The Japanese Institute of
Certified Public Accountants

Improved Transparency in Auditor Reports

Results of Trial Run of KAM Communication

The Japanese Institute of Certified Public Accounts

November 17, 2017

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Certified Public Accountants

I. About the Trial Run

About the Trial Run

Purpose	To identify practical issues related to the adoption of communicating KAM		
Participating audit firms	7 audit firms (including the BIG 4 firms)		
Participating auditees	26 companies		
Industries	Manufacturing and construction industries: 13 companies Non-manufacturing industries: 13 companies (including 5 financial institutions)		
Company size	Consolidated net sales or revenue		(Ref. info: No. of all listed companies[*1])
	➢ Over ¥1tn	12 companies	143 companies
	➢ Over ¥500bn less than ¥1tn	5 companies	135 companies
	➢ Over ¥100bn less than ¥500bn	4 companies	650 companies
	➢ Less than ¥100bn	5 companies	2,703 companies
Financial Reporting Framework	➢ J-GAAP	17 companies	3,524 companies[*2]
	➢ IFRS or US-GAAP	9 companies	145 companies
Fiscal Year	Consolidated financial statements for fiscal years ended December 2016 to March 2017		
Method	A questionnaire (multiple choice and written questions) was sent to both companies and audit firms		
Period of trial run	Late August 2017 to October 2, 2017		

*1: According to *eol*, the database provided by PRONEXUS INC. (information gathered as of June 2017).
Information on companies that do not prepare consolidated financial statements is based on individual financial statement data.

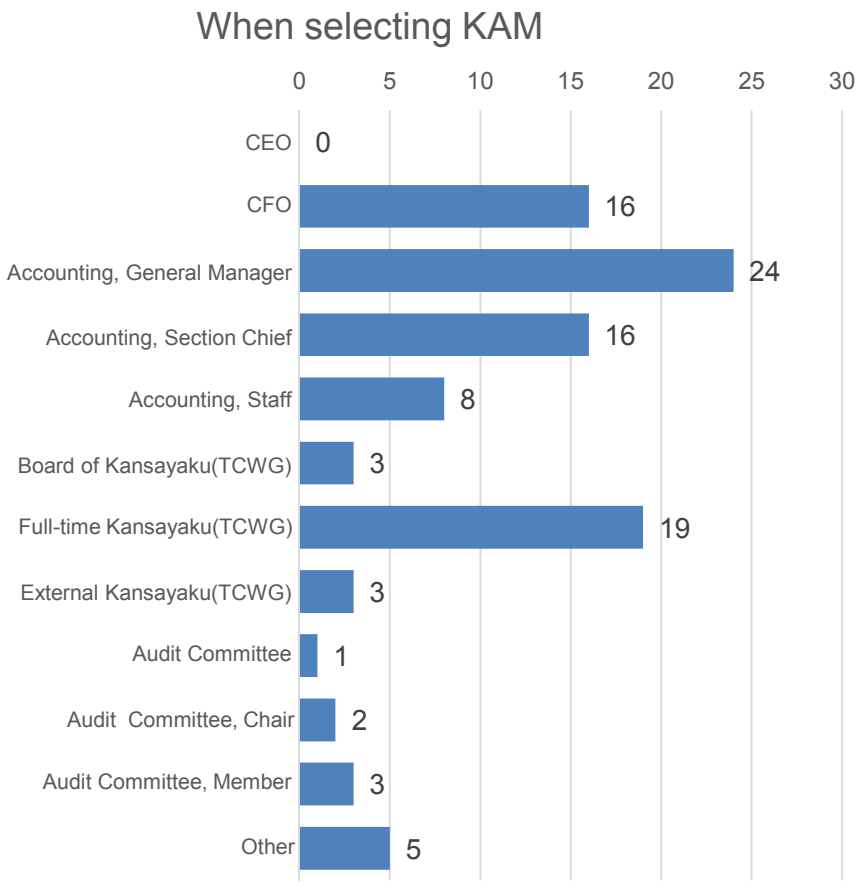
*2: According to data provided by Internet Disclosure Co., Ltd.

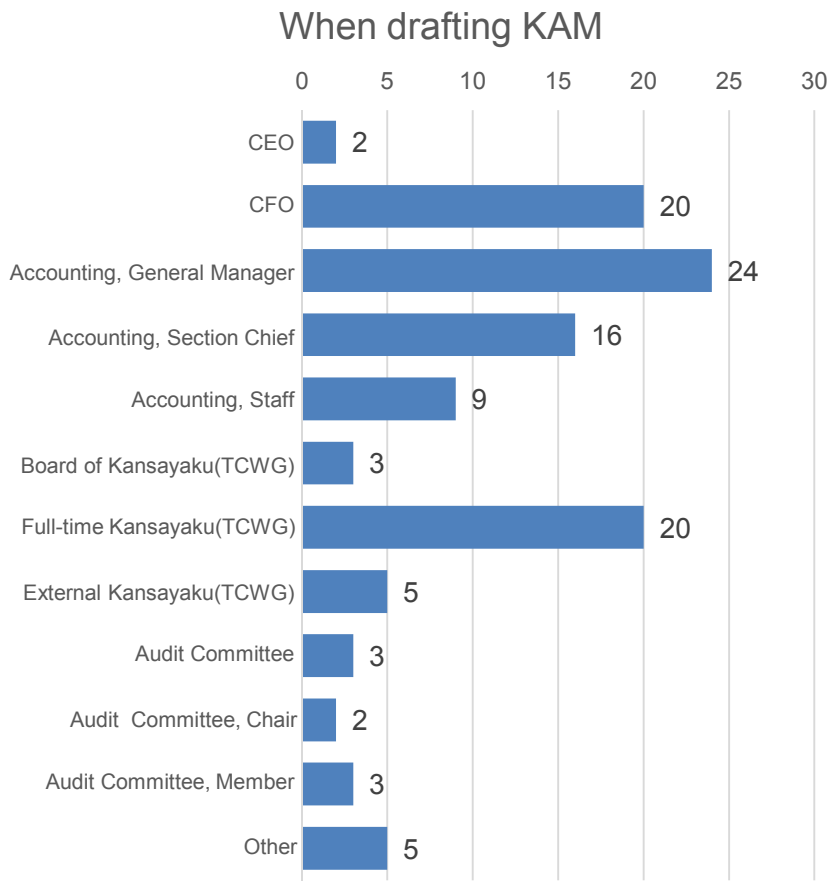
About the Trial Run: Questionnaire

Auditee	Auditor (Audit team)
■ Expected changes from introduction of KAM communication • Whether there were any difficulties • Impact on communication between management/TCWG and the independent auditor • Impact on disclosures • Contribution to engagement between the company and shareholders • Impact on the audit report from TCWG ■ Time required for discussion of KAM ■ Others • Challenges to achieve the intended purpose • Applicability, effective date and desired preparation period • Others	■ About the selected KAM ■ Feedback on selecting and drafting KAM • Difficulties when selecting KAM • Difficulties when drafting KAM • Views for including the outcome of or observation from the auditor's response ■ Impact on communication with the company ■ Expected additional workload for communicating KAM ■ Others • Challenges to achieve the intended purpose • Applicability, effective date and desired preparation period • Others

