



**The Japanese Institute of
Certified Public Accountants**

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Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
Washington DC 20006-2803
USA

Re: JICPA Comments on the PCAOB Rulemaking Docket Matter No. 034

The Japanese Institute of Certified Public Accountants (“we”, “our” and “JICPA”) is grateful for the opportunity to comment on the Public Company Accounting Oversight Board (“PCAOB”) Rulemaking Docket Matter No. 034: *Proposed Auditing Standards – The Auditor’s Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion, The Auditor’s Responsibilities Regarding Other Information in Certain Documents Containing Audited Financial Statements and the Related Auditor’s Report, and Related Amendments to PCAOB Standards* (“the Proposed Standards”).

The discussion enhancing the information value of the auditor’s report takes place around the world. In addition, due to globalization of the reporting entities’ activities, consistency between the auditors’ reports is becoming more critical. If the auditors’ reports significantly differ in form or content according to the auditing standards with which auditors comply, auditors and users alike may be seriously confounded. The resulting confusion would surely not be in the public interest. We encourage the PCAOB to collaborate with the IAASB, a body engaged in a similar project focused on revisions for auditor reporting, and to align both standards by reducing unnecessary differences insofar as possible.

JICPA is responding to the Proposed Standards for two principal reasons. First, any JICPA members registered with the PCAOB would be directly affected by new standards. Second, we believe it is important to seek international solution as possible to maintain the consistency in the auditor’s report globally, in order to protect the interests of investors and further the public interest. Below we provide comments to specific questions from Appendix 5 of the Proposed Standards: *Additional Discussion of the Proposed Auditor Reporting Standard, Proposed Amendments to PCAOB Standards, and Comments on the Concept Release* that we consider especially relevant from Japanese or international perspective.

Sincerely yours,

Sayaka Sumida
Executive Board Member - Auditing Standards
The Japanese Institute of Certified Public Accountants

Our Comments to Specific Questions in Appendix 5
Additional Discussion of the Proposed Auditor Reporting Standard, Proposed Amendments to PCAOB Standards, and Comments on the Concept Release

Definition / Determination of Critical Audit Matter

12. Is the definition of a critical audit matter sufficient for purposes of achieving the objectives of providing relevant and useful information to investors and other financial statement users in the auditor's report? Is the definition of a critical audit matter sufficiently clear for determining what would be a critical audit matter? Is the use of the word "most" understood as it relates to the definition of critical audit matters?
14. Are the proposed requirements regarding the auditor's determination and communication of critical audit matters sufficiently clear in the proposed standard? Why or why not? If not, how should the proposed requirements be revised?
16. Are the factors helpful in assisting the auditor in determining which matters in the audit would be critical audit matters? Why or why not?

We understand that paragraphs 7 to 9 of the proposed Auditor Reporting Standard, in conjunction with the definition of a “critical audit matter”, are designed to guide the decision-making process by which the auditor determines critical audit matters. Critical audit matters seem to be similar, conceptually, to the “key audit matters” that the IAASB proposed. Yet the two concepts do not appear to be identical, and it is not clear whether or not there are any substantial differences. Any unnecessary differences would confuse not only an investor who read and analyzes financial statements and auditors’ reports, but also any auditor who audits a company listed on more than one market and accordingly needs to issue the auditor’s report in accordance with both the PCAOB standards and the ISAs. We believe that unnecessary differences should be eliminated insofar as possible, and that any necessary differences should be explicitly clarified and explained.

Audit Procedures, including Resolution of the Critical Audit matter

15. Would including the audit procedures performed, including resolution of the critical audit matter, in the communication of critical audit matters in the auditor's report be informative and useful? Why or why not?

We do not believe that it would be informative or useful to include the audit procedures performed, including resolution of the critical audit matters in the auditor’s report. Following are our reasons for this opinion:

- It is difficult to avoid the impression that the auditor expresses an opinion on that individual matter, even if the language preceding the Critical Audit Matters section explains otherwise.
- It is difficult to summarize the procedures performed in succinct way, particularly in complex, judgmental areas of the audit. Information which summarized only parts of the procedures performed is likely to mislead the users about a complete picture of the auditor’s response to the identified risks.
- If the auditor is allowed to include the audit procedures and the results of the procedures in the description of critical audit matters, it creates a situation where only some descriptions include the procedures and the results of the procedures, and as a result users may misinterpret that there are unresolved issues on the critical audit matter where the audit

procedures and the results of the procedures are not included in the description of the critical audit matter.

To avoid these unintended consequences, the PCAOB should clearly state that inclusion of the audit procedures, including the auditors' approaches and the result of the audit procedures should not be allowed. Likewise, the PCAOB should remove the descriptions of the audit procedures from the illustrative examples.

Audit Documentations

19. Does the proposed documentation requirement for non-reported audit matters that would appear to meet the definition of a critical audit matter achieve the Board's intent of encouraging auditors to consider in a thoughtful and careful manner whether audit matters are critical audit matters? If not, what changes should the Board make to the proposed documentation requirement to achieve the Board's intent?

