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The Japanese Institute of Certified Public Accountants

To JICPA members

Audit Consideration related to COVID-19 (Part 5)

Today, JICPA updated “Audit Consideration related to COVID-19 (Part 5)” (originally released on May 8th) that mainly focuses on considerations of audit opinion and written representations in forming an opinion on the financial statements prepared in accordance with the Companies Act.

Please find below the updated English translation of the original in Japanese.

Please be reminded that JICPA shall provide this English translation to be used solely as a reference material (not necessarily word-for-word translation of original full sentences) to aid in the understanding of our original release in Japanese.

1. Considerations on Modified Opinions due to the auditor’s inability to obtain sufficient appropriate audit evidence

(1) Considerations regarding auditor’s judgment about materiality and pervasiveness

If the auditor is unable to obtain sufficient appropriate audit evidence even by performing alternative procedures to conclude that the financial statements as a whole are free from material misstatement as a result of taking actions for preventive measures to avoid further spread of COVID-19, the auditor shall express a qualified opinion or disclaim an opinion as the following table. (See paragraph A9 of the Auditing Standards Committee Statement (ASCS¹) 705.)

It does not necessarily mean that the auditor needs to express a modified opinion if the amount of the specific area relating to the scope limitation exceeds materiality for the financial statements as a whole. The auditor needs to exercise professional judgment as to whether a modification to the opinion is necessary (See paragraph 6(2) of ASCS 705).

¹ Auditing standards generally accepted in Japan consist of Auditing Standards codified by the Business Accounting Council (BAC), and Auditing Standards Committee Statements (ASCSs) and a Quality Control Standard Committee Statement (QCSCS) issued by the Japanese Institute of Certified Public Accountants (JICPA). The ASCSs and a QCSCS are developed based on Auditing Standards codified by the BAC, and to converge with the International Standards of Auditing (ISA) and the International Standard on Quality Control 1 (ISQC 1) issued by the International Auditing and Assurance Standards Board (IAASB)."

(Types of Modified Opinions Due to the Auditor’s Inability to Obtain Sufficient Appropriate Audit Evidence (See paragraph A1 of ASCS 705))

Nature of Matter Giving Rise to the Modification	Auditor’s Judgement about the Pervasiveness of the Effects or Possible Effects on the Financial Statements	
	Material but not Pervasive	Material and Pervasive
Inability to obtain sufficient appropriate audit evidence	(i) Qualified opinion	(ii) Disclaimer of opinion

- (i) If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive, the auditor shall express a qualified opinion.
- (ii) If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive, the auditor shall disclaim an opinion. (See paragraph 4 of ASCS 705)

(2) Considerations when expressing a modified opinion

Even though the auditor has made efforts to obtain sufficient appropriate audit evidence and addressed postponement of the due date of the auditor’s report, as a result of taking actions for preventive measures to avoid further spread of COVID-19, the auditor may not be able to obtain sufficient appropriate audit evidence. If the effect is material, it is necessary for the auditor to carefully consider the implications for the auditor’s report with regard to the scope limitation.

If the auditor expresses a modified opinion, it is important to communicate with management and those charged with governance in a timely and appropriate manner. In forming an opinion, the auditor needs to fulfil his/her accountability to management and those charged with governance based on the auditor’s judgment in light of the facts and circumstances. In particular, if the auditor expresses an opinion other than unmodified opinion (including disclaimer of opinion) for the financial statements of a listed company, it is necessary to make effort and fulfil his/her accountability to stakeholders.

- (i) Treatment of modified opinion in the Companies act
(details omitted)
- (ii) Modified Opinions and Delisting Rule policy
According to the delisting rule policy of the Tokyo Stock Exchange, if an auditor’s report or quarterly review report contains "Adverse opinion/Adverse conclusion" or "Disclaimer of opinion/Disclaimer of conclusion", the stock of the audited company shall be included in monitoring list. The stock may become delisted only when the exchange deems it difficult to maintain market order and make a

judgement from comprehensive perspective.

However, it was clarified that the delisting rule policy does not apply when the auditor disclaim an opinion or disclaim a conclusion due to the impact of COVID-19 ("Response to the Spread of Coronavirus (COVID-19): Overview of TSE Disclosure & Listing Rule Policy ([Link](#)) "). In the case of a qualified opinion/qualified conclusion, it does not fall under the delisting rule policy.

