

TECHNICAL STAFF PAPER

**Subject: ED 03/11 Proposed Definition of Public Interest Entity for the Code
– Summary and Analysis of Key Issues.**

Purpose

The purpose of this paper is to provide the Board:

- A summary of respondents comments raised in response to APESB's ED 03/11 Proposed Definition of Public Interest Entity for the Code; and
- Technical staff views and recommendations.

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

1. Respondents' Comments

(i) Respondents' comments on AUST 290.25.1

Analysis of Respondents' Comments

Australian Securities and Investments Commission (ASIC), the Auditing and Assurance Standards Board (AUASB), the Joint Accounting Bodies (JAB) and Australasian Council of Auditors-General (ACAG) are supportive of the amendments made in respect of the proposed definition of Public Interest Entity (PIE).

AUASB, ACAG and JAB agrees with the proposed amendments to define a PIE in the Australian context. Technical staff has held further discussions with APRA and are awaiting further guidance with respect to the inclusion of APRA regulated entities in either AUST 290.25.1 or AUST 290.26.1.

BDO noted that unless specific APRA approval is obtained, that they do not want all Authorised Deposit-taking Institutions (ADIs) to be treated as a PIE. A size limit should be set for ADIs that are large enough to be treated as sophisticated ADIs. However, based on discussions with APRA there are only 5 sophisticated ADIs in Australia and all the other ADI's will be considered to be standardised ADI's.

Deloitte, PwC, KPMG and EY do not support the inclusion of ADIs, Life Insurance (LI) and General Insurance (GI) in AUST 290.25.1 and suggests that these entities should be included in paragraph AUST 290.26.1.

KPMG and EY noted that these entities should be considered for their 'nature and size'. Deloitte and PwC further noted that the requirements in CPS 510 are not the same independence requirements as those of Listed Entities and therefore not all APRA regulated entities should be subject to paragraph 290.25.

Australian Treasury recently issued the *Corporations Legislation Amendment (Audit Enhancement) Bill 2011*. In this bill Treasury is proposing certain new requirements that will apply to auditors of listed and *other public interest entities* (such as ADIs and insurance companies subject to prudential supervision by the Australian Prudential Regulation Authority). Accordingly, it appears that Treasury considers ADI and Insurance companies subject to APRA regulations as *other public interest entities*.

Deloitte also raised the issue of authorised and registered Non-operating Holding Companies (NOHC) and have stated that pre-CPS 510, NOHC were given separate auditor independence requirements, and the new CPS 510 introduces new requirements for auditors of NOHCs. Given APRA's separate treatment of NOHC, Deloitte is of the view that they should be carved out of the PIE requirements. Technical Staff have referred this matter to APRA and are awaiting further guidance in this regard.

BDO, Pitcher Partners (PP) and GT are concerned about international consistency and proposed that minimal wording changes to the IESBA Code is desired.

Deloitte, PwC, KPMG and EY suggested that the reference to Listed Entities should extend to those entities that are also listed in other jurisdictions.

Technical staff views are:

1. Technical Staff agree that the definition of Listed Entities should include Listed Entities in other jurisdictions.
2. Technical Staff has held discussions with APRA and is awaiting APRA's guidance in respect of the appropriate classification of APRA regulated entities and the treatment of NOHCs.

(ii) Respondents' comments on paragraph 290.26 and AUST 290.26.1

Analysis of Respondents' Comments

Deloitte, PwC, EY and KPMG are of the view that the APRA regulated entities should be included in this paragraph as entities that are likely to be PIE's.

PP concurs with the intention of paragraph 290.26 but wants to have further guidance on the 'size and nature' requirement. They argue that entities without economic significance should not be included as a PIE.

PwC agrees with the removal of the reference to 'member bodies' and the editorial change to use 'shall determine' instead of 'are encouraged to'.

ASIC is of the view that all the entities listed in AUST 290.26.1 should be assumed to be PIEs unless compelling reasons exist for the entity's exclusion from PIE status. ASIC further stated that all disclosing entities are PIEs and that this category of entities should be included in AUST 290.25.1.

Technical staff views are:

1. Technical staff has held discussions with APRA and awaiting further guidance from APRA in respect of the appropriate classification of APRA regulated entities in either AUST 290.25.1 or AUST 290.26.1.

2. Due to the mandatory requirement of “shall” external auditors will have to document their judgements when they determine that a particular entity is not a PIE. Further as there is potential to have a disclosing entity that may have a minimal public interest it is advisable to leave disclosing entities in this paragraph.

