g. institutional or sophisticated investors) and the terms of debentures.

Deloitte suggested taking into consideration the guidance in paragraph 290.26 regarding size and range of stakeholders including the size of the Co-operative and the holders of debentures (e.g. employees or members).

ASIC agrees that Co-operative that issue debentures to the public should be deemed to be PIEs.

JAB and PP expressed the same view on Co-operatives that issue debentures to the public as they had for Disclosing Entities.

Authorised Deposit-taking Institutions (ADI), General Insurance (GI) and Life Insurance (LI) regulated by APRA

BDO and PwC commented that ADI, GI and LI do not satisfy the definition in paragraph 290.25(b) suggesting that these entities were not required by regulators (i.e. APRA) to achieve the same audit independence requirements as Listed Entities.

KPMG noted that overall audit independence for ADI, GI and LI are substantially consistent with requirements of the Corporations Act and noted that it would be appropriate to include APRA regulated entities in the definition under paragraph 290.25(b) subject to specification of appropriate size limits.

PwC did not believe ADI, GI and LI satisfy paragraph 290.25(b) but consider they are captured by paragraph 290.26. However, they do not consider all APRA regulated entities will be PIEs.

PP and EY suggested that a test of economic significance should be adopted (same test for Disclosing Entities) to determine PIE.

Deloitte expressed the view that APRA imposed some but not all independence requirements of the Corporations Act on ADI, GI and LI and suggest that other factors need to be taken into consideration.

GT noted that certain exemptions are granted for particular groups (i.e. Credit Unions) and these exemptions take those groups outside of the PIE definition.

ASIC recommended that ADI, GI and LI should be deemed to be PIEs.

Tier 1 Public Sector Entities

KPMG, GT, PP, PwC, Deloitte, EY, APPC and ACAG support the exclusion of public sector entities as PIEs and commented that independence requirements for public sector entities are set by the Auditors-General.

ACAG specified that the independence provision as specified in Auditor General Act 1997 is similar but not the same as required by listed entities. ACAG further stated, "*In AASB 1053, the Basis for Conclusions makes it clear that the AASB intends the definition only for private sector application.*"

EY further suggested that the nature of public interest is different to the financial stake test because public sector entities are more concerned with policy, resource allocation, service delivery and national strategy.

Technical staff views are:

General

JAB, ASIC and EY have all welcomed APESB's views on the entities that are likely to be PIEs. Based on the diversity of the responses it appears that providing guidance on PIE's will be beneficial to Members and Firms. However, the fact remains that this will ultimately be a decision of professional judgement and there should be some flexibility in determining which entity is a PIE in order to exclude smaller entities and entities with less economic significance where the public interest element is minimal.

There is a debate in Canada regarding whether to exclude small cap entities from the PIE requirement. However, the proposed threshold for the Canadian market cap exclusion is only \$10m. The \$1 billion threshold proposed by EY (Financial stake or amounts due to non related members of the public) will probably only capture the ASX 100 Index participants as at 9 August 2011 if you consider market capitalisation. The smallest market cap entity on the ASX 100 had \$0.95 billion as at that date. Accordingly, the proposed threshold appears to be too large.

Listed Entities

Listed entities will need to comply with Public Interest Entities requirements as they are publicly listed with external shareholders and are subject to auditor rotation requirements under s.324DC of the *Corporations Act 2001*. The intention of the new Code's definition is to cover more than just Listed Entities as Public Interest Entities. Therefore, Listed Entities are captured by paragraph 290.25(a).

Disclosing Entities

Disclosing Entities are defined by Section 111AC of the *Corporations Act 2001* as entities that hold Enhanced Disclosure Securities (ED Securities). The Corporate Law Reform Act 1994 introduced enhanced disclosure requirements for disclosing entities, which include:

- listed entities and listed registered schemes;
- entities and registered schemes which raise funds pursuant to a prospectus;
- entities and registered schemes which offer securities other than debentures as consideration for an acquisition of shares in a target company under a takeover scheme; and
- entities whose securities are issued under a compromise or scheme of arrangement.

Under the *Corporations Act 2001*, Disclosing entities needs to comply with the following:

- the continuous disclosure requirements, which include a requirement to provide information which, if generally available, would be likely to have a material effect on the price or value of the entity's securities. Listed disclosing entities must immediately make such disclosure to the Australian Securities Exchange (the ASX), while unlisted disclosing entities must make such disclosure to the ASIC as soon as practicable;
- the half-year reporting requirements, which include a requirement to prepare a half-year report; and
- the annual reporting requirements, which require disclosing entities incorporated or formed in Australia to prepare a financial report for the financial year in accordance with Part 2M.3 of the *Corporations Act 2001*.

Furthermore, Disclosing Entities need to comply with Tier 1 Reporting requirements (full IFRS) under AASB 1053 as it is one of the entities that satisfy with the definition of Public Accountability.

Co-operative that issue debentures to public

According to research done by the AASB, there are currently very few co-operatives that issue debentures to the public in Australia. They have been classified as Public Accountability Entities in accordance with AASB 1053 and arguably, they are a PIE as they have issued debentures to the public.

