

Understanding the BEIS consultation

‘Restoring trust in audit and corporate governance’

A series of frequently asked questions on the key proposals

Expanding the definition of a Public Interest Entity

Introduction

On 18 March 2021, the Government (BEIS) published its long-awaited consultation on reforms aimed at ‘Restoring trust in audit and corporate governance’ (the Consultation). It’s a significant Consultation with 98 questions covering almost all 155 recommendations from the Kingman, CMA and Brydon reviews, and sets out a broad programme of reform for auditors, companies, directors, audit committees, investors, other stakeholders and the regulator. The deadline for responses to the Consultation was 8 July 2021. See our [summary briefing document](#) for more details of the key proposals.

These ‘frequently asked questions’ are part of a series intended to help you understand the implications of these proposals in more detail.

This is not an exhaustive list, and we’re sure there will be plenty of questions we’ve not yet thought about. Our answers are based on our interpretation of the Government’s proposals.

There’s also still a lot of uncertainty about what will be implemented, and the details of any new regime; the thoughts we’ve set out below are designed to help you think through the implications for your organisation, but please do remember that the final rules could well result in a different outcome.

One of the most significant proposals of the Consultation is to expand the definition of a Public Interest Entity. Here we’ve explained what new requirements might be applicable to Public Interest Entities, as well as how the definition of Public Interest Entity might change.

If you would like to discuss any of these points further, please ask your usual PwC contact, or alternatively you can contact:

Sotiris Kroustis

PwC UK Head of Public Policy
sotiris.kroustis@pwc.com

Gilly Lord

Global Leader, Public Policy & Regulation
gillian.lord@pwc.com

Jayne Kerr

Director, Audit Strategy and Public Policy
jayne.l.kerr@pwc.com

Definition of a PIE

1 What's today's definition of a UK PIE and what regimes do today's PIEs have to follow?

Public Interest Entities or 'PIEs' are currently defined as:

- entities whose transferable securities are admitted to trading on a UK regulated market (informally – companies with listed equity or debt on the London Stock Exchange);
- credit institutions (informally – banks); or
- insurance undertakings.

(Note that some large private and AIM companies are considered 'Other Entities of Public Interest' (OEPIs) because, although they don't meet the current definition of a PIE, they could be of significant interest to wider stakeholders. OEPIs already have to apply certain PIE restrictions, this is covered in more detail in questions 3, 10, 11 and 12 below).

PIEs face a number of legal and regulatory requirements over and above those faced by other companies. These cover corporate reporting, audit and governance requirements. (There are also some requirements that apply only to listed PIEs but we have not covered these in this paper).

The key requirements that apply to today's PIEs are detailed in an appendix, but in summary:

Governance requirements

PIEs must have an audit committee with a majority of independent members, and at least one member with competence in accounting or auditing.

Proposed expanded definition

2 How does the Consultation suggest that the definition of a PIE might be changed?

As we've described above, right now, only entities listed on the London Stock Exchange, banks and insurers are considered PIEs under the current UK regime. However, the Government is proposing to expand the PIE definition to include large private companies and large AIM companies as well as potentially some 'Third Sector' organisations (see questions 13 and 14 below).

Private companies

The Consultation sets out two possible options for size thresholds to be included in an expanded PIE definition; if a UK private company met the threshold, it would be deemed a PIE:

Option 1: To adopt the test already used to identify those large private companies that are required to include a corporate governance statement in their directors' report. That provision covers all companies with either:

- more than 2,000 employees; or
- a turnover of more than £200 million and a balance sheet of more than £2 billion.

Corporate reporting requirements

PIEs with over 500 employees must include a non-financial information statement in their strategic report.

Audit requirements

- PIEs must re-tender their audit appointment every 10 years and rotate the audit firm every 20 years.
- The FRC must inspect PIE auditors at least once every three years.
- There are extensive restrictions on the non-audit services that auditors of PIEs can provide. Only those services on a short permissible list (included in the FRC's Ethical Standard) can be provided, with a cap on the level of fees that can be earned from non-audit services.
- The Ethical Standard also imposes strict rules on the tenure of audit partners and staff and requirements for cooling off periods between employment by the audit firm and employment by the audited entity.
- A number of UK Auditing Standards contain specific requirements in relation to PIEs which increase the level of review and reporting required from the auditor. Notably, PIE auditors are required to issue a public 'extended audit report', setting out the details of the key audit matters considered, amongst other areas.

The Government estimates that this would result in c.1,960 entities being brought within the definition of a PIE.

Option 2: To adopt a narrower test based on the threshold for additional non-financial reporting requirements for existing PIEs.

This would mean the definition of PIE was expanded to cover large companies with both:

- over 500 employees; and
- a turnover of more than £500 million.

The Government estimates that this would result in c.1,060 additional entities being designated as a PIE.