Parties with whom the Auditor Communicated in the Trial Run Process

Parties with whom the auditor communicated when selecting and drafting KAM:





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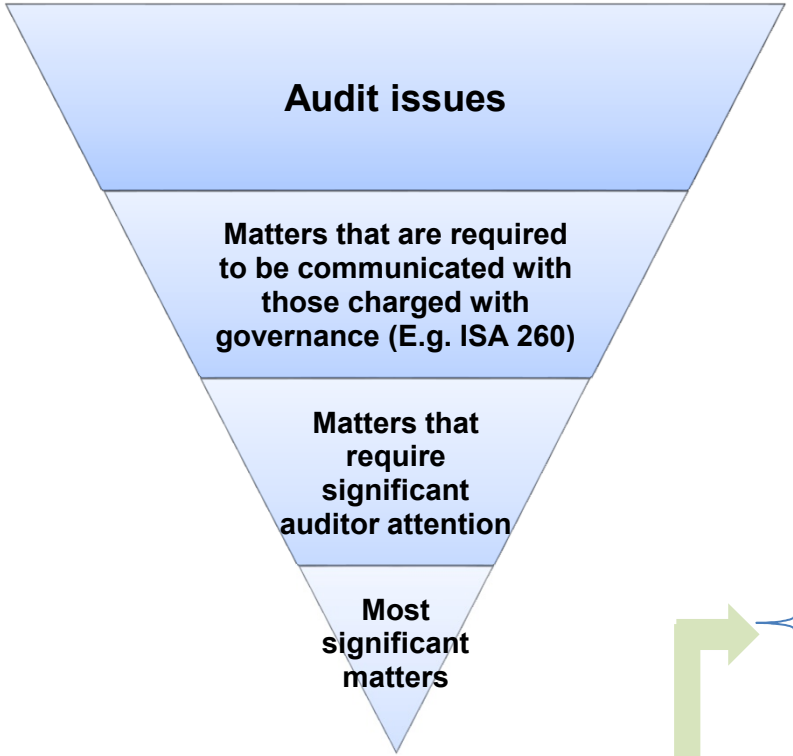
II. Overview of the Selected KAM

Process for Determining KAM and Description of KAM in the Auditor's Report

Narrowing down the most significant matters in the individual audit (relative concept)



Explanation about the nature of KAM

Description of each KAM

Independent Auditor's Report

Audit Opinion

.....

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

xxx (Subheading describing each KAM)

Include a reference to the related disclosure, if any, in the financial statements and address:

- Why the mater was determined to be KAM; and
- How the matter was addressed in the audit.

xxx (Subheading describing each KAM)

xxxxx

Distribution of the Number of Selected KAM

Number of KAM	Number of companies	Breakdown by Financial Reporting Framework	
		J-GAAP	US-GAAP, IFRS
1	5	4	1
2	11	7	4
3	2	2	0
4	6	3	3
5	1	1	0
6	1	0	1

Total number of KAM	68	41	27
Average number per company	2.61	2.41	3.00

(Reference Information)

★ Number of KAM in UK in the 2nd year (2014/2015)
(Source: UK FRC Report)
Average number per company: 3.9

★ Number of KAM in Singapore in the 1st year (fiscal year ended December 2016)
(Source: Joint report by ACCA, ACRA, ISCA and NTU)
Average number per company: 2.3

Distribution of Selected KAM by Area

Area	Number of KAM
Impairment of assets (non-current assets other than goodwill)	18
Accounting for business combinations, and the recognition and the valuation of goodwill	17
Provisions, asset retirement obligations and contingent liabilities	14
Revenue recognition (percentage of completion method, estimates of variable consideration, cut-off and overstatement risk)	9
Valuation of assets (including measurement of fair value)	8
Tax calculations (including recoverability of deferred tax assets)	4
Reserves requiring specialized and complex calculations (accounting estimates)	3
Scope of consolidation	1
IT systems related to financial reporting	1

* Since there were 6 cases in which both “Impairment of assets (non-current assets other than goodwill)” and “Accounting for business combinations, and the recognition and the valuation of goodwill” were included in a single KAM, and 1 case in which both “Accounting for business combinations, and the recognition and the valuation of goodwill” and “Valuation of assets (including measurement of fair value” were included in a single KAM, the total sum above is 7 more than the total in the previous slide.

Summary of the Descriptions of Individual KAM

Although the style and granularity of the descriptions of KAM vary, they can be summarized and classified into the following categories.

Why the matter was determined to be KAM	How the matter was addressed in the audit
• Impact on financial statements is quantitatively material. • Process for calculating numerical data is complex. (e.g. the assessment and estimating processes) • Calculation of financial numbers requires consideration of management's intent regarding future events and elements that are significantly subjective. • Whether intentional or not, it contains elements that could easily give rise to errors in applying accounting standards or accounting treatment.	• Assessment of the design and operating effectiveness of related internal controls. • Overview of the analytical procedures performed. • Overview of the substantive procedures performed. - Some describe procedures performed for specific risks only, but others describe procedures performed more comprehensively. - Use of the work of experts. (Often describe which areas the work of experts is used for.) - The work requested specifically to the overseas component auditor and relevant discussion with the component auditor

Views for Including the Outcome of or Observation from the Auditor's Response

Under the International Standards on Auditing, inclusion of the outcome of or observation from the auditor's response is not mandatory. However, the auditor can choose to include them.

◆ Results of the trial run

Outcome or observation	Number of cases
Included	16 (23.5%)
Not included	52 (76.5%)

◆ Did you think inclusion of the outcome or observation is preferable? State the reasons (replies from auditors).

	Replies
a. Yes	9 (34.6%)
b. No	17 (65.3%)

Reasons for "a. Yes"

- ✓ Without the outcome or observation, it may give the impression to the reader that the description is incomplete.
- ✓ The auditor's observation should be included since it is useful information for users.

Reasons for "b. No"

- ✓ Inclusion of the outcome or observation could give users of financial statements the impression that KAM is a separate opinion on an individual matter. Therefore, unless there is a compelling need, the outcome or observation should not be included.
- ✓ For an audit issue that is routine in nature and therefore selected as KAM every year, it would not be particularly useful for users if the description includes the outcome or observation such as "No Issues were detected" or "We determined it is appropriate" every year.
- ✓ Even if a misstatement or deficiency of internal control identified in relation to a particular KAM is described in the auditor's report, users would not be able to appropriately assess these matters only from the description.

Relationship between the Description of KAM and the Disclosure of the Company (1)

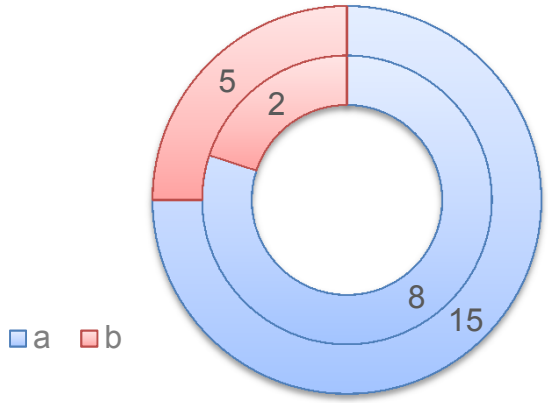
	Total	Breakdown by Financial Reporting Framework	
		J-GAAP	US-GAAP IFRS
a. Based on the information disclosed in the financial statements, the auditor was able to describe KAM specific to the company's audit.	39 (54.9%)	13 (31.7%)	26 (86.7%)
b. While not disclosed in the financial statements, by using the information publicly available from the company, the auditor was able to describe KAM specific to the company's audit.	10 (14.1%)	8 (19.5%)	2 (6.7%)
c. The auditor needs to include original information in order to describe KAM specific to the company's audit.	20 (28.2%)	18 (43.9%)	2 (6.7%)
d. Other	2 (2.8%)	2 (4.9%)	0 (0%)
Total: (Note: The number of replies does not match the number of KAM, as some respondents chose multiple answers)	71 (100%)	41 (100%)	30 (100%)

Respondents who replied "b" and "c" proceeded to the next question (next page).

