

### Extract From IESBA Final Pronouncement (Part 4A and Glossary)

This paper includes the paragraphs relevant to the final revisions to the Definitions of Listed Entity and Public Interest Entity in the IESBA Code.<sup>1</sup>

## PART 4A – INDEPENDENCE FOR AUDIT AND REVIEW ENGAGEMENTS

### SECTION 400

## APPLYING THE CONCEPTUAL FRAMEWORK TO INDEPENDENCE FOR AUDIT AND REVIEW ENGAGEMENTS

### Introduction

#### General

...

#### Public Interest Entities

- 400.8 Some of the requirements and application material set out in this Part are applicable only to the audit of financial statements of public interest entities, reflecting significant public interest in the financial condition of these entities due to the potential impact of their financial well-being on stakeholders.
- 400.9 Factors to consider in evaluating the extent of public interest in the financial condition of an entity include:
- The nature of the business or activities, such as taking on financial obligations to the public as part of the entity's primary business.
  - Whether the entity is subject to regulatory supervision designed to provide confidence that the entity will meet its financial obligations.
  - Size of the entity.
  - The importance of the entity to the sector in which it operates including how easily replaceable it is in the event of financial failure.
  - Number and nature of stakeholders including investors, customers, creditors and employees.
  - The potential systemic impact on other sectors and the economy as a whole in the event of financial failure of the entity.
- 400.10 Stakeholders have heightened expectations regarding the independence of a firm performing an audit engagement for a public interest entity because of the significance of the public interest in the financial condition of the entity. The purpose of the requirements and application material for public interest entities as described in paragraph 400.8 is to

<sup>1</sup> The International Ethics Standards Board for Accountants' *International Code of Ethics for Professional Accountants (including International Independence Standards)*

meet these expectations, thereby enhancing stakeholders' confidence in the entity's financial statements that can be used when assessing the entity's financial condition.

### **Reports that Include a Restriction on Use and Distribution**

- 400.11 An audit report might include a restriction on use and distribution. If it does and the conditions set out in Section 800 are met, then the independence requirements in this Part may be modified as provided in Section 800.

### **Assurance Engagements other than Audit and Review Engagements**

- 400.12 Independence standards for assurance engagements that are not audit or review engagements are set out in Part 4B – *Independence for Assurance Engagements Other than Audit and Review Engagements*.

### **Requirements and Application Material**

#### **General**

- R400.13** A firm performing an audit engagement shall be independent.
- R400.14** A firm shall apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence in relation to an audit engagement.

### **Prohibition on Assuming Management Responsibilities**

- R400.15** A firm or a network firm shall not assume a management responsibility for an audit client.
- 400.15 A1 Management responsibilities involve controlling, leading and directing an entity, including making decisions regarding the acquisition, deployment and control of human, financial, technological, physical and intangible resources.
- 400.15 A2 When a firm or a network firm assumes a management responsibility for an audit client, self-review, self-interest and familiarity threats are created. Assuming a management responsibility might also create an advocacy threat because the firm or network firm becomes too closely aligned with the views and interests of management.
- 400.15 A3 Determining whether an activity is a management responsibility depends on the circumstances and requires the exercise of professional judgment. Examples of activities that would be considered a management responsibility include:
- Setting policies and strategic direction.
  - Hiring or dismissing employees.
  - Directing and taking responsibility for the actions of employees in relation to the employees' work for the entity.
  - Authorizing transactions.
  - Controlling or managing bank accounts or investments.
  - Deciding which recommendations of the firm or network firm or other third parties to implement.

- Reporting to those charged with governance on behalf of management.
- Taking responsibility for:
  - The preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework.
  - Designing, implementing, monitoring or maintaining internal control.

400.15 A4 Subject to compliance with paragraph R400.16, providing advice and recommendations to assist the management of an audit client in discharging its responsibilities is not assuming a management responsibility. The provision of advice and recommendations to an audit client might create a self-review threat and is addressed in Section 600.

