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September 11, 2014
Ms. Kathleen Healy
Technical Director
International Auditing and Assurance Standards Board
International Federation of Accountants
529 5th Avenue, 6th Floor
New York, NY 10017 USA

Dear Ms. Healy,

Re: JICPA Response to the Proposed Changes to the International Standards on Auditing (ISAs), *Addressing Disclosures in the Audit of Financial Statements*

The Japanese Institute of Certified Public Accountants ("we", "our," and "JICPA") is grateful for the opportunity to comment on the Proposed Changes to the International Standards on Auditing (ISAs), *Addressing Disclosures in the Audit of Financial Statements* ("Proposed ISAs"). Our comments and suggestions are provided below for your consideration.

I. Request for Specific Comments

1. Whether, in your view, the proposed changes to the ISAs are appropriate and sufficient for purposes of enhancing the focus of the auditor on disclosures and, thereby, will further support the proper application of current requirements in the ISAs?

Disclosures are becoming more important for the decision-making of the users of audited financial statements. Auditors, meanwhile, are facing new practical challenges arising from the evolving nature of disclosures. We therefore believe that it would be meaningful to have a project to deal with the issue of disclosures in an audit. We also concur with the IAASB's decision to seek necessary guidance for addressing practical challenges arising from the evolving nature of disclosures and for enhancing the auditor's focus on disclosures. We do not, however, believe that the proposed changes to the ISAs relevant to the assertions would be appropriate means for enhancing the focus of an auditor on disclosures or for supporting the proper application of the current requirements in the ISAs. For more detail, please see our comment to question 3 below.

2. Are there any specific areas where, in your view, additional enhancement to either the requirements or guidance of the ISAs would be necessary for purposes of effective auditing of disclosures as part of a financial statement audit?

No. We have not identified any specific areas where we believe additional enhancement would be necessary.

3. Whether, in your view, the proposed changes to the assertions will help appropriately integrate the work on disclosures with the audit work on the underlying amounts, thereby promoting an earlier and more effective audit of disclosures?

We do not believe that the proposed change to the assertions will promote an earlier or more effective audit of disclosures.

We concur that is important to encourage the consideration of disclosures at the early stage of an audit. Changing the ISAs to highlight this point will promote the effective conduct of audits. We agree with the relevant changes in the proposed ISAs, except for those relating to the assertions.

Considering the nature of the work of a financial statement audit, we are concerned that the proposed changes to the assertions (which integrate assertions relating to presentations and disclosures into those relating to classes of transactions, events and account balances) could undermine the effective conduct of the audit.

Paragraphs A 124(a) (assertions about classes of transactions and events for the period under audit) and A 124(b) (assertions about account balances at the period end) in extant ISA 315 deal with the recognition and measurement of financial information. Paragraph A 124(c) (assertions about presentation and disclosure), meanwhile, deals with the presentation and disclosure of financial information. The risks considered in the auditing of classes of transactions and events may differ from the risks considered in the auditing of account balances. An auditing focus from a wider perspective, not merely from a specific class of transaction, event or account balance, is also more important for presentations and disclosures. We understand that these points are reflected in the current assertion categories.

Yet the integration of the assertions as proposed seems to suggest that the auditor is always required to consider a number of assertions about presentations and disclosures for each class of transaction, event and account balance. It also suggests that the auditor is required to design and perform substantive procedures for all of those assertions. This approach would make the audit work needlessly complex. We are also concerned that the proposed changes could undermine the effective auditing of presentations and disclosures. It is essential, for an effective audit of presentations and disclosures, to consider risks from a wider perspective, not merely from a specific class of transaction, event or account balance, and to design appropriate audit procedures in response to those assessed risks.

There is also a risk that an auditor would not appropriately focus on disclosures not directly related to recorded classes of transactions, events, or account balances. For example, disclosures about risks, estimation uncertainties, or going concern issuesmay not directly relate to recorded classes of transactions, events or account balances. The proposed paragraph A124a of ISA 315 only provides general explanations for these types of disclosures, which states that “the assertions described in paragraph A124(a)-(b) above, adapted as appropriate, may also be used…”. This guidance seems to suggest that the risk assessment for these disclosures is relatively less important than the disclosures directly related to paragraph A124(a)-(b). The former disclosures, however, are quite important.

The evaluation of the financial statements as a whole is also very important for the presentations and disclosures, especially for their completeness, relevance, and understandability. Yet the proposed changes to the assertions would make the audit works related to classes of transactions, events and account balances unnecessarily complex, and the assertions of the presentation and disclosure would not be treated separately. We are therefore concerned that the auditor would not appropriately focus on the financial statements as a whole, and ultimately, that the proposed change could exacerbate the issue of higher volume of note disclosures increases the risks that useful or relevant information may be obscured.