Relationship between the Description of KAM and the Disclosure of the Company (2)

- Question posed to respondents who replied “b” or “c” to the previous question: what was the company’s reaction to the description of KAM?

Inner circle: b. Information other than financial statements
Outer circle: c. Original information



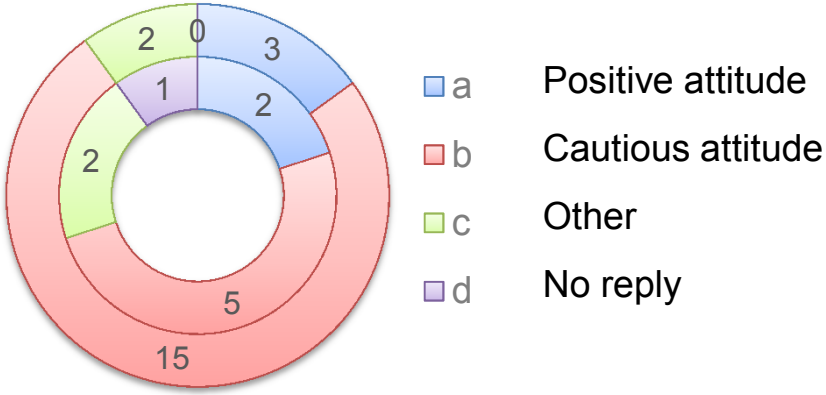
a. Since KAM is a matter of the auditor’s judgement, the company agreed to the description of KAM without argument.

b. We discussed changes to the description of KAM with the company.

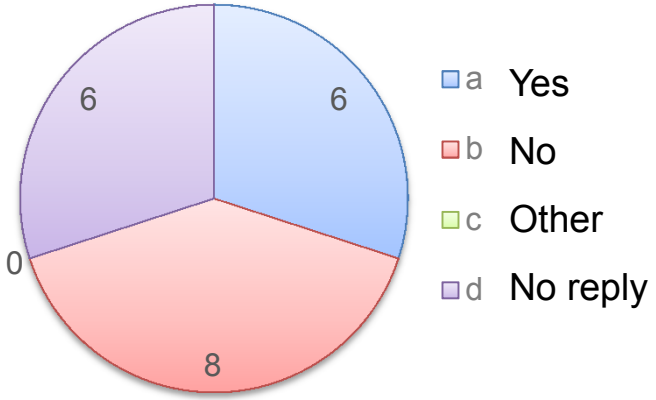
c. Others

- Question posed to respondents who replied “b” or “c” to the previous question: what was the company’s reaction to expanding the disclosures in the financial statements?

Inner circle: b. Information other than financial statements
Outer circle: c. Original information



- Question posed to respondents who replied “c” to the previous question: did it involve a sensitive matter?



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III. Feedback on the Trial Run and Expected Changes/Impacts

Discussion on KAM:
Whether there were any difficulties (Replies from companies)

(Question)
In the discussion with the auditor on KAM, were there any difficulties?

	Total	Breakdown by Financial Reporting Framework	
		J-GAAP	US-GAAP IFRS
a. No	16 (53.3%)	8 (40.0%)	8 (80%)
b. Yes	13 (43.3%)	11 (55.0%)	2 (20%)
No reply	1 (3.3%)	1 (5.0%)	0 (0%)

Details of responses “b. Yes”

- ✓ The criteria for describing KAM is not clear since it is a matter of the auditor’s professional judgment.
- ✓ The concept that KAM is “not a separate opinion on an individual matter”.
- ✓ There was a concern that descriptions of KAM from the auditor’s perspective could make the company’s business risks look more serious than reality and it was difficult for the company and the auditor to seek agreement.
- ✓ Regarding the descriptions of why the matter was determined to be KAM and how the matter was addressed in the audit, there was a difference in opinion between the auditor and the company regarding the qualitative expression, which required multiple discussions.
- ✓ It is likely that the discussion on to what extent non-public information should be included in KAM takes time.

Discussion on KAM:
Whether there were any difficulties (Replies from auditors)

◆ Were there any difficulties in communicating with those charged with governance?

	Total	Breakdown by financial reporting framework	
		J-GAAP	US-GAAP IFRS
a. No	22 (84.6%)	13 (76.5%)	9 (100%)
b. Yes	4 (15.4%)	4 (23.5%)	0 (0%)

b. Breakdown by types of difficulties

a. Insufficient understanding of KAM.	2 cases
c. There was a tendency to keep the number of and descriptions of KAM to a minimum.	2 cases

◆ Were there any difficulties with management (e.g. CFO)?

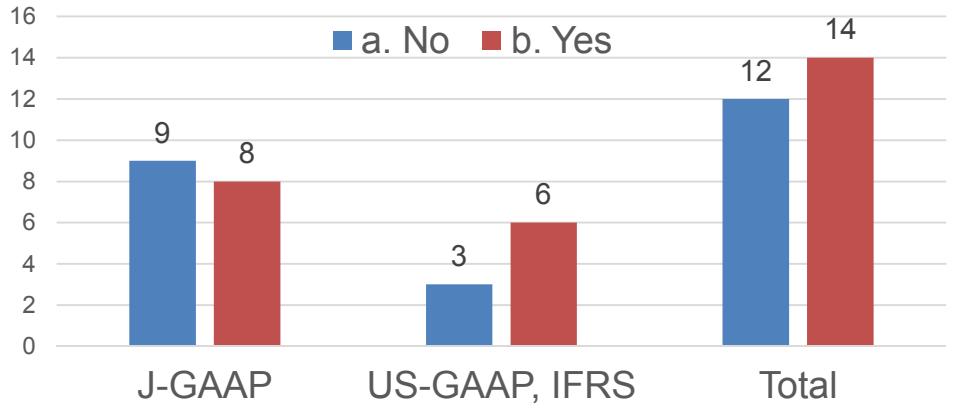
	Total	Breakdown by financial reporting framework	
		J-GAAP	US-GAAP IFRS
a. No	19 (73.1%)	11 (64.7%)	8 (88.9%)
b. Yes	7 (26.9%)	6 (35.3%)	1 (11.1%)

b. Breakdown by types of difficulties

a. Insufficient understanding of KAM.	1 case
c. There was a tendency to keep the number and descriptions of KAM to a minimum.	4 cases
d. Other	2 cases

Difficulties when Selecting KAM
(Replies from auditors)

◆ Were there any difficulties or questions when selecting KAM? If so, what kind of difficulties?

