

EXPOSURE DRAFT NZAuASB 2017-3

PROPOSED AMENDMENTS TO THE DEFINITION OF A PUBLIC INTEREST ENTITY

(ED NZAuASB 2017-3)

Invitation to Comment

October 2017

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External Reporting Board
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Exposure Draft NZAuASB 2017-3 Proposed Amendments to the Definition of a Public Interest Entity	

Information for Respondents

Invitation to Comment

The New Zealand Auditing and Assurance Standards Board (NZAuASB)¹ is seeking comments on the specific matters raised in this Invitation to Comment. We will consider all comments before finalising amendments to the definition of a public interest entity.

If you want to comment, please supplement your opinions with detailed comments, whether supportive or critical of the proposals, as both supportive and critical comments are essential to a balanced view.

Comments are most useful if they indicate the specific paragraph to which they relate, contain a clear rationale and, where applicable, provide a suggestion for an alternative. Feel free to provide comments only for those questions, or issues that are relevant to you.

Submissions should be sent to:

Chief Executive
External Reporting Board
PO Box 11250
Manners St Central
Wellington 6142
New Zealand

Email: submissions@xrb.govt.nz

(please include the title of the Exposure Draft in the subject line)

We would appreciate receiving a copy of your submission in electronic form (preferably Microsoft Word format) as that helps us to efficiently collate and analyse comments.

Please note in your submission on whose behalf the submission is being made (for example, own behalf, a group of people, or an entity).

The closing date for submissions is 27 November 2017.

Publication of Submissions, the Official Information Act and the Privacy Act

We intend publishing all submissions on the XRB website (xrb.govt.nz), unless the submission may be defamatory. If you have any objection to publication of your submission, we will not publish it on the internet. However, it will remain subject to the Official Information Act 1982 and, therefore, it may be released in part or in full. The Privacy Act 1993 also applies.

If you have an objection to the release of any information contained in your submission, we would appreciate you identifying the parts of your submission to be withheld, and the grounds under the Official Information Act 1982 for doing so (e.g. that it would be likely to unfairly prejudice the commercial position of the person providing the information).

¹ The NZAuASB is a sub-Board of the External Reporting Board (XRB Board), and is responsible for setting auditing and assurance, including professional and ethical, standards.

List of Abbreviations

The following abbreviations are used in this Invitation to Comment.

ED	Exposure Draft
IESBA	International Ethics Standard Board for Accountants
IFRS	International Financial Reporting Standards
ITC	Invitation to comment
NZAuASB	New Zealand Auditing and Assurance Standards Board of the External Reporting Board
PES	Professional and Ethical Standard
PIE	Public Interest Entity

Questions for Respondents

1. Do you agree with the proposal to amend the New Zealand definition of 'a public interest entity' so that "voluntary" PIEs are no longer automatically caught within the public interest entity definition?
2. Do you agree with the proposed effective date? If not, why not, and what alternative do you propose?

1. Introduction

1.1 Purpose of this Invitation to Comment

1. The purpose of this ITC is to seek comments on proposed amendments to the definition of a Public Interest Entity (PIE) in New Zealand as described in ED NZAuASB 2017-3 *Proposed Amendments to the Definition of a Public Interest Entity* (the ED).

1.2 Reason for issuing this exposure draft

2. In May 2017, the NZAuASB issued an exposure draft ED 2017-1², proposing to amend the long association requirements in PES 1 (Revised).³ As part of this consultation, the NZAuASB sought feedback to inform its understanding of entities that elect, but are not required, to apply the tier 1 financial reporting requirements. This ITC refers to such entities as “voluntary PIEs”.
3. Almost all submissions received in response to ED 2017-1 raised concerns that including voluntary PIEs within the New Zealand PIE definition was not in the public interest and indicated possible unintended consequences of doing so. Submitters were strongly in favour of excluding “voluntary” PIEs from the New Zealand PIE definition.
4. The feedback received provided further information about the reasons why an entity may voluntarily elect to adopt the tier 1 requirements. The NZAuASB therefore now considers that excluding such entities from the New Zealand PIE definition is in the public interest.
5. This exposure draft seeks feedback on the proposed amendment to the definition of a PIE to exclude “voluntary” PIEs.