**R400.16** When performing a professional activity for an audit client, the firm shall be satisfied that client management makes all judgments and decisions that are the proper responsibility of management. This includes ensuring that the client's management:

- (a) Designates an individual who possesses suitable skill, knowledge and experience to be responsible at all times for the client's decisions and to oversee the activities. Such an individual, preferably within senior management, would understand:
  - (i) The objectives, nature and results of the activities; and
  - (ii) The respective client and firm or network firm responsibilities.However, the individual is not required to possess the expertise to perform or re-perform the activities.
- (b) Provides oversight of the activities and evaluates the adequacy of the results of the activities performed for the client's purpose.
- (c) Accepts responsibility for the actions, if any, to be taken arising from the results of the activities.

#### Public Interest Entities

**R400.17** For the purposes of this Part, a firm shall treat an entity as a public interest entity when it falls within any of the following categories:

- (a) A publicly traded entity;
- (b) An entity one of whose main functions is to take deposits from the public;
- (c) An entity one of whose main functions is to provide insurance to the public; or
- (d) An entity specified as such by law, regulation or professional standards to meet the purpose described in paragraph 400.10.

400.17 A1 When terms other than public interest entity are applied to entities by law, regulation or professional standards to meet the purpose described in paragraph 400.10, such terms are regarded as equivalent terms. However, if law, regulation or professional standards designate entities as "public interest entities" for reasons unrelated to the purpose described in paragraph 400.10, that designation does not necessarily mean that such entities are public interest entities for the purposes of the Code.

- R400.18** In complying with the requirement in paragraph R400.17, a firm shall take into account more explicit definitions established by law, regulation or professional standards for the categories set out in paragraph R400.17 (a) to (c).
- 400.18 A1 The categories set out in paragraph R400.17 (a) to (c) are broadly defined and no recognition is given to any size or other factors that can be relevant in a specific jurisdiction. The Code therefore provides for those bodies responsible for setting ethics standards for professional accountants to more explicitly define these categories by, for example:
- Making reference to specific public markets for trading securities.
  - Making reference to the local law or regulation defining banks or insurance companies.
  - Incorporating exemptions for specific types of entities, such as an entity with mutual ownership.
  - Setting size criteria for certain types of entities.
- 400.18 A2 Paragraph R400.17 (d) anticipates that those bodies responsible for setting ethics standards for professional accountants will add categories of public interest entities to meet the purpose described in paragraph 400.10, taking into account factors such as those set out in paragraph 400.9. Depending on the facts and circumstances in a specific jurisdiction, such categories could include:
- Pension funds.
  - Collective investment vehicles.
  - Private entities with large numbers of stakeholders (other than investors).
  - Not-for-profit organizations or governmental entities.
  - Public utilities.
- 400.19 A1 A firm is encouraged to determine whether to treat other entities as public interest entities for the purposes of this Part. When making this determination, the firm might consider the factors set out in paragraph 400.9 as well as the following factors:
- Whether the entity is likely to become a public interest entity in the near future.
  - Whether in similar circumstances, a predecessor firm has applied independence requirements for public interest entities to the entity.
  - Whether in similar circumstances, the firm has applied independence requirements for public interest entities to other entities.
  - Whether the entity has been specified as not being a public interest entity by law, regulation or professional standards.
  - Whether the entity or other stakeholders requested the firm to apply independence requirements for public interest entities to the entity and, if so, whether there are any reasons for not meeting this request.
  - The entity's corporate governance arrangements, for example, whether those charged with governance are distinct from the owners or management.

*Public Disclosure – Application of Independence Requirements for Public Interest Entities*

**R400.20** Subject to paragraph R400.21, when a firm has applied the independence requirements for public interest entities as described in paragraph 400.8 in performing an audit of the financial statements of an entity, the firm shall publicly disclose that fact in a manner deemed appropriate, taking into account the timing and accessibility of the information to stakeholders.