(iii) Considerations in relation to Article 130 of Rules of Corporate Accounting

Due to the time constraint, the auditor's report for non-consolidated financial statements along with supplementary schedules can be issued first leaving the auditor's report for the consolidated financial statements to be issued at a later date. This may make it possible for the auditor to avoid expressing a modified opinion and to express an unqualified opinion where there is a delay in receiving responses from overseas component auditors.²

(details omitted)

(3) Considerations to express modified opinion

If the auditor expresses a qualified opinion due to the inability to obtain sufficient appropriate audit evidence, the auditor is required to specify in "Basis for Qualified Opinion" the reason that the auditor determines that the possible effects of the modification on the financial statements are material but not pervasive (i.e., the reason for not disclaiming an opinion) . It needs to be stated in an understandable and concrete manner from the perspective of the financial statement users (See IV.5.(1) of Revised Auditing Standards codified by the Business Accounting Council (issued in September 3, 2019) and paragraph 19(2) of ASCS 705)

Usually the basis of the auditor's judgment is considered to be sufficiently explained if the

² If specified in the articles of incorporation, companies may choose not to include the consolidated financial statements when mailing the notice of the general shareholders' meeting and instead disclose them on their website. (Item 4, Article 134 of Rules of Corporate Accounting)

(The following postscript was added on May 15th, 2020)

The Ministry of Justice announced on May 15th that they published a revised Ministry of Justice Ordinance (#37 of the Ministry of Justice Ordinance) with regard to Regulations for Enforcement of the Companies Act and Rules of Corporate Accounting and made effective on the same day. The ordinance states as follows: If a company commences procedures to hold general shareholders meeting within six month from the effective date, and if the company satisfies certain conditions such as obtaining an unmodified opinion on its financial statements from the auditor, the company may also disclose its non-consolidated financial statements and auditor's report on their website instead of mailing with the shareholders' meeting notice.

description below are included for undetected misstatements. (See Auditing Standards Committee Research Report No. 6, Q1-6)

- Which account balances, classes of transactions or disclosures in the financial statements are related?
- What assertions would be associated with the undetected misstatement?
- Why was the auditor not able to obtain sufficient appropriate audit evidence due to the inability to perform necessary procedures? When expressing a modified opinion, various considerations (including both quantitative and qualitative) are necessary. Therefore, the auditor needs to explain the basis relevant to such considerations along with the relevant background in an understandable manner.
- The amounts of account balances, classes of transaction, or disclosures for which sufficient appropriate audit evidence is not available.

The description such as "we were unable to obtain sufficient appropriate audit evidence for a subset of the amount recorded in the financial statements" lacks concreteness. The description of the exact amount contributes to the understanding of the users of the auditor's report.

(4) Illustrative examples of auditor's reports

(details omitted)

(Reference) Flow Chart of Types of Audit Opinions

(details omitted)

2. Considerations of written representations from the management

(1) Descriptions related to the COVID-19

The COVID-19 is prevalent worldwide and have been making a wide range of impacts on financial reporting. Under these circumstances, the auditor may ask management to make written representations regarding the business impact due to COVID-19 and how such impact has been addressed in financial reporting.

In some cases, it may be necessary for the auditor to confirm the completeness of information provided from management by, for example, adding the following underlined wordings to the illustrative examples of ASCS 580 "Written Representations" and other related ASCSs, depending upon the auditor's judgment.

<Financial Statements>

- Significant assumptions used in making accounting estimates, including those measured at fair value, are reasonable. As for the impact due to COVID-19, we (as an audited company) made best estimates based on all available information as of the date of preparation of the financial statements.

- All events that have a significant impact on financial statements that occurred after the closing date until the date of this written confirmation, including events related to COVID-19 are recorded or disclosed within the note.
- The disclosures related to accounting estimates, including additional disclosures of information based upon certain assumptions related to COVID-19, are complete and appropriate under the applicable financial reporting framework.
- There are no subsequent events (including the impact to XX due to the COVID-19) requires adjustment to the accounting estimates and disclosures included in the financial statements.

<Information provided>

- We have provided you with all information relevant to significant changes in the procedures, internal controls, policies and procedures we have made in response to the impact of COVID-19 on our internal controls.
- All transactions, including related matters due to the impact of COVID-19, have been recorded in the accounting records and are reflected in the financial statements.

(2) Written representation with Signature or Name and Seal
(details omitted)