



**Consultation Paper: Proposed Definition of *Public Interest Entity* for the Code**

Prepared and issued by **Accounting Professional & Ethical Standards Board Limited**

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## **Commenting on this Consultation Paper**

Comments on this Consultation Paper should be forwarded so as to arrive by **15 July 2011**.

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A copy of all submissions will be placed on public record on the APESB website: [www.apesb.org.au](http://www.apesb.org.au).

## **Obtaining a copy of this Consultation Paper**

This Consultation Paper is available on the APESB website: [www.apesb.org.au](http://www.apesb.org.au). Alternatively, any individual or organisation may obtain one printed copy of this Consultation Paper without charge until **15 July 2011** by contacting:

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## **Reasons for issuing Consultation Paper 01/11**

Accounting Professional & Ethical Standards Board Limited (APESB) is reviewing the definition of “*Public Interest Entity*” contained within the revised APES 110 *Code of Ethics for Professional Accountants* (APES 110) in the Australian context. The definition of *Public Interest Entity* is central to the “stricter” independence requirements of section 290 of the revised Code.

APESB has prepared six options for stakeholders to consider the definition of ‘*Public Interest Entity*’ and is seeking stakeholders views on these six options. Stakeholder can also contribute additional options for the APESB’s consideration or options which are variations on the proposed options in this consultation paper.

## Background

At the November 2010 Board meeting, APESB approved a project to further explore the definition of *Public Interest Entity* in the revised APES 110 *Code of Ethics for Professional Accountants* (the Code) in the Australian context. The current definition of *Public Interest Entity* is the same as the IESBA's definition without any Australian modification or guidance. At the time the Board also considered the definition of *Public Interest Entity* taking into account existing and proposed definitions in several other jurisdictions. (Refer Appendix 1)

The benefits of having an Australian definition is supported by:

- the professional bodies; and
- Australian Securities and Investments Commission (ASIC).

The professional bodies have stated that the benefit of an Australian definition is in the public interest and that it would ensure that certain entities are always treated as *Public Interest Entities* rather than risking non-consensus between firms. The Professional bodies have stated in their submission that they support a *Public Interest Entity* definition in the Australian context.

ASIC has recommended that *Public Interest Entity* be defined with reference to AASB's definition of *Publicly Accountable Entity*. In ASIC's view this represents better practice for Australian entities and their auditors to have consistency in approach in the sense that the entities which are held to the higher financial reporting requirements are the same entities that are held to the stricter auditor independence requirements.

The accounting firms are generally supportive of retaining the IESBA definition and believe that it should only capture listed entities.

However, the view that the definition of *Public Interest Entity* only captures Listed Entities is contrary to IESBA's stated intention of expanding the more stricter independence requirements from Listed Entities in the previous IESBA Code to *Public Interest Entities* in the revised Code. (Refer Appendix 2 *Basis for Conclusions for revised APES 110*)

At the 2010 World Congress of Accountants the IESBA Chairman publicly stated that the definition of *Public Interest Entities* covers more than Listed Entities. As an example, he noted the European Union (EU) definition which he said in addition to typical listed companies captures banks and insurance companies.

## Specific matters for comment

APESB has provided six options for stakeholders consideration to define "*Public Interest Entity*" in the Australian context:

1. Maintain IESBA's definition of *Public Interest Entity* as per the IESBA's Code without modification;
2. Align the definition of *Public Interest Entity* with AASB's *Publicly Accountable Entity*;
3. Adopt the definition of "*Public Interest Entity*" which is similar to the EU;
4. An alternative to option 3 modelled on the *Public Interest Entity* definition in Singapore;
5. Adopt "*Public Interest Entity*" definition as proposed by the IESBA with amendments to link it to "*Public Accountability*"; or
6. Amend paragraph 290.26 in APES 110 to include reference to public issuers of debt and equity instruments.

### **Option 1: Maintain IESBA's definition of Public Interest Entity as per the IESBA's Code without modification**

The definition of "Public Interest Entity" in the revised APES 110 has two limbs as noted below:

#### *Public Interest Entity*

- (a) *A Listed Entity; and*
- (b) *An 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.*

The second limb considers that in some cases legislation or regulation may specify which entities have a public interest and thus those entities will need to comply with the more restrictive independence provisions.

Section 290 contains additional provisions that reflect the extent of public interest in certain entities.

