

February 12, 2021

To JICPA members

The Japanese Institute of Certified Public Accountants

Remote Work Series No.4

Considerations When Visits to Components are Restricted

<<I. Introduction>>

With the novel coronavirus infectious disease (COVID-19) continuing to spread, the use of remote work in the operations of the companies subject to audit and the audit teams is expanding rapidly, and in some cases making it difficult to visit components both in Japan and throughout the world. In such cases, the auditor may perform audit procedures by visiting the component as prescribed in Auditing Standards Committee Statement 600 “Special Considerations - Audits of Group Financial Statements (Including the Work of Component Auditors)”, or perform procedures using remote work instead of being involved through visits, etc. to the component auditor, or become involved in the work performed by the component auditor (hereinafter, “remote-work approach”).

With regard to the performance of audit procedures using the remote work approach or involvement in the work performed by the component auditor, these “Considerations” do not constitute new requirements, but considering the requirements of Auditing Standards Committee Statements, auditors in a remote work environment should take them into account. In addition, for audits other than group audits, the auditor may refer to these “Considerations” when performing audit procedures during visits to the company’s locations.

<<II. What is the remote-work approach?>>

In these “Considerations”, the remote-work approach to performing audit procedures or becoming involved in the work performed by the component auditor, refers to the use of communication technology such as telephone lines or the Internet to send and receive necessary information between the auditor and the component or the component auditor, enabling the auditor as group audit team to perform audit procedures, or become involved in the work performed by the component auditor, from a remote location.

In recent years, due to the development of tablets and smartphones equipped with operating systems, there are times when it is no longer necessary to depend on personal computers and communications equipment.

Moreover, the use of shared cloud services has enabled the sending and receiving, or simultaneous review, of materials created in electronic format between the auditor and the component, or the sending and receiving of audit instructions and responses created in electronic format, and the review of audit documentation created in electronic format between the auditor and the component auditor.

[Figure1] What is the remote-work approach to performing audit procedures or becoming involved in the work performed by the component auditor?

The remote-work approach to performing audit procedures or becoming involved in the work performed by the component auditor refers to...

- ◆ the use of communication technology such as telephone lines or the Internet,
- ◆ to send and receive necessary information between the auditor and the component or the component auditor,

enabling the auditor as group audit team to perform audit procedures, or become involved in the work performed by the component auditor, from a remote location.

<<III. Considerations when performing audit procedures on component financial information and becoming involved in the work performed by the component auditor>>

1. Use of the remote-work approach to perform audit procedures on component financial information - basic approach to audit evidence

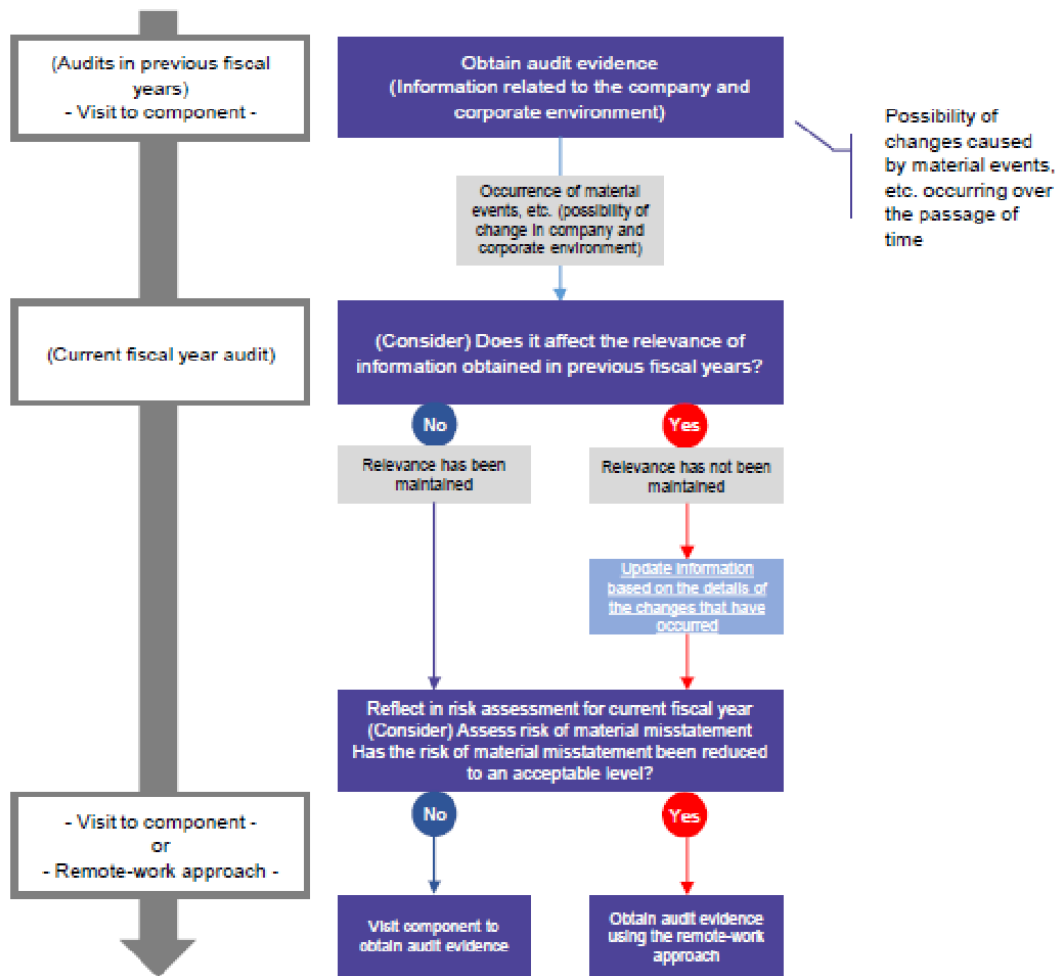
The auditor shall design and perform audit procedures to reduce the audit risk to an acceptable level, including determining the extent of their own involvement, based on new material events and conditions that have arisen at the component, the economic environment, the assessment of the risk of material misstatement in relation to the component, the status of necessary audit evidence, the results of site-visits by the auditor in previous fiscal years, and the results of interviews with the component auditor. In such cases, the auditor shall consider the relevance and reliability of the information to be used as audit evidence (Paragraph 7 of Auditing Standards Committee Statement 500, “Audit Evidence”; hereinafter, “ASCS 500”). The reliability of the information used as audit evidence, therefore the persuasiveness of the audit evidence itself, is influenced by the source of the information, the type of information, and where relevant the evaluation of the internal controls over the creation and management of the information.

