Hong Kong Institute of
Certified Public Accountants
香港會計師公會

Our Ref.: C/EC

Sent electronically through the IESBA Website (www.ethicsboard.org)

6 May 2021

Ken Siong
Senior Technical Director
International Ethics Standards Board for Accountants
529 Fifth Avenue, 6th Floor
New York, NY 10017
The United States of America

Dear Sir,

IESBA Exposure Draft
Proposed Revisions to the Definitions of Listed Entity and Public Interest Entity in the Code

The Hong Kong Institute of Certified Public Accountants (HKICPA) is the only body authorised by law to set and promulgate financial reporting, auditing and ethical standards for professional accountants in Hong Kong. We are grateful for the opportunity to provide you with our comments on this Exposure Draft (ED).

The HKICPA appreciates the IESBA's time and effort in organizing the international webinar on the ED and explaining the changes.

We acknowledge and agree that it would be difficult, if not impossible, to develop a single definition of Public Interest Entity (PIE) at a global level that can be consistently applied by all jurisdictions without modification and further refinement at a local level. We also acknowledge the outcome of the definition of PIE project will be critical and have significant interaction with other projects (e.g. Non-assurance Services and Fees projects).

We have had mixed views on the proposed broad approach. Some stakeholders have expressed concerns that the approach will drive increased differences between jurisdictions.

We have reached out to our small and medium practices (SMPs) and they have key concerns about the increased role of firms to determine if any additional entities should be treated as PIEs and new disclosure requirement in the proposed changes.

We encourage the IESBA to re-consider the impact of elevating the extant application material that encourages firms to determine whether to treat additional entities as PIEs to a requirement. For the proposed transparency disclosure requirement, we suggest the IEBSA to perform further analysis to ensure there is no unintended consequences.

To assist local bodies and firms to adopt and implement the new proposed requirement, we would appreciate the IESBA considering developing more comprehensive guidance material such as staff publications, FAQs and online training. These would help to explain the key changes in the proposed requirements and promote consistency in implementation across jurisdictions.

Our responses to the specific questions raised in the ED are set out in the Appendix for your consideration.

If you have any questions regarding the matters raised above, please contact Selene Ho, Deputy Director of the Standard Setting Department (selene@hkicpa.org.hk).

Yours faithfully,

Chris Joy
Executive Director

CJ/SH

HONG KONG INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS' COMMENTS ON THE IESBA'S EXPOSURE DRAFT ON PROPOSED REVISIONS TO THE DEFINITIONS OF LISTED ENTITY AND PUBLIC INTEREST ENTITY IN THE CODE

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?*

   Overall, we support the overarching objective set out in proposed paragraphs 400.8 and 400.9. However, the definition of "financial condition" is unclear and it may be interpreted differently by every stakeholder. It could also be challenging to distinguish the "financial condition" and other aspects of the entity as they may interlink in practice. For example, the poor financial condition of a property management company of a large-scale estate may create certain adverse impacts in other aspects (e.g. insurance, security, poor service quality), even though the residents may still be required to provide funding to support it. Financial failure of the property management company may expose residents to increase risk (e.g. Fire accidents, burglary) of financial loss.

   We would like to highlight that the auditor, in general, has no responsibility for the "financial condition" of the entity other than providing an audit opinion on the financial statements based on its audit work. However, following proposed paragraph 400.8, it may imply that the auditor has expanded responsibility in the public interest. Local stakeholders commented that confidence in the financial statements could be enhanced by improving the quality of audit, but not through expanding responsibilities of the auditors.

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 generally agreed with the proposed list of factors set out in paragraph 400.8 for determining the level of public interest in an entity. However, we have a concern about how the list of factors interact with R400.14 and R400.16. Our local SMPs also share their observation that certain factors are inconsistent and too wide, for example:

   - In "…The importance of the entity to the sector in which it operates... ", the word "sector" is not defined and it would be difficult to assess the "importance" of the entity without further context e.g. by market share.
   - In "…entity is subject to regulatory supervision designed to provide confidence that the entity will meet its financial obligation…", the regulatory supervision could be very wide in scope. It would be useful to give examples of regulatory supervision e.g. reporting on capital adequacy, liquidity
   - For the "*Size of the entity*", it would be helpful to provide further guidance by explaining the size of the entity is relative to what stakeholder base (e.g. sector or public as a whole) or base on the revenue or assets of the entity.
   - While certain factors consider the financial obligation to the public as a whole, some other factors extend to a specific sector, nature of stakeholders (e.g. customers and employees), or even to other sectors. It may increase the

judgement exercised at the firm level, and increase the inconsistency among firms, jurisdictions and at the global level.