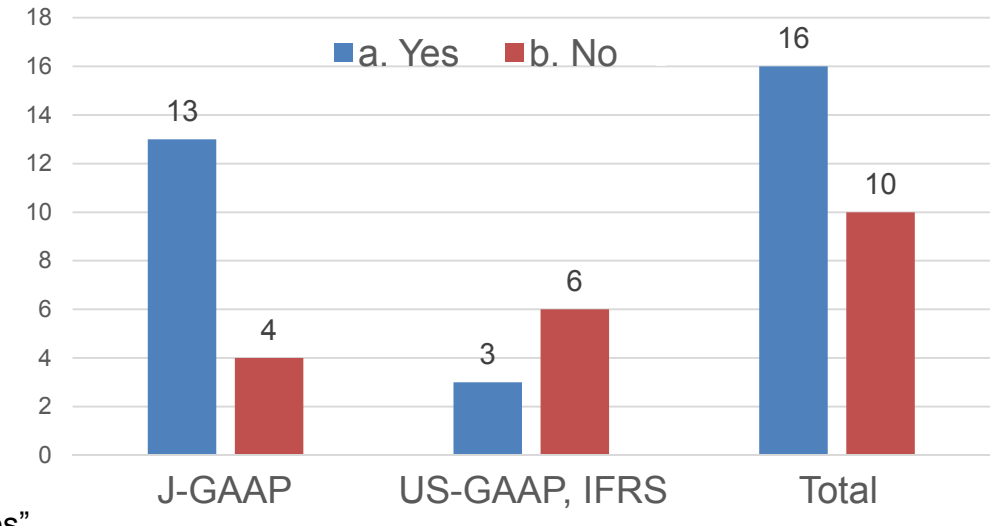


Main details of replies, if the respondent replied “b. Yes”.

- ✓ When selecting an item related to revenue recognition as KAM, the company expressed a concern that it may give the impression on the financial statement that the company had a problem.
- ✓ When selecting an item related to revenue recognition as KAM, there is a risk of repeating the same descriptions each year unless there are changes in the business environment.
- ✓ For a matter that has no significant impact on financial statements, but for which there was extensive communication with those charged with governance related to the matter or it was addressed as a significant matter in internal control audits, it is difficult to determine whether it should be selected as KAM.
- ✓ Disclosing too many items as KAM could confuse users but disclosing too few items will not achieve the intended purpose of improving the transparency of audit reports.
- ✓ While a matter related to IT systems was a significant audit matter, it was determined not to be KAM based on the concept that KAM is selected by relative importance.

Difficulties when Drafting the Descriptions of KAM:
Identification of KAM and why the matter was determined to be KAM (Replies from auditors)

◆ Were there any difficulties when drafting the identification of KAM and why the matter was determined to be KAM?

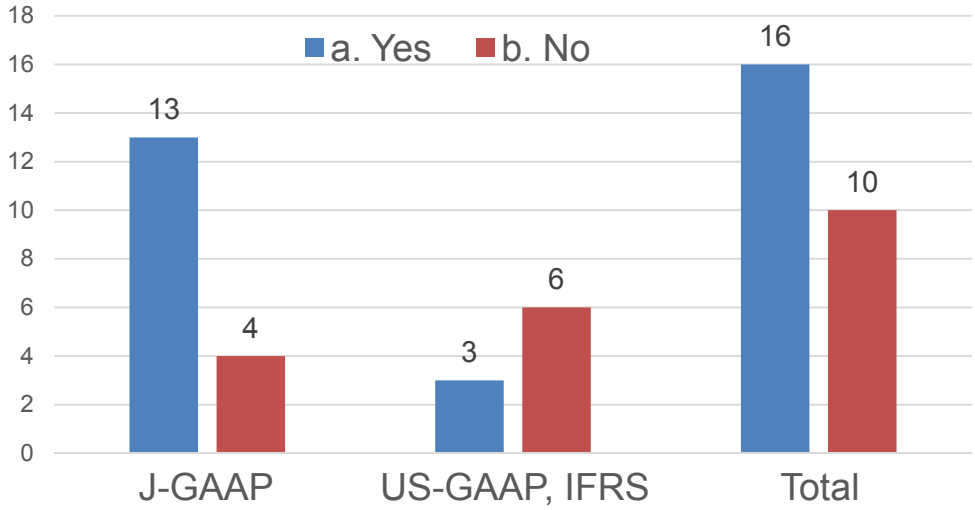


Details of replies “a. Yes”

- ✓ It was difficult to strike an appropriate balance between simplifying the expressions to be understandable for users and using accurate expressions to avoid misunderstandings.
- ✓ Given that specific disclosure requirements under J-GAAP are relatively fewer than IFRS and US-GAAP, it was difficult to decide how much detail should be included in the descriptions of KAM. Furthermore, when describing why the matter was determined to be KAM, it was difficult to decide to what extent technical accounting terms can be used.
- ✓ When describing KAM, it was necessary to discuss with the company whether to include information not disclosed by the company. The difficulties arose in encouraging the company to amend and revise the company’s disclosures before finalizing the description of KAM.
- ✓ As there were no clear criteria for the descriptions of KAM, there was a tendency to simplify the descriptions.

Difficulties when Drafting the Description of KAM:
How the matter was addressed in the Audit (Replies from auditors)

◆ Were there any difficulties when drafting <u>how the matter was addressed in the audit?</u>

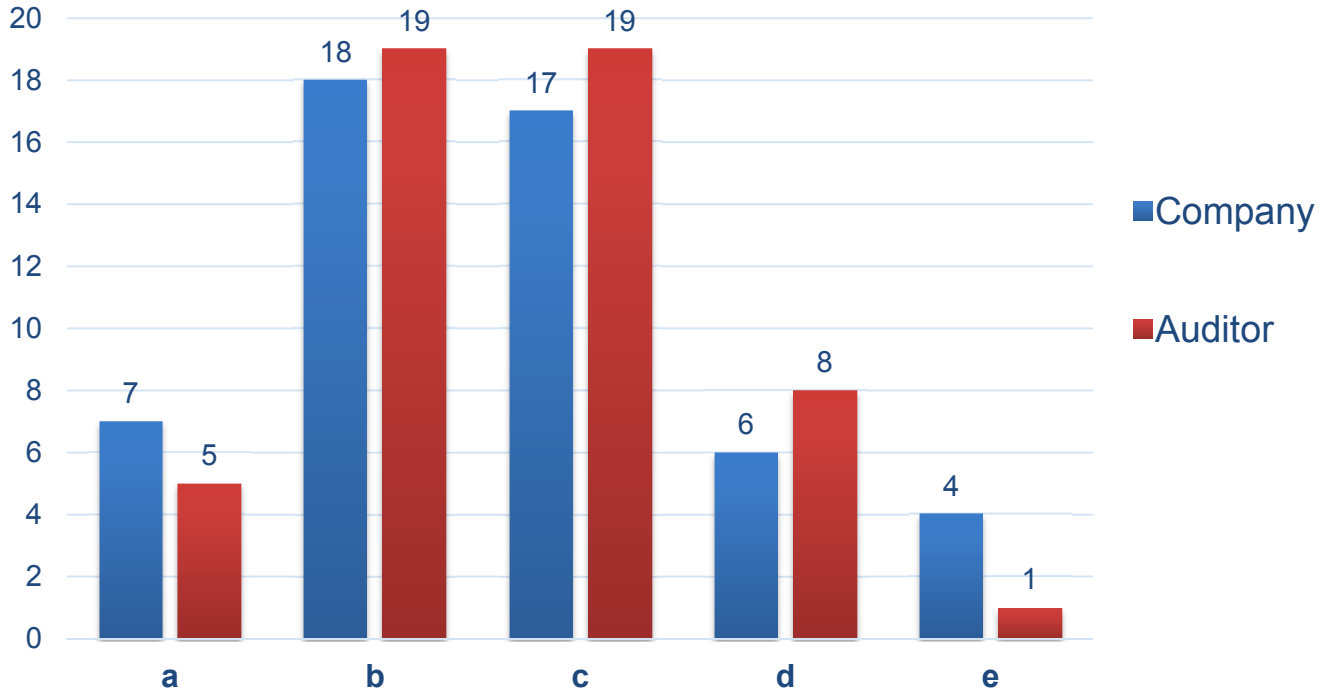


Details of replies “a. Yes”