1.3 Timeline and next steps

6. Submissions on ED NZAuASB 2017-3 are due by **27 November 2017**. Information on how to make submissions is provided on page 3 of this ITC. The NZAuASB considers that a 30-day consultation period is appropriate, given that this matter was explored in ED NZAuASB 2017-1, the proposals are consistent with the feedback received in response to that ED and due to the limited nature of the proposed amendment.
7. The NZAuASB will consider the submissions received immediately after the consultation period ends.
8. The NZAuASB proposes that the amendment to the definition of public interest entity will be effective on 15 December 2018, to align with the proposed changes to the long association requirements.

2. Overview of ED NZAuASB 2017-3

9. The international Code of Ethics defines PIEs as
 - a) all listed entities; and

² ED NZAuASB 2017 -1 *Proposed Amendments to Professional and Ethical Standard 1 (Revised) Provisions Addressing the Long Association of Personnel with an Assurance Client*

³ PES 1 (Revised), Code of Ethics for Assurance Practitioners

- b) any entity:
- i. defined by regulation or legislation as a public interest entity; or
 - ii. 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 IESBA has the expectation that national standard setters will adopt a definition that is appropriate for their jurisdiction.

10. The International Code also states that:

"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 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.

11. The definition of a PIE is significant because it determines which independence requirements an auditor is required to apply. The independence requirements are more stringent where the auditor is engaged to conduct an assurance engagement for an entity that is a PIE. These more stringent requirements impact on:⁴

- the provision of various non-assurance services;
- employment with an audit client; and
- the long association requirements.

12. When the NZAuASB decided to revise PES 1 to align more closely with the IESBA Code in 2012, the NZAuASB sought feedback about and deliberated on the appropriate definition of a PIE in the New Zealand context. The NZAuASB decided to align the definition of a PIE with all those entities that report using the tier 1 financial reporting requirements as per the accounting standards framework.⁵ The XRB had determined and included entities in tier 1 based on whether or not such an entity was considered to have public accountability. The XRB had performed a cost benefit analysis to identify tier 1 entities. Publicly accountable entities are required to apply the highest financial reporting requirements. It was therefore agreed that it was appropriate and in the public interest that the auditor of such entities apply the most stringent independence criteria.

13. At that time, the NZAuASB was in favour of applying the stricter independence requirements to all entities that are required *or that elect* to apply the tier 1 accounting requirements. The NZAuASB considered that if an entity held itself out to apply the highest requirements, the auditor should similarly be held to the highest standards.

14. However, in response to the ED NZAuASB 2017 -1, almost all respondents did not consider that including "voluntary" PIEs within the New Zealand PIE definition was in the public interest.

⁴ A summary of the prohibitions that apply to PIEs is available on the [IFAC website](#).

⁵ Further background information can be found in the "[Explanation of Decisions made by the NZAuASB in finalising PES 1](#)" document on the XRB website.

15. Entities choose to apply the tier 1 financial reporting requirements for various reasons. These include:
 - Ease of reporting to parent entities;
 - Compliance with an incorporation/formation document;
 - Meeting group reporting requirements;
 - Allowing greater comparison with both national and international competitors;
 - Expecting to ultimately be in a position where tier 1 reporting will be mandatory and do not wish to transition;
 - Believing tier 1 reporting requirements produce a better set of financial statements.
16. An unintended consequence of including “voluntary” PIEs in the definition of a public interest entity may be a reduction in the quality of financial reporting, in that an entity that may otherwise apply the tier 1 reporting requirements is instead applying the tier 2 requirements. In these cases, the independence rules for the auditor have impacted on the accounting requirements selected by the preparer. Entities have been penalised by their choice to prepare better quality financial reports.
17. “Voluntary” PIEs do not necessarily have the same characteristics as those entities that are required to apply the tier 1 requirements, that is, they do not have public accountability in fact, and therefore the impact of their activities on the public interest is decreased.
18. The NZAuASB adopts the international standards and therefore will only make limited amendments to those international standards where there is a compelling reason to do so. Changes to independence requirements have impacted on the compelling reasons previously identified so that the NZAuASB no longer considers that the compelling reason test will be met. The NZAuASB therefore proposes to exclude “voluntary” PIEs from the New Zealand PIE definition. Including “voluntary” PIEs broadens the New Zealand definition beyond the guidance and the intention of the IESBA Code. In other jurisdictions, there will be entities that apply full IFRS but that are not defined as a PIE. Including “voluntary” PIEs results in the New Zealand definition being broader than in other jurisdictions and including entities that are not captured by the intent of the international requirements.
19. Accordingly, the NZAuASB believes that it is appropriate and responsive to concerns expressed to revise the definition of public interest entity in New Zealand to exclude “voluntarily” PIEs from the definition.