*290.26 Firms and member bodies 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, and pension funds;*
- *Size; and*
- *Number of employees.*

The previous IESBA Code applied the more restrictive independence provisions to Listed Entities. By defining "Public Interest Entity" in the manner noted above, IESBA clearly intended that the more restrictive independence requirements (*refer to key changes in Independence I project in Appendix 2*) to apply to entities that have a public interest element (i.e. not only Listed Entities). If the intention was to only apply it to Listed Entities then limb (a) of the definition would have been sufficient and it is not necessary to have limb (b) or to change the application from Listed Entities (in the previous IESBA Code) to *Public Interest Entities* in the new IESBA Code.

This is similar to the approach adopted by Hong Kong (*Refer Appendix 1*).

### **Option 2: Align the definition of Public Interest Entity with AASB's Publicly Accountable Entity**

The AASB's definition of *Publicly Accountable Entity* is based on the International Accounting Standards Board's (IASB) definition. The IASB define "*public accountability*" to identify entities that are required to prepare financial statements based on full IFRS accounting standards. This definition with additional Australian guidance has been adopted by the AASB in Australia (*refer below*).

Extract from Appendix A of AASB 1053 *Application of Tiers of Australian Accounting Standards*:

**Public accountability** means accountability to those existing and potential resource providers and others external to the entity who make economic decisions but are not in a position to demand reports tailored to meet their particular information needs.

A for-profit private sector entity has public accountability if:

- (a) its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets); or
- (b) it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses. This is typically the case for banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks.

In AASB 1053 the AASB has deemed that in the for profit sector the following entities have “Public Accountability”.

*B2 The following for-profit entities are deemed to have public accountability:*

- (a) disclosing entities, even if their debt or equity instruments are not traded in a public market or are not in the process of being issued for trading in a public market;
- (b) co-operatives that issue debentures;
- (c) registered managed investment schemes;
- (d) superannuation plans regulated by the Australian Prudential Regulation Authority (APRA) other than Small APRA Funds as defined by APRA Superannuation Circular No. III.E.1 Regulation of Small APRA Funds, December 2000; and
- (e) authorised deposit-taking institutions.

The tier 1 reporting requirement in AASB 1053 applies to the *Publicly Accountable Entities* in the ‘for profit’ sector and the Australian Government and State, Territory and Local Governments.

We are aware that AASB went through an extensive due process as part of the differential reporting project to identify which entities in Australia have public accountability.

The Australian regulator, ASIC, believes that the Australian definition should be consistent with the definition of *Publicly Accountable Entity* adopted by the Australian Accounting Standard AASB 1053. As noted by ASIC this would increase simplicity and reduce any possible confusion amongst auditors and audit clients of which entities should be treated as having public accountability.

The current proposal in New Zealand is to adopt a *Public Interest Entity* definition which is linked to Issuers and entities subject to tier 1 reporting requirements which is similar to this option.

### **Option 3: Adopt a definition of “Public Interest Entity” which is similar to the EU**

One of the reasons that the IESBA adopted the term *Public Interest Entity* was to align the IESBA definition with the definition used in the European Union (EU).

The definition of *Public Interest Entity* adopted by the EU is as follows:

*Public Interest Entities ('PIE')* means;

- *companies or other bodies corporate governed by the law of a Member State whose transferable securities are admitted to trading on a regulated market of any Member State within the meaning of point 14 of Article 4(1) of Directive 2004/39/EC;*
- *credit institutions as defined in point 1 of Article 1 of Directive 2000/12/EC relating to the taking up and pursuit of business of credit institutions, and*
- *insurance undertakings within the meaning of Article 2(1) of Directive 91/674/EEC.*

From an Australian context an equivalent definition would be:

*Public Interest Entities ('PIE')* means;

- *Listed Entities;*
- *Banks; and*
- *Insurance Companies.*

### **Option 4: An alternative to option 3 modelled on the Public Interest Entity definition in Singapore**

This option is an alternative to Option 3 and is based on the definition adopted in Singapore.