The Consultation includes a question asking which of these two thresholds should be used or, indeed, if there could be other options.

AIM companies

The proposed threshold for an AIM company to become a PIE is that it has a market capitalisation of over €200million.

3 Would private companies be assessed against these thresholds at the individual company level or at the group level?

When assessing if these thresholds are met, the tests would be applied to companies in their own right and also, in the case of parent companies, the tests would be applied to the consolidated group.

If the group exceeds the thresholds, it is proposed that the parent would qualify as a PIE if it is required to file group accounts in the UK. It should be noted that this is

different to the existing tests for PIEs and Other Entities of Public Interest ('OEPIs' – see questions 10, 11 and 12 for more details on OEPIs) which are applied at the entity level only.

4 Over what period or periods would the size thresholds be applied when determining if a company becomes or ceases to be a PIE?

The Consultation tells us that the Government will consider an appropriate period over which the thresholds must be met in determining whether an organisation has become a PIE, but there is no definitive indication of what that period will be. An example is given that large companies and AIM listed companies might be required to meet the thresholds for three consecutive financial

years or for two out of the last three years, before qualifying to be a PIE. Similar provisions might be applied for ceasing to qualify as a PIE where these are not met.

'New PIE' requirements

5 What would this mean for large private UK companies and groups? Will they have to comply with all of the existing requirements?

Whether the new population of PIEs has to comply with all of the existing requirements of PIEs will depend on the exact mechanism used to enact the new PIE definition. In the Consultation, the Government does propose that an expanded PIE definition would operate to 'extend the scope of existing audit and corporate reporting requirements to the new population of PIEs'.

In addition, in the Government's impact assessment that accompanies the Consultation, the modelling assumes that the new population of PIEs will incur costs associated with reallocation of non-audit services, audit committee appointment and meeting costs, costs from compliance with additional regulatory requirements, costs of mandatory firm rotation and costs of meeting reporting requirements under the Non-Financial Reporting Directive. All of this suggests that it's probable that new PIEs will be subject to the same regimes faced by existing PIEs (unless specific carve-outs are created).

It is worth noting that certain large private companies already have to report annually on their corporate governance arrangements under The Companies (Miscellaneous Reporting) Regulations 2018 because they meet the size criteria set out in Option 1 above.

These entities would also qualify as OEPIs under the Ethical Standard 2019 and so already have to comply with the non-audit service restrictions that are applicable to PIEs (with the exception of the 70% fee cap).

6 The Consultation sets out a number of new proposals that would apply to existing PIEs. Would these new proposals also apply to large private companies if they become PIEs under the expanded definition?

As noted in question 5 above, the Consultation proposes that the existing auditing and corporate reporting requirements applicable to today's PIEs would extend to the 'new PIEs' under the expanded definition. It also goes on to say that the expanded definition would 'generally frame the scope of any new regulatory measures in relation to audit, corporate reporting and corporate governance as set out in the Consultation (except where there is good reason to take a different approach)'. This last sentence seems to suggest that the new PIEs proposed in the Consultation would be subject to most of the new requirements set out by the Consultation. These new requirements include the proposals that directors should make a statement about the effectiveness of internal control over financial reporting ('UK SOx'), new

disclosure requirements around resilience, fraud and capital maintenance; and increased accountability and regulatory enforcement for directors.

However, we note that the drafting of this sentence is perhaps deliberately non-specific and that this may mean that there could be flexibility in application.

A potential policy outcome (responsive to the need for a proportionate regime) could be that a sub-category of larger PIEs applies all of the new requirements, with smaller PIEs only subject to a core set of less onerous requirements.

PIEs in groups

7 What if more than one company within a group is designated to be a PIE under the expanded definition? Would all of the requirements apply to every PIE in the group?

Under the current PIE regime, PIEs are defined at an entity level. If an entity is designated a PIE, then that entity must apply all of the PIE requirements regardless of whether there are other PIEs in the same group.

If this same approach were to be applied in respect of the new requirements, we anticipate that some complexity might arise.

For example, a group containing more than one PIE might wish to take a group-wide approach to a UK internal controls attestation ('UK SOx'); having to scope and execute a UK SOx approach for two different statutory entities could be significantly more complex.

The Consultation acknowledges that where there is more than one PIE in a group, there may need to be differences in how individual requirements apply to PIEs that are part of a group (the example given is that corporate reporting requirements will differ for parent companies who may be required to report in respect of the group). However, at this stage there is no clarity on what the approach may be.

8 What happens in a situation where a UK group is already headed by an existing PIE (a listed company for example) but a subsidiary in the group meets the private company PIE threshold and becomes a new PIE under the expanded definition?

In this situation, which we expect could be relatively common in large UK listed groups, the subsidiary which becomes a new PIE may already have been indirectly impacted by some existing PIE requirements.

