

441 G St. N.W.
Washington, DC 20548

May 3, 2021

Mr. Ken Siong
Senior Technical Director
International Ethics Standards Board for Accountants
529 Fifth Avenue, 6th Floor
New York, NY 10017

GAO's Response to the International Ethics Standards Board for Accountants' January 2021 Exposure Draft, *Proposed Revisions to the Definitions of Listed Entity and Public Interest Entity in the Code*

Dear Mr. Siong:

This letter provides GAO's response to the exposure draft, *Proposed Revisions to the Definitions of Listed Entity and Public Interest Entity in the Code*. GAO promulgates generally accepted government auditing standards (GAGAS) in the United States. GAGAS provides a framework for conducting high-quality audits of government awards with competence, integrity, objectivity, and independence. Our comments reflect the importance we place on reinforcing the values promoted in both the *International Code of Ethics for Professional Accountants (Code)* and GAGAS.

We appreciate the International Ethics Standards Board for Accountants' (IESBA) efforts to raise the bar for ethical conduct and practice for all professional accountants. We support the IESBA's efforts to clarify the definition of "listed entity" and enhance the user community's confidence in the audits of financial statements. In our specific comments, we suggest exempting public sector entities from qualifying as public interest entities (PIE) unless governing bodies specifically identify them as such. We also recommend that the IESBA refrain from issuing standards that affect performing and reporting on audits of financial statements, as we believe that this is more properly the role of the International Accounting and Assurance Standards Board (IAASB). We believe that our suggestions will improve the clarity of the Code.

Request for Specific Comments

Overarching Objective

- 1. Do you support the overarching objective set out in proposed paragraphs 400.8 and 400.9 as the objective for defining entities as PIEs for which the audits are subject to additional requirements under the Code?**

We support the overarching objective in proposed paragraphs 400.8 and 400.9.

- 2. Do you agree with the proposed list of factors set out in paragraph 400.8 for determining the level of public interest in an entity? Accepting that this is a non-exhaustive list, are there key factors which you believe should be added?**

We believe that the proposed list of factors for determining the level of public interest in an entity is generally helpful. We suggest that the IESBA consider making the fifth bullet point either the

third or final bullet of the list, as the current third, fourth, and sixth bullet points have a natural progression from one to the next.

Approach to Revising the PIE Definition

3. Do you support the broad approach adopted by the IESBA in developing its proposals for the PIE definition, including:

- **Replacing the extant PIE definition with a list of high-level categories of PIEs?**
- **Refinement of the IESBA definition by the relevant local bodies as part of the adoption and implementation process?**

We do not share the IESBA's confidence (noted in para. 55 of the explanatory memorandum) that the refined definition, as modified by local jurisdictions, will resolve the issue of different categories of PIE across jurisdictions. As noted in paragraph 27 of the explanatory memorandum, it is difficult to establish a concise definition that can be universally adapted at the global level. It is unclear how a broader definition that relevant local bodies are expected to refine will address the underlying problem of global adoption and a lack of consistency among jurisdictions.

However, we agree that permitting local bodies to refine the IESBA PIE definition as part of the adoption and implementation process is appropriate. We believe that this will codify a process that is already in practice. In addition, local bodies can best adjust the categories to exclude entities that should not be treated as PIEs, even if they nominally belong to one of the high-level PIE categories.

PIE Definition

4. Do you support the proposals for the new term “publicly traded entity” as set out in subparagraph R400.14(a) and the Glossary, replacing the term “listed entity”? Please provide explanatory comments on the definition and its description in this ED.

We believe that the definition of “publicly traded entity” that replaces “listed entity” better encompasses the types of entities that would be treated as PIEs. However, we suggest that the IESBA consider also defining in the glossary or describing in the application guidance “financial instruments” as noted in the second bullet of paragraph 38 of the explanatory memorandum.

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

We largely agree with the remaining PIE categories set out in subparagraphs R400.14 (b) to (f). However, we note that both in the explanatory memorandum (para. 43) and the additional staff publication,¹ public sector entities are specifically not included as a distinct PIE category. A number of public sector entities have functions that arguably fall within one of the additional categories (e.g., providing insurance to the public or providing postemployment benefits). We suggest explicitly exempting a public sector entity from qualifying as a PIE unless the responsible governing body identifies it as such. Given the substantial number of public sector

¹International Ethics Standards Board for Accountants, *Proposed IESBA Definition of Public Interest Entity: Supplementary Guidance to Exposure Draft to Aid Local Body Considerations Regarding Adoption and Implementation*, (New York: Mar. 12, 2021).

entities, each potentially having its own responsible governing body, we believe that such an exemption is important and cost-effective.

- 6. Please provide your views on whether, bearing in mind the overarching objective, entities raising funds through less conventional forms of capital raising such as an initial coin offering (ICO) should be captured as a further PIE category in the IESBA Code. Please provide your views on how these could be defined for the purposes of the Code recognizing that local bodies would be expected to further refine the definition as appropriate.**

We believe that local bodies should determine whether to expand the PIE definition in the IESBA Code beyond what is included in the exposure draft. The extent of public interest in an initial coin offering (ICO) or other less conventional forms of raising capital may vary significantly based on the particular details of that offering (e.g., number of investors, complexity, and proposed amount of capital to be raised). As such, we believe that local bodies are in a better position to determine whether a particular entity offering an ICO should be classified as a PIE.