The definition of *Public Interest Entity* adopted by Singapore is as follows:

*Extract from Accounting and Corporate Regulatory Authority Singapore (ACRA) - Public Interest Entities include:*

- (a) Companies listed on the Singapore Stock Exchange (the “Exchange”) and companies wishing to list on the Exchange by way of an initial public offering;*
- (b) Companies in regulated industries such as banks and insurance companies; and*
- (c) Other entities which raise funds from the public, such as charities.*

From an Australian context an equivalent definition would be:

*Public Interest Entities ('PIE')* means;

- *Listed Entities;*
- *Entities in regulated industries such as Banks and Insurance companies; and*
- *Other entities who issue debt and equity instruments to the public.*

This definition is similar to the proposed definition in Canada where it is proposed that the strict independence requirements be applied to “Reporting Issuers” (Refer Appendix 1)

**Option 5: Adopt “Public Interest Entity” definition as proposed by the IESBA with modification to link it to Public Accountability**

Currently in Australia the audit regulator (ASIC) has not specified in regulation which entities have a public interest element. However, the Australian Accounting Standards Board (AASB) has defined *Publicly Accountable Entity* in AASB 1053 *Application of Tiers of Australian Accounting Standards* (AASB 1053) issued in June 2010. The AASB makes standards under Section 334 of the *Corporations Act* and in effect the standards issued by the AASB are legislative instruments. Accordingly legislation in Australia already specifies which entities have *public accountability*.

In October 2009 the Australian Auditing and Assurance Standards Board (AUASB) issued Auditing Standard ASA 102 *Compliance with Ethical Requirements when Performing Audits, Reviews and Other Assurance Engagements* (ASA 102). ASA 102 is a legislative instrument made under the *Corporations Act 2001* and specifies that in Australia the relevant ethical requirements are specified in APES 110. Accordingly ASA 102 provides APES 110 with a certain level of legal status in respect of *Corporations Act* audits.

If viewed from a “principles” based manner, it can be argued that in substance the *Public Interest Entity* and *Publicly Accountable Entity* are addressing similar concepts (i.e. entities that have public interest element) and thus legislation already exist in Australia on what is a “*Public Interest Entity*”. Both definitions arguably have equal legal weight given its association with legislative instruments - AASB 1053 and ASA 102.

If the two definitions are not linked, in practice the two definitions will be applied on a case by case basis by Member in Public Practice/Firms. This may have unintended adverse consequences as gaps may be created where entities that are of significant public interest, but which are not listed should be held to greater account for their financial reporting requirements but the auditing of these entities will not be conducted in accordance with higher independence standards. Therefore, changing the definition of “*Public Interest Entity*” within APES 110 to include specific reference to an entity which is defined by regulation or legislation as having ‘*Public Accountability*’ is another option to consider. Please refer below to the proposed amendments to the definition and paragraphs 290.25 and 290.26:

*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 Entities are:*

- (a) *All Listed Entities; and*
- (b) *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 or (c) defined by regulation or legislation as an entity that is publicly accountable.*

290.26 Firms and member bodies 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, and pension funds;~~
- Size; and
- Number of employees.

As AASB 1053 will be captured by limb (c) APESB has received legal advice that the reference to holding assets in a fiduciary capacity is not required.

**Option 6: Amend paragraph 290.26 in APES 110 to include reference to public issuers of debt and equity instruments**

This option is an alternative to Option 5. Instead of changing the definition of ‘Public Interest Entity’, paragraph 290.26 can be amended to include reference to public issuers of ‘debt and equity instruments’. Please refer to the following proposed amendments to paragraph 290.26:

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 funds;
- Size; and
- Number of employees.

**Question 1**

Should the revised APES 110 use IESBA’s definition of “Public Interest Entity”?

**Question 2**

Please provide your rationale for supporting one or more of the proposed six options in this Consultation Paper which can be used as the definition of “Public Interest Entity” for the purpose of revised APES 110?

**Question 3**

If you would like to provide additional option(s) to define “Public Interest Entity” in the Australian context, please provide your proposed definition(s) and provide detailed analysis and reasoning for the relevant proposed definition(s).

Your responses should include reasons to support your position and outline the implications of any alternative definitions.

### ***Request for comments***

Comments are invited on this Consultation Paper: Proposed Definition for *Public Interest Entity* by **15 July 2011**. APESB would prefer that respondents express a clear opinion on the specific questions raised and that opinions are supplemented by detailed comments.