(iii) **Transitional Provisions**

Analysis of Respondents' Comments

BDO noted that the change of date might trigger retrospective consequences and urges that if the commencement date is pushed back to 2013, then similar changes should be made to extend the date in transitional paragraph 4 to 1 July 2012.

EY and Deloitte support the commencement date of 1 January 2013, but note that the new commencement date should only apply to the additional entities that became PIE's in the Australian context due to the operation of paragraphs AUST 290.25.1 and AUST 290.26.1.

KPMG also supports the new commencement date; however they do not consider that it is necessary to change the dates in paragraph 4 and 6 as they believe that the firms have already implemented these changes.

Technical staff views are:

1. Majority of the stakeholders preferred the commencement date of 1 January 2013.
2. IESBA commencement date for the auditor independence requirements applicable to PIEs is 1 January 2012 in line with the IESBA Code. The auditor independence requirements applicable to PIEs in APES 110 will commence on 1 January 2013.
3. It is noted that international firms would adopt the auditor independence requirements applicable to PIEs from 1 January 2012. APES 110 (Issued December 2010) also had a start date of 1 January 2012 in respect of the PIE provisions. However, in the Consultation Paper CP 01/11 and PIE ED 03/11 APESB indicated a start date of 1 January 2013.

Accordingly, most national firms would have justifiably believed that the new provisions would only be applicable from 1 January 2013. Given that it is now November 2011 it is advisable to leave the date as proposed in ED 03/11. Then in effect the international firms would have early adopted the auditor independence requirements applicable to PIE provisions in line with their international obligations.

(iv) **Operative Date**

Analysis of Respondents' Comments

The majority of the respondents agree with the commencement date of 1 January 2013 subject to the comments noted above.

2. **Technical Staff Recommendations**

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

- Reference to Listed Entities should be as per the defined term in APES 110 and the reference to the *Corporations Act 2001* be noted in a footnote.

3. Summary

Overall, the majority of the respondents were supportive of the PIE definitions subject to their views on the APRA regulated entities.

Appendix A depicts the amended version of the relevant paragraphs subject to receiving further feedback from APRA.

Authors: Channa Wijesinghe
Si-Jia Li

Date: 10 November 2011

Appendix A

Revised Paragraph 290.25 - 290.26.1 (Include AUST paragraphs).

Section 290 Independence – Audit and Review Engagements

[Paragraphs 290.1 – 290.24 of extant Section 290 remain unchanged.]

Public Interest Entities

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

- (a) A All Listed Entity~~*ies~~; ~~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.

AUST 290.25.1 The following entities in Australia satisfy the conditions in paragraph 290.25:

- Listed Entities;
- Authorised Deposit-taking Institutions, regulated by the Australian Prudential Regulatory Authority (APRA) under the *Banking Act 1959* and subject to Prudential Standard CPS 510 Governance (CPS 510);
- Authorised Insurers regulated by APRA under Section 122 of the *Insurance Act 1973* and subject to CPS 510; and
- Life Insurance Companies and Friendly Societies regulated by APRA under section 17 of the *Life Insurance Act 1995* and subject to CPS 510.

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 and pension funds;
- Size; and
- Number of employees.

AUST 290.26.1 The following entities in Australia will generally satisfy the conditions in paragraph 290.26 as having a large number and wide range of stakeholders and thus are likely to be classified as Public Interest Entities. In each instance Firms shall consider the nature of the business, its size and the number of its employees.

- Disclosing Entities as defined in Section 111AC of the *Corporations Act 2001*;
- Registrable Superannuation Entity (RSE) licensees, and RSEs under their trusteeship that have five or more members, regulated by APRA under the *Superannuation Industry (Supervision) Act 1993*; and
- Other issuers of debt and equity instruments to the public.

* Includes a listed entity as defined in Section 9 of the *Corporations Act 2001*.

TRANSITIONAL PROVISIONS

The Code is subject to the following transitional provisions:

Public Interest Entities

1. Section 290 of the Code contains additional Independence provisions when the Audit or Review Client is a Public Interest Entity. The additional provisions that are applicable because of the new definition of a Public Interest Entity or the **guidance requirements** in paragraph 290.26 are effective on January 1, 201**32**. For partner rotation requirements, the transitional provisions contained in paragraphs 2 and 3 below apply.