For example, the parent company in the group will already be subject to the mandatory audit firm rotation requirements, and it's likely that the changes in the audit firm at the parent level may also have been made at subsidiary level. Restrictions in the provision of non-audit services (applicable to existing PIEs) also apply to all subsidiaries of PIEs, so again, these requirements will already have been implemented at the subsidiary.

However, there are plenty of other existing requirements (such as the need for an audit committee, publication of a non-financial information statement and an extended auditor report) which will not have been applied at the subsidiary level. In addition, the new PIE requirements will apply at both the parent and subsidiary PIE level – subject to the commentary set out in our answer to question 7 (above).

9 I'm the director of a UK company that's owned by an overseas listed group. My company is likely to become a UK PIE under the new definitions. If we have to apply the mandatory audit firm rotation regime and change our audit firm in the UK, what will this mean for the auditor of our parent company?

Where a UK subsidiary of an overseas parent becomes a PIE under an expanded definition, that PIE would be subject to the mandatory firm rotation rules in the UK.

However the overseas parent will not be subject to the UK mandatory firm rotation rules, so this means that although the audit firm of the UK subsidiary will have to rotate at some point, the overseas parent will not be forced to change audit firm. This could lead to having different audit firms performing audits in different parts of the group.

In some overseas territories, regulators have imposed their own audit firm rotation regimes, so it's also possible that the parent could already be subject to a different rotation approach, adding further complexity. Currently, the Consultation does not contemplate any exemptions for subsidiary PIEs impacted by this type of situation.

10 What about the restrictions on provision of non-audit services? If I'm a director of a UK PIE, do these restrictions impact other companies in the group?

Assuming that the current approach set out in the Ethical Standard is followed, the restrictions on provision of non-audit services would apply to the PIE, to a UK parent of the PIE, and to all subsidiaries of the PIE (whether they are in the UK or elsewhere in the world).

OEPIs

11 What will happen to the category of OEPIs under the new proposal?

The FRC Ethical Standard 2019 introduced a new category of UK companies – 'Other Entities of Public Interest (OEPIs)'. OEPIs have to apply the same restrictions on non-audit services provided by their auditor as those applicable to PIEs, with the exception of the 70% fee cap.

The Ethical Standard defines OEPIs as including larger private companies – with the thresholds being those used in Option 1 for the expanded PIE definition as set out in the Consultation (see question 2 above).

If the Government goes ahead and uses Option 1 for the new PIE definition, then many companies who had previously categorised themselves as OEPIs would become PIEs under this new definition. Even if the Government opts for Option 2, many existing OEPIs (those with high turnover) would become PIEs.

These OEPIs would most likely have to abide by all of the requirements of a PIE, including mandatory firm rotation and the 70% fee cap on non-audit services. They would also be subject to many of the new proposals in the Consultation.

So, if you're a director of a current OEPI, and your company is likely to become a new PIE, there will be plenty of new requirements for you to tackle.

We don't know yet whether the FRC will continue to identify certain companies as OEPIs, over and above the new definition of PIE that the Consultation contemplates.

12 I'm an OEPI owned by a PE house, and we benefit from the 'carve out' in the Ethical Standard – what will happen to this carve out?

The FRC Ethical Standard 2019 contains a 'carve out' allowance for OEPIs that are owned by private equity (PE) houses. Normally, an OEPI would be subject to restrictions on non-audit services that their audit firm can provide – and the UK parent of the OEPI would be subject to the same restrictions.

However, the carve out allowance for OEPIs owned by PE houses allows that even restricted services can be provided by the OEPI audit firm to the UK PE house parent (and other portfolio companies) as long as those services are not in respect of, or relevant to the OEPI itself, or its subject matter.

This allowance for PE houses that invest in OEPIs is embedded in the Ethical Standard 2019. If certain of these OEPIs are designated as PIEs in the legislation that implements the Government's proposals, it is not clear whether the carve out will remain valid.

AIM Companies

13 What would be the impact on AIM companies that qualify to be PIEs?

The Consultation suggests that AIM companies that would qualify as PIEs under the new regime would face the same requirements as any other PIE. Some AIM companies are already considered to be OEPIs and so for these companies, as we explain in question 11 above, the restrictions on non-audit services will not be new.

In addition, AIM companies also have to apply and report against a recognised governance code under AIM Rule 26; this means that some will already have an audit committee that would comply with the requirements for

PIE audit committees. AIM companies are also already subject to the FRC's Corporate Reporting Review process and their auditors are already subject to the FRC's Audit Quality Review process and Audit Enforcement Procedures and certain auditing standard requirements, including having an extended audit report.

However, AIM companies are not currently subject to a mandatory audit firm rotation regime, and this, together with the new PIE requirements will create new demands for AIM companies that are designated as PIEs.