## Appendix 1 – Other Jurisdiction’s Definition of PIE

Country	<i>Public Interest Entity Definition</i>	Comments
New Zealand	<p><b><i>Public Interest Entities</i></b></p> <p>43. The Code contains additional provisions that reflect the extent of public interest in certain entities. For the purpose of this Code, <i>public interest entities</i> are:</p> <p>(a) All <i>issuers</i> as defined in the Financial Reporting Act 1993; and</p> <p>(b) All other Tier 1 entities (as outlined in the Accounting Standards Review Board’s “Proposed Application of Accounting and Assurance Standards under the Proposed New Statutory Framework for Financial Reporting”, Discussion Document, September 2009).</p> <p>44. Firms 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 (for example, trusts that have a large number of beneficiaries). Factors to be considered include:</p> <p>(a) The nature of the business, such as the holding of assets in a fiduciary capacity for a large number of stakeholders;</p> <p>(b) Size; and</p> <p>(c) Number of employees.</p> <p><i>Proposed Application of Tier 1 includes:</i></p> <p>(a) <i>In the For-Profit Sector:</i></p> <p style="padding-left: 20px;">(i) <i>Issuers of Securities Traded in a Public Market;</i></p> <p style="padding-left: 20px;">(ii) <i>Fiduciary Holders of Assets.</i></p> <p>(b) <i>Public Entities:</i></p> <p style="padding-left: 20px;">(i) <i>Crown;</i></p> <p style="padding-left: 20px;">(ii) <i>Local Authorities;</i></p> <p style="padding-left: 20px;">(iii) <i>Other leviers of coercive revenue, which would include ACC, EQC, Fire Services Commission and any other entities that are leviers of coercive revenue;</i></p> <p style="padding-left: 20px;">(iv) <i>Other entities with expenditure ≥\$20m.</i></p> <p>(c) <i>Other Not-For-Profit Entities:</i></p>	New Zealand has taken a similar approach in its ED on the Code by defining the term by reference to legislation and including a list of institutions that satisfy the definition

	<p>(i) <i>Publicly accountable entities, which comprise registered charities and any other not-for-profit organisation that receives funds from the public, with expenditure ≥\$10m;</i></p> <p>(ii) <i>Other entities with expenditure ≥\$10m.</i></p> <p>Source: PSB, <i>ED/Code of Ethics: Independence in Assurance Engagements (Revised)</i>, NZICA, 2010, p.13-14</p>	
United States	<p><b>Public Interest Entities</b></p> <p>Solely for the purpose of this conceptual framework, the following entities are considered to be public interest entities:</p> <ol style="list-style-type: none"> <li>1) Entities subject to Securities and Exchange Commission reporting requirements;</li> <li>2) employee benefit and health and welfare plans subject to Employee Retirement Income Security Act audit requirements;</li> <li>3) government retirement plans;</li> <li>4) entities or programs (including for-profit entities) subject to Single Audit Act OMB Circular A-133 requirements and entities or programs subject to similar program oversight; and</li> <li>5) financial institutions, credit unions, and insurance companies. These entities are public interest entities because their audited financial statements are directly relied upon by significant numbers of stakeholders to make investment, credit, or similar decision (for example, in the case of a publicly held company) or indirectly relied upon through regulatory oversight (for example, in the case of pension plans, banks, and insurance companies) and, therefore, the potential extent of harm to the public from an audit failure involving one of these entities would generally be significant.</li> </ol> <p style="text-align: right;">Source: AICPA, Code of Conduct, <a href="http://www.aicpa.org/Research/Standards/CodeofConduct/Pages/et_100.aspx">http://www.aicpa.org/Research/Standards/CodeofConduct/Pages/et_100.aspx</a></p>	Definition of public interest entity for the purposes of ET Section 100-1 Conceptual Framework for AICPA Independence Standards.
United Kingdom	<p><b>“public interest entity”</b> means an issuer –</p> <p>(a) whose transferable securities are admitted to trading on a regulated market; and</p> <p>(b) the audit of which is a statutory audit within the meaning of section 1210 of the Act;</p> <p>“issuer” and “regulated market” have the same meaning as in Part 6 of the <i>Financial Services and Markets Act 2000</i> (see sections 102A to 103);</p>	The UK definition of public interest as contained in the Statutory Auditors Instrument 2008 is based on the European Union’s definition.