Partner Rotation

2. For a partner who is subject to the rotation provisions in paragraph 290.151 because the partner meets the definition of the new term “Key Audit Partner,” and the partner is neither the Engagement Partner nor the individual responsible for the Engagement Quality Control Review, the rotation provisions are effective for the Audits or Reviews of Financial Statements for years beginning on or after January 1, 201**32**. For example, in the case of an Audit Client with a calendar year-end, a Key Audit Partner, who is neither the Engagement Partner nor the individual responsible for the Engagement Quality Control Review, who had served as a Key Audit Partner for seven or more years (i.e., the audits of 200**53** – 201**10**), would be required to rotate after serving for one more year as a Key Audit Partner (i.e., after completing the 201**24** audit).
3. For an Engagement Partner or an individual responsible for the Engagement Quality Control Review who immediately prior to assuming either of these roles served in another Key Audit Partner role for the client, and who, at the beginning of the first fiscal year beginning on or after January 01, 201**24**, had served as the Engagement Partner or individual responsible for the Engagement Quality Control Review for six or fewer years, the rotation provisions are effective for the audits or reviews of Financial Statements for years beginning on or after January 01, 201**32**. For example, in the case of an Audit Client with a calendar year-end, a partner who had served the client in another Key Audit Partner role for four years (i.e., the audits of 2002-2005) and subsequently as the Engagement Partner for five years (i.e., the audits of 2006-2010) would be required to rotate after serving for one more year as the Engagement Partner (i.e., after completing the 2011 audit).

Non-assurance services

4. Paragraphs 290.156-290.219 address the provision of non-assurance services to an Audit or Review Client. If, at the effective date of the Code, services are being provided to an Audit or Review Client and the services were permissible under the June 2006 Code (revised February 2008) but are either prohibited or subject to restrictions under the revised Code, the Firm may continue providing such services only if they were contracted for and commenced prior to July 1, 2011, and are completed before January 1, 201**32**.

Fees – Relative Size

5. Paragraph 290.222 provides that, in respect of an Audit or Review Client that is a Public Interest Entity, when the total fees from that client and its related entities (subject to the considerations in paragraph 290.27) for two consecutive years represent more than 15% of the total fees of the Firm expressing the opinion on the Financial Statements, a pre- or post-issuance review (as described in paragraph 290.222) of the second year's audit shall be performed. This requirement is effective for Audits or Reviews of Financial Statements covering years that begin on or after January 01, 2013~~4~~. For example, in the case of an Audit Client with a calendar year end, if the total fees from the client exceeded the 15% threshold for 201~~24~~ and 201~~32~~, the pre- or post-issuance review would be applied with respect to the audit of the 201~~32~~ Financial Statements.

Compensation and Evaluation Policies

6. Paragraph 290.229 provides that a Key Audit Partner shall not be evaluated or compensated based on that partner's success in selling non-assurance services to the partner's Audit Client. This requirement is effective on January 1, 201~~32~~. A Key Audit Partner may, however, receive compensation after January 1, 201~~32~~ based on an evaluation made prior to January 1, 201~~32~~ of that partner's success in selling non-assurance services to the Audit Client.

CONFORMITY WITH INTERNATIONAL PRONOUNCEMENTS

APES 110 and the IESBA Code

APES 110 incorporates the *Code of Ethics for Professional Accountants* (IESBA Code) issued by the International Ethics Standards Board for Accountants (IESBA) in July 2009.

Compliance with the IESBA Code

The principles and requirements of APES 110 and the IESBA Code are consistent except for the following:

- The addition of a Scope and Application section in APES 110;
- The addition of paragraphs and definitions prefixed as AUST in APES 110. The additional definitions are of AASB, Administration, AuASB, AUASB, Auditing and Assurance Standards, Australian Accounting Standards and Member;
- APES 110 generally refers to Members whereas the IESBA Code refers to professional accountants;
- Defined terms are in title case in APES 110;
- APES 110 tailors the following IESBA defined terms to the Australian environment: Audit Engagement, Engagement Team, Financial Statements, Firm, Member in Public Practice, and Review Engagement;
- Paragraph 290.25 of APES 110 expresses Public Interest Entity in the singular form consistent with its definition in section 2;
- Paragraph 290.26 in APES 110 mandates Firms to determine whether additional entities are Public Interest Entities and the reference to Member Bodies has been removed; and
- Unless strict requirements are met, APES 110 prohibits Members in Public Practice from providing accounting and bookkeeping services and preparing tax calculations for Audit Clients which are Public Interest Entities, even in emergency situations (refer paragraphs 290.172 – 290.173 and 290.185).

Effective Date:

The revisions are effective from 1 January 2013