- ✓ It was very difficult to find expressions that are understandable for users, while describing the audit procedures performed by the audit team without misunderstandings.
- ✓ It took time to determine the appropriate expressions for industry-specific and technical terms that could be understood by users.
- ✓ It was difficult to determine which procedures should be included, and how detailed and specific the descriptions should be. Including procedures that are non-routine only makes the descriptions poor.
- ✓ As there were no clear criteria for the descriptions of KAM, there was a tendency to simplify the descriptions.
- ✓ We needed to discuss whether to refer to the component auditor, and whether to identify the name of the component auditor in KAM, considering that the group auditor should be responsible for the group audit opinion.

Changes to Communications on Higher Risks

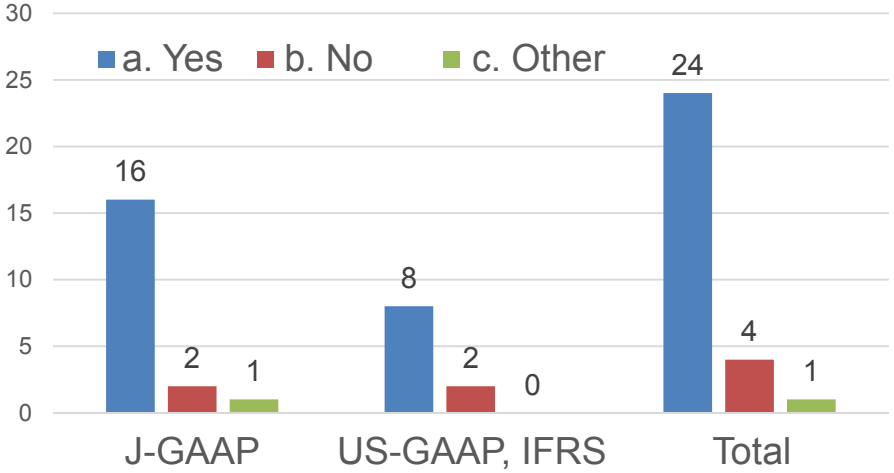
(Question)
If KAM is required, do you expect any changes in communications on higher risks which impact the Company's financial statements? (Multiple answers allowed.)



a. There will be hardly any changes.
b. Communication between management and the auditor will be improved.
c. Communication between those charged with governance and the auditor will be improved.
d. Communication between management and those charged with governance will be improved.
e. Other

Impacts on Disclosures
(Replies from companies)

(Question)
If KAM is required, do you foresee any impacts on company disclosures, such as the annual securities report and IR?



"b. No" ⇒ Reasons

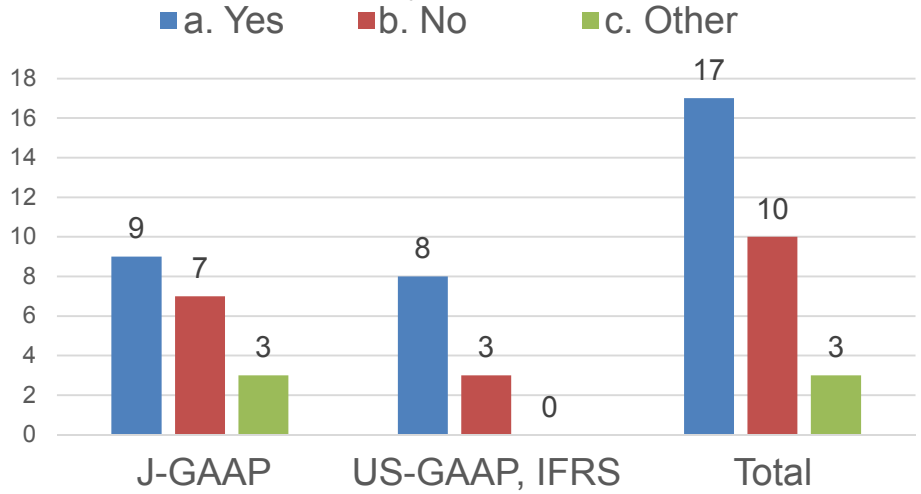
- ✓ Current disclosures are already adequate and there will be no impact.
- ✓ Management decides which matters to be disclosed to the third parties and the details of the disclosure by taking into account carefully the stakeholders' interests. The descriptions in the audit report should also be decided in the same framework.
- ✓ Unless there is a difference of opinion between the company and the auditor, there should be no impact on the company's disclosures.

"a. Yes" ⇒ Details of expected impact

- ✓ The descriptions of KAM should be based on the information publicly available by the company. Therefore, improving the company's disclosure will be necessary to include detailed facts and circumstances in the KAM description.
- ✓ Additional disclosure through IR may be necessary, especially when the descriptions of KAM change significantly from the previous year.
- ✓ Investors and analysts may demand more detailed explanations in the annual securities reports and IR activities.
- ✓ Disclosures explaining management views on KAM (e.g. disclosure on business risks) will be necessary. It will encourage the filing of annual securities reports prior to the shareholders meetings.
- ✓ Request from the audit firm to disclose more detailed information will be increasing.

Contribution to the Engagement between the Company and its Shareholders (Replies from the companies)

(Question)
If KAM is required, do you expect it to be useful for the engagement with shareholders?



Reasons for "b. No"

- ✓ Since questions from shareholders generally tend to focus on business matters, shareholders may not have much interest in the descriptions of KAM.
- ✓ Matters determined to be KAM are significant enough that the company has already made substantive amount of disclosure on those matters, and has already answered shareholders' questions on those matters at the AGM. Therefore, there will be no major changes to the "dialogue with shareholders" as a result of KAM.