	<p><i>“transferable securities” means anything which is a transferable security for the purposes of Directive 2004/39/EC of the European Parliament and of the Council on Markets in Financial Instruments.</i></p> <p style="text-align: right;">Source:  <a href="http://www.frc.org.uk/documents/pagemanager/pob/TheStatutoryAuditorsTransparencyInstrument2008FINAL.pdf">http://www.frc.org.uk/documents/pagemanager/pob/TheStatutoryAuditorsTransparencyInstrument2008FINAL.pdf</a></p>	
European Union	<p><b>Public Interest Entities</b> (‘PIE’) means;</p> <ul style="list-style-type: none"> <li>• <i>companies or other bodies corporate governed by the law of a Member State whose transferable securities are admitted to trading on a regulated market of any Member State within the meaning of point 14 of Article 4(1) of Directive 2004/39/EC;</i></li> <li>• <i>credit institutions as defined in point 1 of Article 1 of Directive 2000/12/EC relating to the taking up and pursuit of business of credit institutions, and</i></li> <li>• <i>insurance undertakings within the meaning of Article 2(1) of Directive 91/674/EEC.</i></li> </ul> <p><i>As indicated above the EU definition is broader than listed entities and specifically includes credit institutions and insurance companies.</i></p> <p style="text-align: right;">Source: Agenda Item 10.1 November 2010 APESB Board Meeting<sup>1</sup></p>	The definition of public interest entity adopted by the European Union.
Singapore	<p>Accounting Corporation Regulation Authority (ACRA) focuses its resources on reviewing public accountants and accounting entities that audit public interest entities.</p> <p>Public interest entities include:</p> <ol style="list-style-type: none"> <li>(a) Companies listed on the Singapore Stock Exchange (the “Exchange”) and companies wishing to list on the Exchange by way of an initial public offering;</li> <li>(b) Companies in regulated industries such as banks and insurance companies; and</li> <li>(c) Other entities which raise funds from the public, such as charities.</li> </ol> <p style="text-align: right;">Source: ACRA, 2007, <a href="http://www.acra.gov.sg/NR/rdonlyres/C6F367C7-0655-4136-9812-2961AD536A0/9856/PracticeMonitoringProgrammePublicReport2007.pdf">http://www.acra.gov.sg/NR/rdonlyres/C6F367C7-0655-4136-9812-2961AD536A0/9856/PracticeMonitoringProgrammePublicReport2007.pdf</a></p>	Singapore’s Accounting Regulatory Commission’s definition of Public Interest Entities.

<sup>1</sup> From November Board Meeting Agenda sent view email by Rozelle

Hong Kong	<p><b>Public Interest Entities</b></p> <p>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 entities are:</p> <p>(a) All listed entities; and</p> <p>(b) 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.</p> <p>290.26 Firms are required to determine whether to treat additional entities, or certain categories or entities, as public interest entities because they have a large number and wide range of stakeholders. Factors to be considered include:</p> <ul style="list-style-type: none"> <li>• 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;</li> <li>• Size, and</li> <li>• Number of employees.</li> </ul> <p style="text-align: right;">Source: HKICPA, code of Ethics for Professional Accountants, HKICPA Members Handbook, 2010</p>	Hong Kong Institute of Certified Practising Accountants (HKICPA) has adopted the International Ethics Standards Board for Accountants' Code of Ethics.
Canada	<p><b>"Reporting Issuer"</b> means an entity that is deemed to be a reporting issuer under the applicable Canadian provincial or territorial securities legislation, other than an entity that has, in respect of a particular fiscal year, market capitalization and total assets that are each less than \$10,000,000. An entity that becomes a reporting issuer by virtue of the market capitalization or total assets becoming \$10,000,000 or more in respect of a particular fiscal year shall be considered to be a reporting issuer henceforward unless and until the entity ceases to have its shares, units or debt quoted, listed or marketed in connection with a recognized stock exchange or the entity has remained under the market capitalization or total assets threshold for a period of two years. In the case of a period in which an entity makes a public offering:</p> <p>a) the term "market capitalization" shall be read as referring to the market price of all outstanding listed securities and publicly traded debt measured using the closing price on the day of the public offering; and</p> <p>b) the term "total assets" shall be read as referring to the amount of total assets</p>	<p>The current proposal in Canada is to use the existing Canadian definition of <i>Reporting Issuer</i>. They believe that the definition of "Reporting Issuer" is broad enough to capture the entities that need to be captured by the <i>Public Interest Entity</i> definition.</p> <p>The definition of <i>Reporting Issuer</i> in Canada is considerably broader than a listed entity. However, it does allow an exemption for small cap entities</p>