However, this must be assessed on a case by case basis and accordingly it is proposed that the guidance in this respect to be changed to “*other public issuers of debt and equity instruments.*”

APRA regulated ADI, GI and LI companies

Paragraph 62 of GPS 510, paragraph 60 of APS 510 and paragraph 58 of LPS 510 of the APRA regulation requires ADIs, GIs and LIs to comply with independence test in APES 110. Furthermore, paragraph 77 of GPS 510, paragraph 77 of APS 510 and paragraph 75 of LPS 510 requires auditor rotation.

- The reference made by APRA under paragraph 62 (GPS 510), paragraph 60 (APS 510) and paragraph 58 (LPS 510) to APES 110 is stated in the following manner:
Extract from LPS 510 paragraph 60

“The Board Audit Committee must review the auditor’s engagement at least annually, including making an assessment of whether the auditor meets the Audit Independence tests set out in APES 110 Code of Ethics for Professional Accountants, as well as the additional auditor independence requirements set out in this Prudential Standard.”

- Under the revised Code there will be auditor independence requirements applicable to PIE’s and Non-PIE’s.
- If an entity is a PIE then the independence tests applicable to a PIE must be applied. As the three prudential standards refer to the independence tests of APES 110, in circumstances where an entity is a PIE then the independence tests applicable to a PIE must be applied.

Tier 1 Public Sector Entities

According to paragraph BC35 in the Basis for Conclusion to AASB 1053 (see below extract) the definition of Public Accountability is meant to capture for profit private sector entities. AASB considered the notion of Public Accountability in the general sense, for example social policy obligations, and have concluded that the *Public Accountability* in the general sense does not equate to the same *Public Accountability* in the private sector. This was clearly expressed in BC35 and Appendix B1 of AASB1053.

Extract from AASB 1053:

“For-Profit Entities in the Public Sector

BC35 The Board noted that the definition of public accountability it has adopted has a for-profit private sector orientation as it is based on the definition included in the IFRS for SMEs. The Board noted that the nature of for-profit entities in the public sector may differ from that in the private sector in that many Government Business Enterprises (GBEs) also undertake social policy obligations. Moreover,

the ownership group in many for-profit public sector entities is not a broad group. The Board noted that, although these entities are typically seen as publicly accountable in the general sense of the term, they do not typically fall under the definition of public accountability used for the private sector.

APPENDIX B

B1 Public accountability is defined in Appendix A. The notion of public accountability is consistent with the notion adopted by the IASB in its International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs). It is different from the notion of public accountability in the general sense of the term that is often employed in relation to not-for-profit, including public sector, entities.”

Furthermore, Auditors-General operate in a different environment to Firms in that:

- Auditors-General do not provide other services in the same manner as Firms (i.e. tax services, corporate finance etc) and are thus likely to have minimal conflicts.
- Auditors-General operate under a legal mandate which will override APES 110.

Accordingly, we agree with the Auditors-General’s and other respondents’ view that Public Sector entities should be excluded. We also note that ACAG has agreed to consider PIEs in the public sector on a case by case basis and concurred with the proposed amendments to paragraphs 290.25 and 290.26 in CP 01/11.

(iii) APESB’s view that the definition of a Public Interest Entity in APES 110 is different to AASB’s definition of a Publicly Accountable Entity.

Respondents are invited to comment on whether they agree with APESB’s view that Publicly Accountable Entities as defined by AASB covers a wider range of entities than Public Interest Entities as defined by APESB.

Analysis of Respondents’ Comments

Majority of the respondents agree with APESB’s view that the definition of Public Interest Entities in APES 110 is different to the definition of Publicly Accountable Entity in AASB 1053.

Technical staff views are:

Based on the independent legal review and the majority of the respondents’ comments on this issue, Technical Staff agree that the definition of Public Interest Entity is different to Publicly Accountable Entity.

Other Comments

The majority of the respondents have noted that a start date of 1 January 2013 is preferable to the current start date of 1 January 2012.

2. Technical Staff Recommendations

Subject to the Board review comments on the definition of Public Interest Entities, Technical Staff recommends as follows:

- The Commencement date for the application of Public Interest Entity be changed to 1 January 2013;
- The two limbs in paragraph 290.25 should be linked with “or” rather than “and”;
- Paragraph 290.25 should adopt the singular form of PIE which is consistent with the Definitions;
- Paragraph 290.26 should be changed from “may include” to “include” (refer Appendix 1). This should align with the editorial change proposed in the consultation paper from “are encouraged to” to “shall” in the same paragraph.
- The Public Sector Entities should be excluded from the guidance paragraph on the entities that are likely to be PIEs.

3. Summary

Based on Technical Staff analysis of the respondents’ comments, the following three options are recommended for consideration by the Board.

Option 1

Amend paragraphs 290.25 and 290.26 as depicted in the attached Appendix 1. As the respondents’ views on what are PIEs appear to be divergent, there is value in providing further guidance on the entities that are likely to be PIE’s in the Australian context. This additional guidance can be provided in the Basis for Conclusions.