Other entities

14 Which other entities might be considered as new PIEs under the proposal?

The Consultation states that the Government is open to 'Third Sector entities' (for example certain universities, charities and housing associations) being classed as PIEs where they meet a certain threshold. This may be a different threshold to those proposed above for private companies, given the different nature of their activities.

The Consultation asks what a suitable threshold might be, suggesting that £100m of 'incoming resources' could be used (this is the threshold the FRC used until 2016 to determine which audits of charities to inspect).

At the moment, the Government is not considering any further types of entity that might be added to the PIE definition, but is open to arguments that other types of entities should be included as PIEs if there is a strong public interest in those entities being subject to more stringent regulation. There has been some speculation that large LLPs (which would include audit and law firms) could be considered for inclusion.

Appendix

PIEs face a number of legal and regulatory requirements over and above those faced by other companies. These cover corporate reporting, audit and governance requirements. The key requirements that apply to today's PIEs are outlined below. (There are also some requirements that apply only to listed PIEs but we have not covered these in this paper).

Governance requirements

- **The FCA Disclosure Guidance and Transparency Rules (DTR) and the PRA Rulebook** require that a PIE must have a body that carries out the role of an audit committee, including monitoring financial reporting and the arrangements for the statutory audit. At least a majority of the members (and in some cases all) must be independent and at least one member must have competence in accounting or auditing, or both. The members as a whole must have competence relevant to the sector in which the issuer is operating.

Corporate Reporting requirements

- **s414CA of the Companies Act 2006** – PIEs with over 500 employees are required to include a non-financial information statement in their strategic report.

Requirements relating to the audit or auditor of a PIE

- **s494ZA of the Companies Act 2006** – sets out tendering and audit firm rotation regulations for PIEs and provisions related to the conduct of an audit tender. Most significantly, there's a requirement to re-tender the PIE company's audit appointment every 10 years and rotate the audit firm every 20 years.
- **Article 3 of The Statutory Auditors and Third Country Auditors Regulations 2016 (SATCAR)** – includes a requirement for the regulator (currently the FRC) to take direct responsibility for inspecting, investigating and imposing sanctions in relation to all audits, including PIEs. This includes the Audit Quality Reviews (AQR) inspection programme that covers all auditors of PIEs at least once every three years.
- **The FRC's Ethical Standard – Revised 2019** – the revised Standard became effective on 15 March 2020 and, for PIEs, introduced a list of permissible non-audit services that auditors of PIEs could provide (some are services required by law or regulation, some are not); auditors of PIEs are not permitted to provide any other non-audit services to that PIE or its related entities. All services require approval by the audit committee or equivalent body. The list of the permissible services being provided applies up and down the control chain:
 - Upstream entities of the PIE within the UK;
 - Downstream controlled entities of the PIE, wherever located in the world.

There is also a cap on how many of the permissible services that are not required by law and regulation can be provided by the auditor (the cap is set at 70% of the audit fee, with some complex rules about how the cap should be calculated).

The FRC's Ethical Standard also includes stricter rules for PIEs on tenure of audit partners and staff and the period before which they can return to the audit; greater restrictions and requirements for cooling off periods between employment by the audit firm and employment by the audited entity; and a cap on fees for non-audit services when compared to audit services.

A number of UK Auditing Standards contain specific requirements in relation to PIEs, these include:

- **ISA (UK) 220 'Quality control for an audit of financial statements'** – requires additional consideration of the Engagement Quality Control Reviewer (in PwC, the Quality Review Partner) of areas, at both the group and component level, such as the independence of the auditor from the company, the nature and scope of corrected and uncorrected misstatements identified and the reasoning of the key audit partner with regard to materiality and significant risks.
- **ISA (UK) 260 'Communication with those charged with governance'** – requires that the PIE auditor submit an additional report to the audit committee, or those charged with governance, on matters including a declaration of independence, a description of the scope and timing of the audit, the audit methodology used, materiality used, any significant difficulties encountered in the course of the audit; any significant matters or deficiencies arising.
- **ISA (UK) 700 'Forming an opinion and reporting on financial statements'** – requires that the auditor's report for PIEs shall include certain additional information, including by whom the auditor was appointed, the date of appointment and uninterrupted tenure, a declaration that no prohibited non-audit services were provided and that the audit firm remained independent in conducting the audit, as well as setting out any services, in addition to the audit, which were provided by the firm but are not disclosed in the annual report or financial statements.
- **ISA 701 – 'Communicating key audit matters in the independent auditor's report'** – requires extended auditor reporting, where an auditor describes the key audit matters, materiality and scoping process in their public auditor's report. Although primarily intended by the auditing standard setters for listed entities, this requirement is also applicable to the current population of unlisted PIEs, i.e. the banks and insurers noted in the definition above.