	<p><i>presented on the most recent financial statements prepared in accordance with generally accepted accounting principles included in the public offering document.</i></p> <p><i>In the case of a reporting issuer that does not have listed securities or publicly traded debt, the definition of reporting issuer shall be read without reference to market capitalization.</i></p> <p>Source: Public Trust Committee, <i>Harmonized Rule of Professional Conduct 204m CICA</i>, 2010</p>	<p>in Canada. The exemption for small cap entities is being currently debated in Canada.</p>
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## **Basis for Conclusions: APES 110 Code of Ethics for Professional Accountants**

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*Prepared by the Technical Staff of the Accounting Professional & Ethical Standards Board*

## BASIS FOR CONCLUSIONS:

### **APES 110 Code of Ethics for Professional Accountants**

This basis for conclusions has been prepared by technical staff of Accounting Professional & Ethical Standards Board Limited (“APESB”). It has been reviewed and approved by the Board of Directors of APESB and is provided for the benefit of stakeholders to gain an understanding of the background to the revision of APES 110 *Code of Ethics for Professional Accountants* (the Code).

The basis for conclusions **does not** form part of APES 110 and is not a substitute for reading the Code.

### **Background**

APESB originally issued the Code in June 2006 and subsequently made amendments in respect of the Network Firm definition (December 2007) and Corporations law changes (February 2008). The Australian Code issued by APESB is based on the *Code of Ethics for Professional Accountants* issued by the International Ethics Standards Board for Accountants (IESBA) of the International Federation of Accountants (IFAC). IESBA issued a revised Code in July 2009. In May 2009 APESB commenced a process to revise its Code to incorporate the changes in IESBA’s Code.

### **Revisions to the existing Code**

The revisions to the existing Code have primarily occurred from the following four inputs and public consultations:

1. IESBA’s revisions to its Code (Reissued in July 2009);
2. APESB’s amendments to the revised IESBA Code;
3. APESB’s changes to the existing Code; and
4. APESB’s consideration of respondents’ comments to APES 110 ED.

### **1. IESBA’s revisions to its Code (Reissued July 2009)**

IESBA commenced revision of its Code in December 2004 and completed three significant projects by July 2009 to strengthen the general provisions and in particular, the auditor independence requirements of its Code.

The three projects undertaken by IESBA and the key changes/issues addressed under each project are outlined below:

#### *i. Independence I*

The significant changes were:

- Extending the independence requirements for audits of Listed Entities to audits of all *Public Interest Entities*;
- Expanding the partner rotation requirements for audits of *Public Interest Entities* to all Key Audit Partners (the Engagement Partner, the individual responsible for the Engagement Quality Control Review and other audit partners on the Engagement Team who are responsible for key decisions or judgments with respect to the Audit Engagement);

- Eliminating the existing flexibility for Firms with few partners to apply alternative safeguards instead of partner rotation to address the familiarity threat;
- Establishing a mandatory "cooling-off" period before a Key Audit Partner joins a former Audit Client that is a *Public Interest Entity*, or the individual who is the Firm's senior or managing partner (chief executive or equivalent) joins such an Audit Client;
- Updating requirements related to the provision of non-assurance services, including setting out additional guidance on the provision of tax services to Audit Clients;
- Providing additional guidance on independence requirements for certain assurance reports that are expressly restricted for use by only the users specified in the report; and
- Splitting existing Section 290 into two sections - revised Section 290, which sets out independence requirements for Audit and Review Engagements of Financial Statements, and a new Section 291, which sets out independence requirements for other Assurance Engagements.

ii. Independence II

The significant changes or issues considered were:

- Additional guidance on provision of internal audit services to an Audit Client;
- The size of fees received from an Audit Client that is a *Public Interest Entity* relative to the size of the Firm's total fees; and
- Additional guidance on providing services to an Assurance Client on a Contingent Fee basis.

iii. Drafting Conventions

This project considered the following significant issues:

- The use of the word "shall" to identify a requirement of the Code;
- Whether a temporary departure from a requirement should be permitted in certain circumstances;
- Revising the description of each category of threats;
- Clarifying the term "clearly insignificant";
- Clarifying the description of the conceptual framework approach; and
- Clarifying the terms "consider", "evaluate" and "determine" in the following manner:
  - "Consider" will be used where the Member has to think about a matter;
  - "Evaluate" will be used when the Member has to assess and weigh the significance of a matter; and
  - "Determine" will be used when the Member has to conclude and make a decision.