Option 2

Amend paragraphs 290.25 and 290.26 as depicted in Appendix 1 and include a new AUST paragraph in 290.26.1 which provides guidance on the entities which are likely to be classified as PIEs in the Australian context. Inclusion in APES 110 will strengthen the requirement for Firms to consider these entities as over time stakeholders are less likely to refer to the Basis for Conclusion.

Option 3

A number of respondents have commented on a threshold test to apply to the list of entities identified in the Consultation Paper. The aim of this test would be to exclude smaller entities. If the Board wishes to pursue this approach then further time is required to develop appropriate thresholds for the different classes of entities.

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Date: 11 August 2011

Appendix A

Revised Paragraph 290.25 - 290.26 (Include AUST paragraph).

Option 1

290.25 Section 290 contains additional provisions that reflect the extent of public interest in certain entities. For the purpose of this section, Public Interest Entity~~ies~~ is ~~are~~:

- (a) A All Listed Entity ~~Entities~~; or and
- (b) An Any entity (a) defined by regulation or legislation as a public interest entity; or (b) for which the audit is required by regulation or legislation to be conducted in compliance with the same Independence requirements that apply to the audit of Listed Entities. Such regulation may be promulgated by any relevant regulator, including an audit regulator.

290.26 Firms ~~and member bodies shall be encouraged to~~ determine whether to treat additional entities, or certain categories of entities, as Public Interest Entities because they have a large number and wide range of stakeholders. Factors to be considered include:

- The nature of the business, such as the holding of assets in a fiduciary capacity for a large number of stakeholders. Examples ~~may~~ include financial institutions, such as banks and insurance companies, public issuers of debt and equity instruments and pension regulated superannuation funds;
- Size; and
- Number of employees.

Extract from Basis for Conclusions

In the Australian context, the following entities are likely to satisfy paragraphs 290.25 and 290.26 and be classified as a Public Interest Entity:

- Listed Entities (as defined in section 9 of the Corporations Act 2001);
- Disclosing entities (as defined in section 111AC of the Corporations Act 2001);
- Authorized Deposit-taking Institutions (that are subject to APS 510 issued by APRA);
- General Insurance Companies (that are subject to GPS 510 issued by APRA);
- Life Insurance Companies (that are subject to LPS 510 issued by APRA).
- Regulated Superannuation Funds other than small APRA funds as defined by APRA Superannuation Circular No. II.E.1 Regulation of Small APRA Funds, December 2000; and
- Other public issuers of debt and equity instruments.

A Member in Public Practice or Firms should consider the requirements and guidance in paragraphs 290.25 and 290.26 and make an assessment whether an entity is a Public Interest Entity. With the exception of Listed Entities, it is possible that in certain circumstances the entities in the categories noted above may not meet the criteria of a Public Interest Entity.

Option 2

290.25 Section 290 contains additional provisions that reflect the extent of public interest in certain entities. For the purpose of this section, Public Interest Entity~~ies~~ is ~~are~~:

- (c) ~~A All~~ Listed Entity ~~Entities~~; ~~or and~~
- (d) ~~An Any~~ entity (a) defined by regulation or legislation as a public interest entity; or (b) for which the audit is required by regulation or legislation to be conducted in compliance with the same Independence requirements that apply to the audit of Listed Entities. Such regulation may be promulgated by any relevant regulator, including an audit regulator.

290.26 Firms ~~and member bodies~~ ~~shall~~ ~~are encouraged to~~ determine whether to treat additional entities, or certain categories of entities, as Public Interest Entities because they have a large number and wide range of stakeholders. Factors to be considered include:

- The nature of the business, such as the holding of assets in a fiduciary capacity for a large number of stakeholders. Examples ~~may~~ include financial institutions, such as banks and insurance companies, public issuers of debt and equity instruments and pension regulated superannuation funds;
- Size; and
- Number of employees.

AUST 290.26.1 In the Australian context, the following entities are likely to satisfy paragraphs 290.25 and 290.26 and be classified as a Public Interest Entity:

- Listed Entities (as defined in section 9 of the Corporations Act 2001);
- Disclosing entities (as defined in section 111AC of the Corporations Act 2001);
- Authorized Deposit-taking Institutions (that are subject to APS 510 issued by APRA);
- General Insurance Companies (that are subject to GPS 510 issued by APRA);
- Life Insurance Companies (that are subject to LPS 510 issued by APRA).
- Regulated Superannuation Funds other than small APRA funds as defined by APRA Superannuation Circular No. II.E.1 Regulation of Small APRA Funds, December 2000; and
- Other public issuers of debt and equity instruments.

A Member in Public Practice or Firms should consider the requirements and guidance in paragraphs 290.25 and 290.26 and make an assessment whether an entity is a Public Interest Entity. With the exception of Listed Entities, it is possible that in certain circumstances the entities in the categories noted above may not meet the criteria of a Public Interest Entity.