Reasons for "a. Yes"

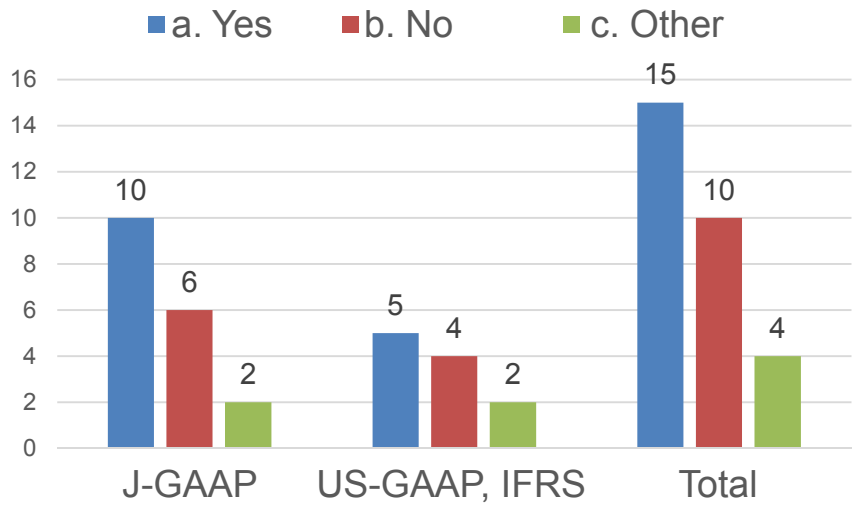
- ✓ The descriptions of the audit procedures will help users understand that the disclosed information passed the auditor's test for potential risk including fraud.
- ✓ Since knowledgeable analysts will understand and analyze the descriptions of KAM, it may help the dialogue with shareholders to a certain extent. Shareholders' questions are likely to increase for better or for worse.
- ✓ It will help shareholders understand industry-specific risks, the company's financial position and performance and audits.

Reasons for "c. Other"

- ✓ KAM will probably be helpful for investors in understanding the audit. However, the company provides consistent explanations to its shareholders using flexible types of disclosures such as the integrated report. Therefore, the effect of KAM on dialogue with shareholders is expected to be limited.

Consequences on the Reports from Those Charged with Governance (Replies from the companies)

(Question)
If KAM is required, do you expect it to impact the descriptions in reports from those charged with governance?



Reasons for "a. Yes"

- ✓ Those charged with governance(TCWG) must determine the appropriateness of the methods and results of the audit. Since KAMs are selected from matters communicated to TCWG, they would need to express their views on KAMs in their report.
- ✓ The annual securities report is generally filed after the AGM. Given the importance of the AGM and that the report from TCWG is presented at the AGM, it is hard to imagine that the report from TCWG would not refer to KAM.
- ✓ Improvement of the report from TCWG will also likely be requested.

Reasons for "b. No"

- ✓ Since the report from TCWG is prepared based on their conclusion on the appropriateness of the methods and results of the audit, the descriptions of their report will not be affected.
- ✓ Since KAM is communicated by the auditor in the auditor's reports, and TCWG do not assume any statutory obligations or liabilities on it, it is unlikely that the responsibility of TCWG relating to their report will be affected.
- ✓ Given that KAM will be determined upon robust discussion between the auditor, the CFO and TCWG, there will be no impact on the report from TCWG.

Time Required for the Trial Run

◆ Approximate number of hours required by companies (Unit: hours)

	Average	Median
Management (CFO)	5.41	3.00
Accounting divisions	14.73	7.50
Those charged with Governance	6.64	3.00
Staff for those charged with governance	5.55	4.00
Total	32.33	18.00

◆ Approximate number of hours required by the auditors (Unit: hours)

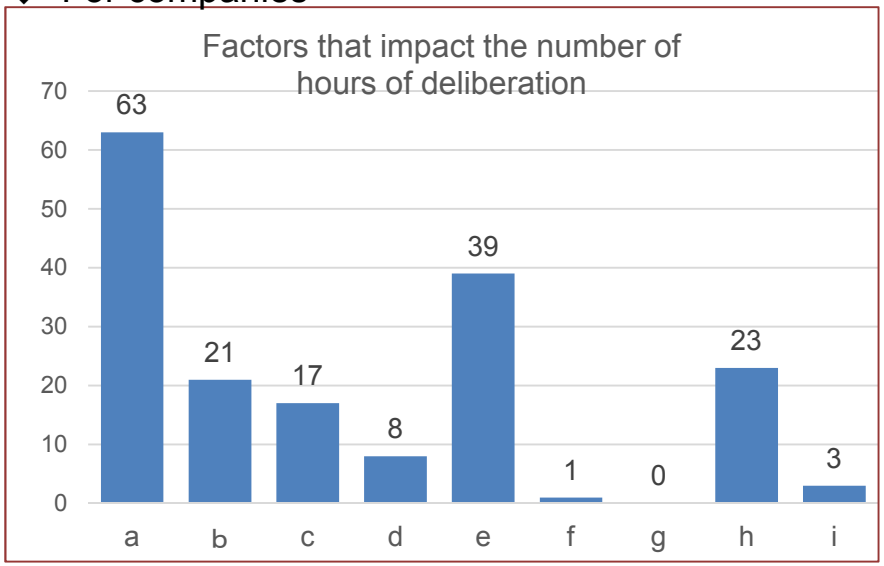
	Average	Median
Partner	36.10	26.75
Manager	36.37	29.75
Senior staff	3.40	0
Total	75.87	59.00

Comments

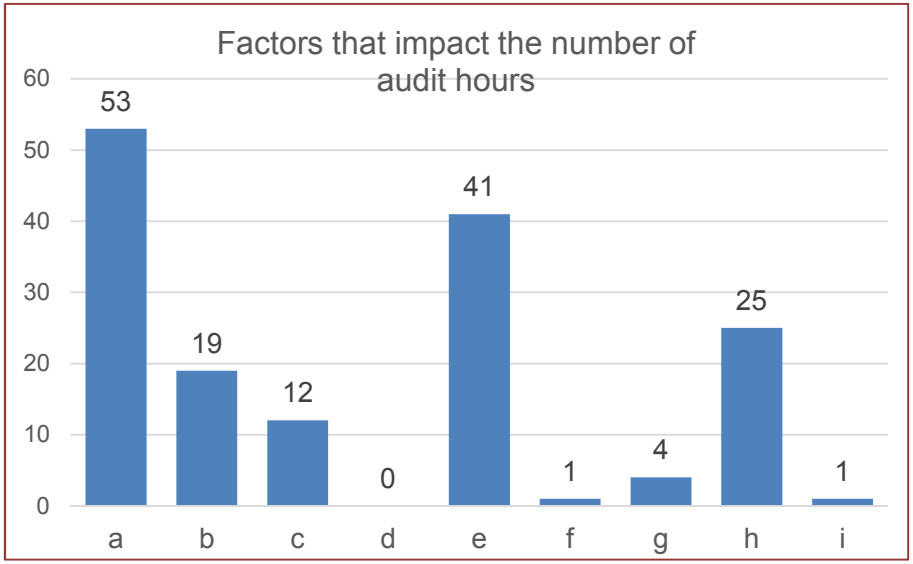
- As the period for the trial run was limited (approx. 1 month), we only selected matters that were clearly significant and that had already been subject to robust communications with management and those charged with governance. Consequently, there were hardly any conflicts of opinion within the audit team or with the company.
- As the trial run was conducted for the prior year audit, there was no need to discuss the disclosures of the financial statements. Therefore, discussion within the audit team and with the company on the descriptions of KAM did not go into depth comparing to those that should be necessary if communicating KAM in the current audit.
- The time we spent on this trial run will not be useful information in considering the time required if KAM is required.