Subsequent to the completion of these projects, IESBA issued a revised *Code of Ethics for Professional Accountants* in July 2009.

## 2. APESB's amendments to the revised IESBA Code

APESB commenced a project in 2009 to revise its Code to bring it into alignment with the revised IESBA Code issued in July 2009. APESB issued an Exposure Draft (APES 110 ED 03/10) in August 2010 which used the IESBA Code as the base document and then incorporated the following changes to tailor it to the Australian environment:

- The addition of a Scope and Application section;
- 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. The significant additional Australian paragraphs relate to inadvertent violations;
- The replacement of the words "professional accountants" in the IESBA Code with the word "Members";
- The inclusion of defined terms in title case;
- The tailoring of the following IESBA defined terms to the Australian environment: Audit Engagement, Engagement Team, Financial Statements, Firm, Member in Public Practice and Review Engagement; 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).

## 3. APESB's changes to the existing Code

In order to achieve closer alignment with the revised IESBA Code, APESB has removed references and paragraphs in the existing Code that incorporated Australian specific legislative requirements such as the *Corporations Act 2001* (particularly in relation to section 290) and privacy legislation (particularly in relation to section 140).

## 4. APESB's consideration of Respondents' comments on APES 110 ED

APESB received ten submissions from the professional accounting bodies, Firms, a Member, the Auditing and Assurance Standards Board (AUASB) and the Australian Securities and Investments Commission (ASIC).

In response to the comments received, APESB has made a number of changes to APES 110 ED. The following summarises the significant issues raised by respondents, and how APESB addressed them.

### *i. Inadvertent violations of the Code*

The IESBA Code (and APES 110 ED) recognises that inadvertent violations of the Code do occur in practice and left it to the judgment of the Firm whether those violations are discussed with Those Charged with Governance. APES 110 ED contained additional Australian specific requirements which state that unless the inadvertent violation was trivial and inconsequential, the Firm must document and discuss it with Those Charged with Governance.

Some respondents raised concerns in respect of the proposed new Australian requirements. The respondents were concerned that the Australian requirements will be an additional

burden on Firms, who in their opinion should have the ability to determine the extent, if any, of discussions required with Those Charged with Governance. On the other hand, ASIC is of the view that the proposed Code should not have any provisions dealing with inadvertent violations and that the IESBA provisions which recognise they occur in practice should be removed.

APESB considered the issue and determined to retain in the final Code the additional Australian paragraphs relating to inadvertent violations in APES 110 ED. APESB determined that these provisions strengthened the Code and create a safeguard in instances where inadvertent violations do occur. Firms should document inadvertent violations as a matter of best practice and the additional requirement imposed by the Code to discuss them with Those Charged with Governance (for example, an Audit Committee) is appropriate.

ii. Definition of Public Interest Entity

Some respondents supported the IESBA definition of *Public Interest Entity* and believed that no further Australian guidance was required. Some firms that responded to APESB's *Consultation Paper: Proposed revision of Code of Ethics for Professional Accountants* expressed the view that the definition of *Public Interest Entities* in Australia should only capture Listed Entities. However, this view is not consistent with IESBA's intended coverage under the *Independence 1* project (refer page 2)

The Board considered the definition of *Public Interest Entity* taking into account existing and proposed definitions in the Canadian, European Union and New Zealand jurisdictions. These jurisdictions have or are proposing to capture a broader range of entities in their respective definitions of a *Public Interest Entity*, not merely Listed Entities. This approach is consistent with IESBA's intention to extend the existing auditor independence requirements for audits of Listed Entities to audits of all *Public Interest Entities* (refer the *Independence 1* project on page 2).