We also note that the term "significant public interest" in 400.8- the word "significant" is judgemental and as currently drafted, it may create a confusion as to whether the IESBA is trying to define "Significant Public Interest Entity" or PIE in the proposal.

We would also recommend the IESBA to re-consider the location of the list of factors currently included in 400.8. Given that these factors are to be considered by local bodies and firms, we consider that including them in the introduction section might not be too appropriate. They should be elevated to the same level as the factors to be considered by firms in 400.16A1.

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 acknowledge and agree that it would be difficult, if not impossible, to develop a single definition of PIE at a global level that can be consistently applied by all jurisdictions without modification and further refinement at a local level.

   We have had mixed views on the proposed broad approach. Some stakeholders have expressed concerns that the approach will drive increased differences between jurisdictions. They are of the view that the extant provisions in the Code allow jurisdictions to add to the list of PIEs where necessary under local laws and regulations. Care should be taken in proposing changes to the extant Code. There are concerns that the approach will spill over to other sections of the Code and have unintended consequences.

   Further guidance on how local bodies should refine the list would be helpful. This would help stakeholders understand the rationale for the refinement and so as not to be seen to be applying the Code inconsistently.

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 generally support the proposals for the new term "publicly traded entity" replacing the term "listed entity" since it would expand the scope of an entity and reduce confusion. While we acknowledge it will difficult to harmonise the definition of PIE and publicly traded entity among international standard-setters (IESBA, IAASB and IASB), our stakeholders expressed that a more converged definition of PIE or publicly trade entity should be developed by international standard setters.

   A converged definition of PIE or public traded entity would be helpful to minimize the expectation gap on financial reporting and auditing among stakeholders.

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

   We generally support the categories under R400.14 (a) to (f) as the categories are generic and not over-prescriptive. However, some stakeholders would like to seek clarification on subparagraph R400.14(f) on what are the "law and regulation" referred to, as they could be very wide in scope.

   For example, a company that operates two bus routes would need to comply with a series of law and regulation (e.g. road-safety law), but its financial statements are not publicly available. The users of the financial statement may include investors and regulators. Shall the firm treat the bus company as a public interest entity as regulators rely on the audited financial statements for making decisions or regulatory purposes?

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 consider that the process of raising capital (e.g. ICO or IPO) should not be the criteria to define whether an entity is a PIE. Instead, the principle as stated in 400.8 and R400.16 should be applied to assess the target entity and whether the funds raised are of significant public interest.

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 acknowledge that the local bodies play a critical role to refine the PIE definition and implementation in each jurisdiction.

   The guidance in 400.15A1 discusses the role of local bodies in refining the PIE list. However, it is not clear from R400.15 that the "law or regulation" refers to the refined list of PIE which is to be determined by local bodies.

   Furthermore, a jurisdiction's law or regulation may define what is a PIE. However, the intention of the definition may not be for the purpose of requiring additional independence requirements on auditors.

   We would recommend the IESBA to clarify the requirement in R400.15.

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 consider it will be necessary for IESBA to develop non-authoritative guidance material (e.g. FAQ) and participate in focus group workshops to support local bodies before and during the implementation stage. It will be helpful for local standard setters to share experience and exchange their observations during the implementation stage – for example, how to devise an appropriate size test and what are the common issues faced.

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 received significant concern and disagreement from our stakeholders on the proposal to introduce a requirement for firms to determine if any additional entities should be treated as PIEs.

   Stakeholders from the SMP community highlighted that, unlike many other jurisdictions, Hong Kong requires a statutory audit for most of the entities and corporations. The proposed revision may impose a significant amount of cost and undue pressure on SMPs to assess whether each client is a PIE at the client acceptance and engagement continuance exercise.