Factors which could impact the Time Required

◆ For companies



◆ For auditors



The top 3 factors that could impact:

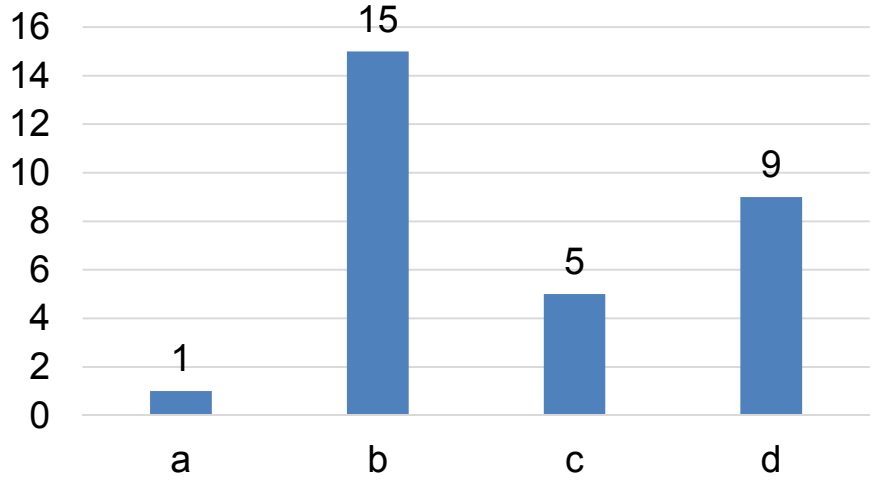
- For the companies
  ⇒ Time spent for discussion with audit firm
- For the audit firm
  ⇒ Audit hours

Weighted aggregation:
Sum of 1st = 3 points, 2nd = 2 points and 3rd = 1 point.

a.	The number of items and contents of potential KAM
b.	The depth of regular communications between management and the auditor
c.	The depth of regular communications between TCWG and the auditor
d.	The auditor's communication skills
e.	The extent of differences in opinions between management and the auditor
f.	Those charged with governance understanding of the audit
g.	Management's understanding of the audit
h.	The company's disclosure (including statutory disclosures and voluntary IR)
i.	Others

Additional Time to be Required
(Replies from companies)

(Question)
If KAM is required, how much additional time will be needed?



a. Hardly any difference

b. Slightly more time

c. Significantly more time

d. Others

Major comments made under “d. Others”

- ✓ It will be between b. and c.
- ✓ It will depend on the extent of differences in opinions between management and the auditor.
- ✓ It will depend on the contents and volume of potential KAM.
- ✓ If the descriptions of KAM includes matters beyond the company’s disclosures, substantial time will be required for discussion and communication between the auditor and the company.
- ✓ Currently, there is already sufficient communication with the auditor, and appropriate disclosures in accordance with the accounting standards have already been made. Therefore, additional disclosures would not be required. However, more time will be necessary for discussion with the auditor.
- ✓ We cannot expect it now.

Additional Time to be Required
(Replies from the auditors)

(Question)
If KAM is required, how much additional time will be needed?

a. Hardly any difference	0
b. The additional time needed will be in proportion to the size of the engagement. Total audit hours, including for quality control, will increase by ( )%.	5
c. The additional time needed will be roughly the same regardless of the size of the engagement. Total audit hours, including for quality control, will increase by ( ) hours.	12
d. Others	9

Numbers for b.

Less than 3%	3 cases
3 to 5%	1 case
5%	1 case

Numbers for c.

Less than 50 hours	4 cases
50 to 100 hours	4 cases
100 to 200 hours	3 cases
Don't know	1 cases

Major comments

- ✓ Additional time will depend greatly not on the size of the engagement but on the complexity of the company and the audit, the number of KAM, the company's disclosure level and understanding of KAM, the company's significant issues and the company's attitude.
- ✓ Additional time will depend on the extent the auditor has already communicated to the company significant matters in the audit.
- ✓ It will depend on the size and complexity of the engagement but it will also be affected by changes in the risk of material misstatements due to the changes in the business environment (including changes in business performance) and changes in audit procedures.
- ✓ The audit hours will increase depending on the number of KAM in the first year but from the second year, there should not be such an increase .

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IV. Issues to be Addressed in Achieving the Intended Purpose of Communicating KAM

Issues to be Addressed in Achieving the Intended Purpose (1)

We asked both companies and auditors about issues related to the system and issues for each stakeholder that need to be addressed in achieving the intended purpose.

Issues relating to the system	
Replies from companies	Replies from auditors
● Promoting better understanding of the purpose of KAM communication (e.g., KAM does not indicate a weakness of the company) ● The disclosure system according to the Companies Act and the Financial Instruments and Exchange Act ● Revision of the disclosure system/standards ● Clarification of the issues concerning original information (including liability issues on shareholder derivative actions) ● The impact on audits pursuant to the Companies Act and the responsibility of those charged with governance (e.g., when those charged with governance and management have different views, the scope of “those charged with governance”) ● Accountability regarding KAM at AGM and IR ● If an event occurring during the period is determined to be KAM, the necessity of timely disclosure from the company ● The relationship between the PCAOB standards applied to US SEC-registered entities and J-GAAP	● Promote the user’s understanding of KAM (e.g. KAM is determined by the auditor’s judgment based on a relative significance of the matters to the individual audit, and it is not necessarily comparable between entities) ● Consideration for effective introduction of KAM taking into account Japan’s cultural background (e.g., preference for homogeneity), consideration of the impact on corporate activities such as IR ● Enhancement and improvement of the disclosure standards (including other information in the annual securities report) ● Clarification of the issues on original information ● The impact on audits pursuant to the Companies Act ● Clarification of legal liabilities of those charged with governance regarding KAM ● Auditor’s responsibility if the event not described in KAM emerges on a subsequent date ● How to communicate KAM in the audit of the restated financial statements ● How to communicate KAM that could impact both financial statement audits and internal control audits ● The difference with PCAOB standards

Issues to be Addressed in Achieving the Intended Purpose (2)

Issues to be addressed by auditors

Issues for auditors	
Replies from companies	Replies from auditors
● Review of the audit plan and approaches ● Commencement of communications early with the auditor, and sufficient consideration of KAM ● A deeper understanding of the company's business ● Consideration of the company's disclosure, user-friendly descriptions of KAM, the audit firms' behavior and action to prevent inconsistencies between the level of precision of the descriptions by the auditors and boilerplate descriptions. ● Issues when there is a disagreement between the company and the auditor ● Issues about information for which public disclosure is not appropriate (e.g., pending litigation) ● Establish rules to discourage KAM from becoming excessively conservative, and complacent and self-serving for the auditor ● Improve the efficiency of the audit process; concerns that it would lead to excessive audit procedures ● Additional burden under the already-tight audit schedule	● More robust and early communication with the company ● How to make the descriptions more user-friendly and what level of descriptions is expected ● Maintain the balance between standardized and company-specific descriptions of KAM, and prevent lengthy and boilerplate descriptions and the attitude of "following what others do" ● Whether consistency of the descriptions of KAM within an audit firm is needed (the degree of details and the descriptions to be included) ● Improve audits of note disclosures ● Ensure sufficient discussion, human resources and audit remuneration ● Improve efficiency of audit procedures, and issues when the event occurred after the period end is determined to be KAM ● Establishment of quality control system including the engagement quality control review ● Issues when accounting irregularity is discovered (e.g., litigation risk)