For example, the definition of *Public Interest Entity* adopted by the European Union (EU) is as follows:

- *companies or other bodies corporate governed by the law of a Member State whose transferable securities are admitted to trading on a regulated market of any Member State within the meaning of point 14 of Article 4(1) of Directive 2004/39/EC;*
- *credit institutions as defined in point 1 of Article 1 of Directive 2000/12/EC relating to the taking up and pursuit of business of credit institutions, and*
- *insurance undertakings within the meaning of Article 2(1) of Directive 91/674/EEC.*

ASIC believes that the Australian definition should be consistent with the definition of Public Accountable Entity in the Australian Accounting Standard AASB 1053 *Application of Tiers of Australian Accounting Standards*. ASIC notes that this approach is simple and reduces any possible confusion amongst Firms and Audit Clients in which there is public interest. The need to adopt a local definition was also supported by the professional accounting bodies. The professional accounting bodies stated that having an Australian definition is in the public interest as it should ensure that certain entities are always treated as *Public Interest Entities* rather than risking not having consensus amongst Firms.

*Public Interest Entity* is defined in section 290 of APES 110 in the following manner:

- (a) *A Listed Entity; and*
- (b) *An 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.*

*Public Accountability* is defined in Appendix A of AASB 1053 in the following manner:

**Public accountability** means accountability to those existing and potential resource providers and others external to the entity who make economic decisions but are not in a position to demand reports tailored to meet their particular information needs.

*A for-profit private sector entity has public accountability if:*

- (a) *its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets); or*
- (b) *it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses. This is typically the case for banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks.*

In AASB 1053, the Australian Accounting Standards Board (AASB) has deemed that in the for-profit sector the following entities have public accountability:

*B2 The following for-profit entities are deemed to have public accountability:*

- (a) *disclosing entities, even if their debt or equity instruments are not traded in a public market or are not in the process of being issued for trading in a public market;*
- (b) *co-operatives that issue debentures;*
- (c) *registered managed investment schemes;*
- (d) *superannuation plans regulated by the Australian Prudential Regulation Authority (APRA) other than Small APRA Funds as defined by APRA Superannuation Circular No. III.E.1 Regulation of Small APRA Funds, December 2000; and*
- (e) *authorised deposit-taking institutions.*

APESB considered whether the AASB's concept of Publicly Accountable Entity might form the basis of a modification to the Code and concluded that further work needs to be done to evaluate whether the AASB's concept is suitable in the context of the Code. In the meantime APESB's view is that the IESBA definition of *Public Interest Entity* should be retained in the Code, without modification at this stage, but will consider the definition of *Public Interest Entity* in the Australian context in 2011. It is noted that due to the transitional provisions the independence requirements in respect of *Public Interest Entities* only commence from 1 January 2012.

iii. Legislative references

APESB considered this issue at the time of issuing the APES 110 ED and determined to remove the paragraphs in the existing APES 110 that incorporated *Corporations Act 2001* requirements. This was done in order to achieve a closer alignment to the IESBA Code and to avoid the risk of having incomplete or inaccurate information about the Act in the Code.

Some respondents have raised concern that APES 110 ED does not assist readers in understanding the differences between the Code's requirements and those of the *Corporations Act 2001* and that this may lead to contraventions of the more stringent independence requirements of the Act.

APESB considered this issue and determined to adopt a footnoting system to warn readers of the Code where a more stringent independence requirement is imposed by the *Corporations Act 2001*. This mechanism will put Members on notice to refer to the Act and will assist in reducing potential contraventions of the independence requirements of the Act.

iv. Prohibitions in respect of Accounting, Bookkeeping and Taxation Services provided to Public Interest Entities

The IESBA Code (and APES 110 ED) permits a Firm to provide services in relation to accounting, bookkeeping and preparing tax calculations to Audit Clients which are *Public Interest Entities* in an emergency situation (Paragraphs 290.172-173 and 290.185). ASIC's view is that this exemption is inappropriate as it creates a self-review threat and undermines the purpose of an independent audit. ASIC further stated that the exemption is unnecessary in Australia where there are a relatively large number of qualified accountants who can be engaged to provide these services. APESB agreed with ASIC's view and has removed this exemption dealing with emergency situations from the revised Code.

v. Convergence

Some respondents to APES 110 ED were of the view that no changes whatsoever should be made to the IESBA Code and that APESB should fully converge with the IESBA Code. While APESB supports the global convergence initiatives of the IESBA it recognises that the IESBA Code is a **minimum** requirement for IFAC Members in more than 120 countries. APESB is aware that many of Australia's international counterparts are modifying the IESBA Code to suit their particular circumstances.

APESB believes that the additional Australian requirements in the Code are appropriate and in the public interest.