   In practical terms, there is little incentive for a firm to define an entity as PIE at the firm level because it would incur additional cost and restrictions (e.g. EQCR) to the firm with little benefit. We may envisage that firms, especially micro-practice units and sole proprietors would likely conclude the entity as a non-PIE.

   Stakeholders also commented that the "reasonable and informed third party" approach would often be taken as hindsight. Regulators may question a firm as to why an entity in a certain industry has not been treated as a PIE where peers have treated entities in the same industry as a PIE before market practice or norms are established.

   We would recommend that the IESBA re-consider elevating the extant application material to a requirement. If the proposed requirement will be finalised as drafted, we recommend the IESBA to clarify that the requirement is only applicable where the firm has reasonable basis to conclude such entity should be treated as a PIE. Depending on the reasons for the determination, it may not be necessary to apply such determination to all the clients in the same industry.

   We also noted that while certain entities may be identified as PIEs under R400.16, it is not clear how an entity may be reclassified from a PIE to a non-PIE. We would recommend the IESBA to develop guidance or factors a firm would need to consider if it re-classifies an entity from PIE to non-PIE.

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

    We noted that certain factors in proposed paragraph 400.16 A1 may not be feasible. For example, it appears to be forward-looking for the auditor to determine whether the entity is likely to become a PIE in the near future.

    Stakeholders generally expect there would be a more robust guideline or comprehensive list of objective criteria from IEBSA or local bodies to help the firm to determine additional PIEs, if deemed necessary, for example, size test for the entities or other kind of objective indicators. It would help to reduce the risk and cost faced by the SMP in determining the PIE at the firm level.

    For example, if an SMP has 200 clients in total, it will require significant time and effort for the firm to consider the factors in the proposed paragraph 400.8 and 400.16 A1 and exercise professional judgment whether each client should be classified as PIE during annual engagement continuation exercise. While if there

are objective criteria and factors for such assessment, the information system could help to reduce the time and efforts.

Stakeholders also commented that while the proposed paragraph R400.16 outlines the factors that need to be considered by the firm in the determination of whether additional entities need to be treated as PIE, the introductory paragraph in 400.8 also provided certain factors. Thus, stakeholders are confused as to why the factors in 400.8 are not included in R400.16 as application material or how these paragraphs are interacting.

Transparency Requirement for Firms

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

We have concerns about the proposal for firms to disclose if they treat an audit client as a PIE as required by proposed paragraph R400.17. We are of the view that the benefits of having this disclosure is less than its potential cost and may lead to unintended consequences.

However, the proposal appears to create different levels of independence when performing an audit (i.e. PIE vs non-PIE), which is contradicting to the objective of the project. We acknowledge that there is no direct linkage between the additional independence requirements for PIE and quality of audit work (including the response to audit risk). However, having such a statement without providing additional context to users may create confusion and add to the expectation gap between stakeholders and auditors.

If the proposal is finalised, we envisage the IEBSA and local bodies would need significant time and effort to educate stakeholders on the meaning of the statement.

In addition, as currently drafted, it is not clear if the disclosure requirement is only for entities classified as PIEs under R400.16 or for PIEs under R400.14 and R400.15 as well.

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 mentioned in Question 11, we have some reservation about the proposed disclosure requirement. The determination to treat an entity as a PIE should be documented in firms' audit working paper or correspondence to regulators so that regulators can note such during their inspection or other regulatory activities.

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

We support the proposals not to review extant paragraph R400.20 at this stage and also not to make corresponding amendments to Part 4B of the Code.

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

Though we support the proposed effective date and acknowledge its interaction with the revisions to the Code for NAS and Fees, some stakeholders commented that the timeline would be tight as local bodies would need time to refine the definition and develop the extensive guideline or size test criteria, and firms would need time revise firms' policies to implement the revised Code.

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.

We support the overarching objective and achieving consistency and matching of terminology among the definition in the IESBA and IAASB Standards. As mentioned in Question 4, stakeholders are looking forward to a converged definition among different standards.

(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.

Given our comments in (a) above that we support a converged definition between the two boards' standards, we would support applying the case-by-case approach more broadly to other categories of PIEs.

(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?

Please refer to our responses in questions 11 and 12.

~ END ~