**R400.21** As an exception to paragraph R400.20, a firm may not make such a disclosure if doing so will result in disclosing confidential future plans of the entity.

**Related Entities**

**R400.22** As defined, an audit client that is a publicly traded entity in accordance with paragraphs R400.17 and R400.18 includes all of its related entities. For all other entities, references to an audit client in this Part include related entities over which the client has direct or indirect control. When the audit team knows, or has reason to believe, that a relationship or circumstance involving any other related entity of the client is relevant to the evaluation of the firm's independence from the client, the audit team shall include that related entity when identifying, evaluating and addressing threats to independence.

**[Paragraphs 400.23 to 400.29 are intentionally left blank]**

## GLOSSARY, INCLUDING LISTS OF ABBREVIATIONS

---

Audit	<i>In Part 4A, the term “audit” applies equally to “review.”</i>
Audit client	<p>An entity in respect of which a firm conducts an audit engagement. When the client is a publicly traded entity in accordance with paragraphs R400.17 and R400.18, audit client will always include its related entities. When the audit client is not a publicly traded entity, audit client includes those related entities over which the client has direct or indirect control. (See also paragraph R400.22.)</p> <p><i>In Part 4A, the term “audit client” applies equally to “review client.”</i></p>
Audit engagement	<p>A reasonable assurance engagement in which a professional accountant in public practice expresses an opinion whether financial statements are prepared, in all material respects (or give a true and fair view or are presented fairly, in all material respects), in accordance with an applicable financial reporting framework, such as an engagement conducted in accordance with <i>International Standards on Auditing</i>. This includes a Statutory Audit, which is an audit required by legislation or other regulation.</p> <p><i>In Part 4A, the term “audit engagement” applies equally to “review engagement.”</i></p>

---

Key audit partner	<p>The engagement partner, the individual responsible for the engagement quality control review, and other audit partners, if any, on the engagement team who make key decisions or judgments on significant matters with respect to the audit of the financial statements on which the firm will express an opinion. Depending upon the circumstances and the role of the individuals on the audit, “other audit partners” might include, for example, audit partners responsible for significant subsidiaries or divisions.</p>
May	<p><i>This term is used in the Code to denote permission to take a particular action in certain circumstances, including as an exception to a requirement. It is not used to denote possibility.</i></p>

---

Proposed accountant	<p>A professional accountant in public practice who is considering accepting an audit appointment or an engagement to perform accounting, tax, consulting or similar professional services for a prospective client (or in some cases, an existing client).</p>
---------------------	---

Public interest entity      For the purposes of Part 4A, an entity is a public interest entity when it falls within any of the following categories:

- (a) A publicly traded entity;
- (b) An entity one of whose main functions is to take deposits from the public;
- (c) An entity one of whose main functions is to provide insurance to the public;  
or
- (d) An entity specified as such by law, regulation or professional standards to meet the purpose described in paragraph 400.10.

The Code provides for the categories to be more explicitly defined or added to as described in paragraphs 400.18 A1 and 400.18 A2.

Publicly traded entity      An entity that issues financial instruments that are transferrable and traded through a publicly accessible market mechanism, including through listing on a stock exchange.

*A listed entity as defined by relevant securities law or regulation is an example of a publicly traded entity.*

Reasonable and  
informed third party

Reasonable and  
informed third party  
test

*The reasonable and informed third party test is a consideration by the professional accountant about whether the same conclusions would likely be reached by another party. Such consideration is made from the perspective of a reasonable and informed third party, who weighs all the relevant facts and circumstances that the accountant knows, or could reasonably be expected to know, at the time that the conclusions are made. The reasonable and informed third party does not need to be an accountant, but would possess the relevant knowledge and experience to understand and evaluate the appropriateness of the accountant's conclusions in an impartial manner.*

*These terms are described in paragraph 120.5 A6.*