Issues to be Addressed in Achieving the Intended Purpose (3)

Issues to be addressed by companies

Issues for companies to address	
Replies from companies	Replies from auditors
● A culture that fosters sharing of risk information with auditors ● Foster the company's positive attitude that KAM is a good opportunity for general investors and shareholders to understand the entity's business ● Early disclosure to and information sharing with auditors ● Ensuring sufficient time for discussion with the auditor ● Increase in workload, time and resources required regarding the request for additional disclosures in financial statements and IR, and increased audit costs ● Reconsideration of the account-closing schedule, enhancement of human resources and improvement of the efficiency of the account closing process ● Extra burden for English translations	● Proactive consideration for disclosing information related to selected KAM ● Concerns that the company may ask the auditor to align with other companies in the same industry in terms of the number of KAM and the level of descriptions ● Sufficient communication with the auditor (including communication with persons other than the CFO and accounting division staff) ● Management's and those charged with governance's understanding of audits including KAM ● Concerns that whether those charged with governance in all companies can conduct meaningful discussions on KAM ● The company's human resources (e.g. the number of staff, impact of personnel transfers)

Issues to be Addressed in Achieving the Intended Purpose (4)

Issues to be addressed by users

Issues on the user's side	
Replies from companies	Replies from auditors
● Appropriate understanding of the descriptions of KAM (KAM is not an alert from the auditor), lowering unreasonable expectations for KAM, and sufficient understanding that KAM is not a separate opinion on individual matters ● Improve the accounting literacy of users ● Concerns whether KAM will be used appropriately. For example, users may incorrectly use KAM for comparison between companies. ● Doubt on whether KAM will really be utilized and whether it will be useful to users ● Guidance will be needed for dialogue with investors regarding KAM	● Appropriate understanding of the descriptions of KAM (users' education is necessary, for example, on the nature of KAM, to prevent unreasonable expectations, and on the difference between the auditor's overall opinion and the results of the auditor's response to individual matters, etc.) ● Concerns of improper company comparisons by companies with KAM ● Acquire accounting and audit knowledge at least necessary to understand KAM ● Users themselves need to consider how they will utilize KAM to make investment decisions ● User groups' analysis to promote improvements in the description of KAM ● Concerns over superficial analysis that only focuses on the number of KAM, the sum of items and trends rather than the substance

Applicability of KAM

Companies and auditors were asked to comment freely on the applicability, effective date, preparation period and other points of concern.

Applicability of KAM

Replies from companies	Replies from auditors
● Given disclosure status and the timing, KAM should be applied (first) to audits for the consolidated financial statements pursuant to the Financial Instruments and Exchange Act. (14 replies) ● KAM should be applied to audits pursuant to the Financial Instruments and Exchange Act. (4 replies) ● KAM should be applied to audits pursuant to the Financial Instruments and Exchange Act and the Companies Act, and both the consolidated and the non-consolidated financial statements. (1 replies) ● KAM should be applied to audits pursuant to the Financial Instruments and Exchange Act and the Companies Act. (3 replies) ● The system of requiring companies to prepare two sets of financial statements pursuant to two laws (Financial Instruments and Exchange Act and the Companies Act) should be firstly repealed. And then, KAM should be adopted. ● If KAM were only applied to audits pursuant to the Financial Instruments and Exchange Act, considering the relationship between the information disclosed pursuant to the Companies Act, how to validate disclosed information pursuant to the Companies Act, and the revision of the timing of submitting the annual securities report (it is common practice that it is submitted after the general meeting of shareholders) is necessary. ● KAM should not be applied uniformly to all listed companies but should be firstly adopted for audits of companies with large market caps.	● Given disclosure status and the timing, KAM should be applied to audits for the consolidated financial statements pursuant to the Financial Instruments and Exchange Act. (19 replies) ● KAM should be applied to audits pursuant to the Financial Instruments and Exchange Act. (1 replies) ● KAM should be applied to audits pursuant to the Financial Instruments and Exchange Act and the Companies Act, and both the consolidated and the non-consolidated financial statements. (1 replies) ● If KAM were only applied to audits pursuant to the Financial Instruments and Exchange Act, the date that the company submits the annual securities report should be moved up before the date of the general meeting of shareholders. ● If KAM were adopted under the current tight financial report and audit schedule, which allow little or no flexibility, the benefits of KAM may not be fully be achieved. If sufficient preparation periods were ensured, such as through phased adoption, it would be possible to apply KAM for all, i.e. to audits pursuant to the Financial Instruments and Exchange Act and the Companies Act, and to consolidated and non-consolidated financial statements. This would make the benefit of KAM understood by a wider range of stakeholders.

Preparation Period and Other Matters

Preparation period and other matters (free comments)	
Replies from companies	Replies from auditors
● A deep understanding of the new requirement is essential and thus a substantial preparation period is necessary. ● It is necessary to clarify how to discuss matters. In-depth discussion should be carried out. ● Care should be taken not to further burden companies that are engaged in legitimate and fair financial reporting by excessive reinforcement of audit procedures. ● We should study the implementation experience of other countries that have already adopted KAM. ● Issues need to be addressed as soon as possible from the perspective of international comparisons. ● Care is necessary regarding the submission deadline and the contents of the description, given that KAM will need to be translated into English for overseas investors. ● The point is whether KAM will instigate dialogue between companies and stakeholders, and thus plain expressions easily understood by users are preferable.	● A deep understanding of the new requirement is essential and thus a substantial preparation period is necessary. ● A reasonable preparation period is required to promote users' proper understanding of the new requirement . ● A period to discuss ideal corporate disclosures is necessary. ● We need to promote discussion to integrate the financial statements pursuant to the Financial Instruments and Exchange Act and the financial statements pursuant to the Companies Act. ● In cases where the parent and its subsidiaries operate in different markets, the qualitative differences (e.g., differences in standards and in practices) need to be considered. ● We need to conduct another trial run in the period prior to formal adoption of KAM, wherein the company and the auditor, without disclosures, take one year to discuss the matters so that both parties accumulate know-how through actual preparation of KAM.

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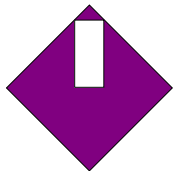
V. Conclusion

Based on the Results of the Trial Run

Purpose and expected benefits	• Improved transparency of audits (promotes understanding of audits and accounting) • Deeper communication between the auditor and management / those charged with governance relating to the impact of higher risks on financial statements • Positive impact on the companies' public reporting and corporate governance; for example, disclosures in annual securities reports and IR, dialogue with shareholders and reports from those charged with governance.
Cost-effectiveness	• [Effects] In addition to the above, it will not change, but deepen, audit methods. ⇒ Toward thinking audit • [Costs] Will not necessarily require a large amount of additional time in each case.
Issues to be addressed in achieving the intended purpose (success factors)	• Establish and promote an understanding of the purpose of KAM • Must raise awareness of each stakeholder to improve auditor reporting. ✓ Continuous improvement of the environment and financial reporting regime ✓ Auditors ⇒ strong attitude of providing meaningful audit information to users of auditor reports ✓ Companies ⇒ proactive attitude towards better disclosures and audits ✓ Users ⇒appropriate and correct use of auditor reports and financial reports including KAM



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Thank you.