Role of Local Bodies

- 7. Do you support proposed paragraph 400.15 A1 which explains the high-level nature of the list of PIE categories and the role of the relevant local bodies?**

We believe that paragraph 400.15 A1 is helpful in clarifying the role of relevant local bodies in implementing the IESBA Code.

- 8. Please provide any feedback to the IESBA's proposed outreach and education support to relevant local bodies. In particular, what content and perspectives do you believe would be helpful from outreach and education perspectives?**

We believe that the IESBA, potentially in coordination with the IAASB, should clarify how auditors should approach an audit of a less complex entity (LCE) that is also a PIE, if LCEs become covered by a separate standard.

Role of Firms

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

We do not support the proposal to require firms to determine if additional entities should be treated as PIEs in the IESBA Code. The IESBA Code should not create requirements for the performance of financial statement audits. The IAASB should promulgate requirements that affect the performance of financial statement audits.

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

We believe that the second bullet in paragraph 400.16 A1 ("Whether the entity is likely to become a public interest entity in the near future.") is not appropriate. While this may be intended to apply to entities preparing for an initial public offering, changes to an entity's product or service, industry developments, and national or global economic events can delay or even cancel such plans. As such, we believe that it is not necessary or appropriate to apply these requirements in anticipation of an event that may not occur.

Transparency Requirement for Firms

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

We do not support the proposal that firms be required by the IESBA Code to disclose whether they treated audit clients as PIEs. With such a requirement, the most appropriate or natural place to disclose such information would be in the audit report. We believe that the IESBA Code should not create reporting requirements for financial statement audits. Requirements that affect the form and content of financial statement audit reports should be promulgated by the IAASB.

12. Please share any views on possible mechanisms (including whether the auditor's report is an appropriate mechanism) to achieve such disclosure, including the advantages and disadvantages of each. Also see question 15(c) below.

As noted in our response to question 11 above, we believe that the auditor's report would be the most obvious location for disclosing that an entity was treated as a PIE. We do not at this point offer an opinion of the advantages or disadvantages of such a disclosure, given that we do not believe that the IESBA should be issuing standards that affect the form and content of financial statement audit reports.

Other Matters

13. For the purposes of this project, do you support the IESBA's conclusions not to:

(a) Review extant paragraph R400.20 with respect to extending the definition of "audit client" for listed entities to all PIEs and to review the issue through a separate future workstream?

We support the IESBA's decision to defer consideration of extending the definition of "audit client" for listed entities to all PIEs.

(b) Propose any amendments to Part 4B of the Code?

We support the IESBA's conclusion to not propose amendments to Part 4B of the Code.

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

We do not offer a response to this question.

Matters for IAASB Consideration

15. To assist the IAASB in its deliberations, please provide your views on the following:

(a) Do you support the overarching objective set out in proposed paragraphs 400.8 and 400.9 for use by both the IESBA and IAASB in establishing differential requirements for certain entities (i.e., to introduce requirements that apply only to audits of financial statements of these entities)? Please also provide your views on how this might be approached in relation to the ISAs and ISQMs.

As stated in our earlier responses, we believe that the IAASB should promulgate any requirements that affect financial statement audit performance and reporting. We recommend that the IAASB minimize the use of differential requirements that only apply to certain entities as much as possible. The IAASB could also explore creating a new section of standards that contains differential requirements for entities of significant public interest. Alternatively, the board can address differential requirements in both the ISAs and ISQMs by inserting additional subsections, using conditional requirement language (e.g., “If ..., then ...”), or both.

(b) The proposed case-by-case approach for determining whether differential requirements already established within the IAASB Standards should be applied only to listed entities or might be more broadly applied to other categories of PIEs.

We believe that more information is necessary to provide an informed response to this question. The IAASB could develop and issue an official discussion paper that details the existing differential requirements within the IAASB Standards and the potential advantages and disadvantages of applying these requirements to PIE categories other than listed entities.

(c) Considering IESBA’s proposals relating to transparency as addressed by questions 11 and 12 above, and the further work to be undertaken as part of the IAASB’s Auditor Reporting PIR, do you believe it would be appropriate to disclose within the auditor’s report that the firm has treated an entity as a PIE? If so, how might this be approached in the auditor’s report?

If the purpose of the requirements and application material for PIEs is to enhance confidence in the financial statements by enhancing confidence in the audit of those financial statements (para. 400.9), then the audit report could be a means of disclosing that the auditor treated the entity as a PIE. An Other Matter paragraph could be one way to communicate this information.

Thank you for the opportunity to comment on these important issues. If you have questions about this letter or would like to discuss any of the matters it addresses, please contact me at (202) 512-3133 or dalkinj@gao.gov.

Sincerely yours,



James R. Dalkin
Director
Financial Management and Assurance