We do not believe the proposed documentation requirement for non-reported audit matters would produce the outcome that the PCAOB expects. The Note to paragraph 14 of the proposed Auditor Reporting Standard and Section V. E. of Appendix 5 state that the auditor would not be expected to provide an explanation for each matter documented in the engagement completion document, reviewed by the engagement quality reviewer, or communicated to the audit committee. They also state that the auditor would be expected to document only those matters that would "appear to meet the definition of a critical audit matter."

However, whether or not an audit matter "appears to meet the definition of a critical audit matter" depends on the auditor's professional judgment, which is inherently subjective. As such, we do not believe that this condition would work effectively. Given the possibility that the auditor's judgments are second-guessed, the auditor would, for example in a preventive manner prepare an extensive amount of unnecessary documentation, or increase the number of critical audit matters disclosed in the auditor's report, and this may result in a considerable burden.

Critical audit matters are those matters the auditor addressed during the audit of the financial statements, which are selected in light of relative significance in the particular period's audit. The auditor must identify all significant findings or issues in an engagement completion document in accordance with Auditing Standard No. 3, and the engagement quality reviewer should review the engagement completion document in accordance with Auditing Standard No. 7. Therefore, requiring documentation of the basis for the auditor's determination that each reported matter was a critical audit matter would be sufficient to achieve the Board's intent of encouraging auditors to consider in a thoughtful and careful manner whether audit matters are critical audit matters. We believe the proposed documentation requirement for non-reported audit matters is not necessary and accordingly, should be deleted.

Illustrative Examples of Critical Audit Matters

25. Do the illustrative examples in the Exhibit to this Appendix provide useful and relevant information of critical audit matters and at an appropriate level of detail? Why or why not?

We have a comment on the status of the illustrative examples, which are included in the Exhibit to Appendix 5 but not in the proposed Auditor Reporting Standard. We believe that the illustrative examples play an important function in both informing the auditor's decision-making process and helping stakeholders' reach a common understanding. We also support the PCAOB's approach to include the illustrative examples with the information

regarding the company's related notes to the financial statements. The examples give the auditors and other relevant stakeholders guidance on the level of description that can reasonably be expected, by showing the relationship between the individual critical audit matter and the related disclosure in the financial statements. We therefore recommend that the PCAOB update the illustrative examples and include them in the final standard together with the information on the company's related notes to the financial statements.

We comment on the contents of the illustrative examples in our responses to questions 15 and 27.

Disclosing Information that Otherwise would not Have Required Disclosure under Existing Auditor and Financial Reporting Standards

27. What benefits or unintended consequences would be associated with requiring auditors to communicate critical audit matters that could result in disclosing information that otherwise would not have required disclosure under existing auditor and financial reporting standards, such as the examples in this Appendix, possible illegal acts, or resolved disagreements with management? Are there other examples of such matters? If there are unintended consequences, what changes could the Board make to overcome them?

First, absent a requirement for the entity to disclose such information, we expect that the auditor would encounter considerable difficulty in disclosing the information in the auditor's report unless the company agreed to disclose the information voluntarily. Given that such matters are likely to be sensitive information for the company to disclose, the company would not be likely to agree to disclose the information in its financial statements.

Second, if information that would not otherwise have to be disclosed under the existing auditor and financial reporting standards would be disclosed as a critical audit matter, a contradiction would emerge between the requirements regarding the communication of critical audit matters and other disclosure mechanisms already in place in the financial reporting system. The example in the Appendix suggests that a deficiency in internal control over financial reporting could be disclosed in the description of critical audit matters in the auditor's report, even if it was not otherwise determined to be a material weakness in accordance with the SEC rule and PCAOB auditing standards under Section 404 of the Sarbanes-Oxley Act of 2002 (internal control reporting requirements). This means that the requirements for critical audit matters would effectively defeat both the purpose of and expected benefits from the internal control reporting requirements. Under internal control reporting requirements, for example, management is required to assess internal control over financial reporting as of the year-end rather than throughout the entire period. We understand that this provides an incentive for management to remedy identified deficiencies before the year-end. The description of critical audit matters, however, could include information about a material weakness that had been remedied before the year-end or a significant deficiency that had been identified during the year, even when the disclosure of the deficiency was not required by the internal control reporting requirements.

We do not believe that the auditor should provide original information about an entity that otherwise would not have required disclosure under financial reporting standards, through the communication of critical audit matters. However, if such disclosure is envisaged, the PCAOB should more clearly describe the cases when it would be necessary to disclose such information. Specifically, it should clarify the relationship between the requirements in the auditing standards regarding the communication of critical audit matters, and the ethical requirements regarding confidentiality. The PCAOB should also clarify, at minimum, it is inappropriate to disclose

information in the description of critical audit matters that other existing reporting requirements have already dealt with. From this standpoint, we believe that the reference to the control deficiency in the illustrative examples should be deleted.