**NZ AUDITING
AND ASSURANCE
STANDARDS BOARD**

**EXPOSURE DRAFT NZAUASB 2017-3
PROPOSED AMENDMENTS TO THE DEFINITION OF A PUBLIC INTEREST ENTITY**

CONTENTS

A: INTRODUCTION

**B: PROPOSED AMENDMENTS TO THE DEFINITIO OF A PUBLIC
INTEREST ENTITY**

C: EFFECTIVE DATE

A: INTRODUCTION

This document sets out proposed amendments to the definition of ‘public interest entity’ in Professional and Ethical Standard 1 (Revised), *Code of Ethics for Assurance Practitioners*. Amended paragraphs are shown with new text underlined and deleted text struck through.

B: PROPOSED AMENDMENTS TO THE DEFINITION OF A PUBLIC INTEREST ENTITY

B.1 PES 1 (Revised) Code of Ethics for Assurance Practitioners

DEFINITION

[NZ] Public interest entity Any entity that meets the Tier 1 criteria in accordance with XRB A1¹ and is not eligible to report in accordance with the accounting requirements of another tier is required or opts to prepare financial statements to comply with Tier 1 For profit Accounting Requirements or Tier 1 PBE Accounting Requirements in accordance with XRB A1.

¹ XRB A1 Application of the Accounting Standards Framework

NZ290.25 Section 290 contains additional provisions that reflect the extent of public interest in certain entities. For the purpose of this section, public interest entities include entities that have public accountability, are deemed to have public accountability or are of economic significance. In New Zealand, the following entities are deemed to be Public Interest Entities:

- Any entity that meets the Tier 1 criteria in accordance with XRB A1⁶ and is not eligible to report in accordance with the accounting requirements of another tier required or opts to prepare financial statements to comply with Tier 1 For profit Accounting Requirements or Tier 1 PBE⁷ Accounting Requirements in accordance with XRB A1⁸.

NZ291.3.1 Section 291 contains additional provisions that reflect the extent of public interest in certain entities. For the purpose of this section, public interest entities include entities that have public accountability, are deemed to have public accountability or are of economic significance. In New Zealand, the following entities are deemed to be Public Interest Entities:

- Any entity that meets the Tier 1 criteria in accordance with XRB A1⁹ and is not eligible to report in accordance with the accounting requirements of another tier required or opts to prepare financial statements to comply with Tier 1 For profit Accounting Requirements or Tier 1 PBE Accounting Requirements in accordance with XRB A1¹⁰.

B.2 PES 3 (Amended) Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance Engagements

Definitions

[NZ12.7] Public interest entity - Any entity that meets the Tier 1 criteria in accordance with XRB A1 and is not eligible to report in accordance with the accounting

⁶ XRB A1 Application of the Accounting Standards Framework.

⁷ Public Benefit Entity

⁸ ~~XRB A1 Application of the Accounting Standards Framework.~~

⁹ XRB A1 Application of the Accounting Standards Framework.

¹⁰ ~~XRB A1 Application of the Accounting Standards Framework.~~

~~requirements of another tier required or opts to prepare financial statements to
comply with Tier 1 For-profit Accounting Requirements or Tier 1 PBE
Accounting Requirements in accordance with XRB A1.~~

C: EFFECTIVE DATE

The revised definition of a ‘public interest entity’ and related changes will be effective on **15 December 2018**.