To encourage auditors to consider the disclosures early in the audit process, we propose that the ISAs emphasize the importance of performing appropriate risk assessment procedures for disclosures and presentations early in the audit process itself. It would also be useful to emphasize the importance of the discussion about the disclosures among the engagement team. The proposed changes relating to these points (e.g., paragraphs A11 of ISA 240, paragraph A12b of ISA 300, and paragraph A21a of ISA 315) are effective measures, and we support them. Yet for the reasons we state above, we doubt it would be effective to integrate the assertions about presentation and disclosure into the other assertions.

At the same time, we agree that the description of the assertion for presentation should be updated for consistency with the evaluation of the presentation of the financial statements undertaken at the end of the audit. We also think that the concept of the relevance of disclosures should be integrated into the assertions. We therefore propose the following revisions:

"(c) Assertions about presentation and disclosure:

- (i) Occurrence and rights and obligations—disclosed events, transactions, and other matters have occurred and pertain to the entity.
- (ii) Completeness—all disclosures that should have been included in the financial statements have been included.
- (iii) *Relevance*~~Classification~~ and understandability— *the information presented in the financial statements is appropriately aggregated or disaggregated, classified, and clearly described in the context of the requirements of the applicable financial reporting framework*~~financial information is appropriately presented and described, and disclosures are clearly expressed~~.
- (iv) Accuracy and valuation—financial and other information are disclosed fairly and at appropriate amounts."

II. Comments on Specific Paragraphs of the Proposed ISAs

- Paragraph 13(a) of ISA 200 (the definition of financial statements)

We understand that the term “obligation” has been changed to “claims against the entity” for better consistency with the terminology used in the accounting standards. We propose that the “or” on the second line be changed to “and.” Without this revision, the proposed definition seems to suggest that the financial statements always communicate either “an entity’s economic recourses” or “an entity’s obligations.”

We also expect readers would not understand the meaning of “explanatory or descriptive information on the face of the financial statements.” We propose that the IAASB provide relevant examples in related application and other explanatory materials.

- Paragraph A128b of ISA 315, second line

The reference to paragraph 25(a) of ISA 315 should be changed to paragraph 26(a) of ISA 315.

- Paragraph A3a of ISA 700

The paragraph seems to discuss whether the accounting policies adopted by management are relevant to the entity. This issue, we think, would be better dealt with in paragraph 13(b) (i.e., “the accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate”). We propose the following revision:

“A3a. The auditor’s evaluation of whether the financial statements appropriately disclose the significant accounting policies selected and applied includes consideration of matters such as ~~the relevance of the accounting policies to the entity, and~~ the clarity with which they have been presented.”

- Paragraph A3b of ISA 700 second bullet

To be consistent with the style of the other bullets, we propose the following revision:

“A3b. Evaluating the understandability…includes consideration of matters such as whether:

- The financial statements, including disclosures, are appropriately classified…, but do not omit relevant information.
- The disclosures *do not* undermine the overall presentation of the financial statements by including information that is not relevant or that is presented in a manner that may obscure a proper understanding of the matters disclosed.
- The placement of significant disclosures gives appropriate prominence to them….”

- Paragraph A4b of ISA 700 the last sentence

We agree to provide guidance regarding the evaluation of the achievement of fair presentation. The current ISAs do not have specific guidance on this topic. We therefore think it would be useful for auditors to find guidance in the ISAs explaining the meaning of the stand-back test.

On the other hand, we propose that the phrase “evolving financial reporting requirements” be deleted in the last sentence. This phrase seems to imply that an auditor evaluating whether financial statements achieve fair presentation is invariably required to compare the requirements of the applicable financial reporting framework with those of other financial reporting frameworks. It also seems to imply that an auditor who finds requirements in other financial reporting frameworks that are not included in the applicable financial reporting framework is invariably required to either ask management for additional disclosures or to depart from a requirement in the applicable financial reporting framework in order to achieve fair presentation. Yet the need for additional disclosure or departure from a requirement should be derived from the specific fact or circumstance of the entity. We understand that when an auditor considers the specific fact or circumstance of the entity, the evolving financial reporting needs may become be one of many factors that the auditor takes into account when determining whether the additional disclosure or departure is necessary. The second sentence ("This evaluation takes into account matters such as the facts and circumstances of the entity...") seems to explain this. This is unclear, however, and we are concerned that readers may have different interpretations.

“The evaluation also includes consideration, for example, of the disclosures needed to achieve a fair presentation arising from matters that may be relevant to the economic decisions of the users of the financial statements, such as ~~evolving financial reporting requirements or~~ the changing economic environment.”

We hope that our views will be of assistance to the IAASB.

Sincerely yours,

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