Audit evidence is cumulative in nature, and is primarily obtained from audit procedures performed during the course of the audit. When assessing audit risk, as stated in Paragraph 9 of the Auditing Standards Committee Statement 315 “Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment”, where the auditor intends to use information obtained from the auditor’s previous experience with the entity and from audit procedures performed in previous audits, the auditor shall determine whether changes have occurred since the previous audit that may affect its relevance to the current audit. Audit evidence obtained from previous audits may provide appropriate audit evidence in cases where the auditor has performed audit procedures to establish its continuing relevance (ASCS 500, Paragraph A11). In previous fiscal years auditors may have visited the component to deepen their understanding of such matters as the business activities of the component (business operations, corporate governance, investments, etc.), the selection and application of accounting policies, business risks, and the company’s performance measures, or have held interviews with the management and the person responsible for accounting. Information related to the company and the corporate environment that has been obtained on such occasions may change with the passage of time, so it is necessary to check whether material events have occurred that lead to changes in the company and its environment, and to consider whether they have affected the relevance of the information obtained in previous fiscal years. Information that has remained relevant should be taken into account during the risk assessment for the current fiscal year, while information that is no longer relevant should be updated to reflect the changes that have

occurred, and incorporated into the risk assessment for the current fiscal year. ¹In cases where, as a result of assessing the risk of material misstatement, it is deemed possible to reduce the risk of material misstatement to an acceptable level, it may be feasible to perform audit procedures based on the remote-work approach to obtain audit evidence for the current fiscal year, instead of visiting the component.

¹ This information may be updated by ascertaining the details of any changes in information related to business risks and the company's performance measures, such as new business activities conducted by the component, and changes in the selection and application of accounting policies.

[Figure 2] Basic approach to audit evidence obtained by means of remote-work approach audit procedures



However, although the reliability of documents other than the original depends on the internal controls over their creation and management, the reliability of information used as audit evidence, therefore the persuasiveness of the audit evidence itself, is affected not only by the source and type of information, and where relevant the condition of internal controls over the creation and management of information themselves, but also by the circumstances in which the audit evidence was obtained. In general, audit evidence provided by original documents is deemed to have greater persuasiveness than audit evidence provided by documents converted to an electronic medium through digitalization, etc. (ASCS 500, Paragraph A31). Considering the spirit of these provisions, when the auditor cannot directly access the original, in cases where audit evidence was obtained by performing audit procedures using the remote-work approach, and has been digitalized by converting the information of the original paper medium into PDF or by photographing information with a camera, the auditor should take into account that its probative force is different from the evidence that has been obtained directly and that audit risk (detection risk) can arise as a result of digitalization, as well as bearing in mind that in some cases it may be necessary to use it in combination with other audit evidence obtained.

2. Considerations when performing audit procedures on component financial information and becoming involved in the work performed by the component auditor using the remote-work approach

In cases where, as a result of assessing the risk of material misstatement for the current fiscal year, the auditor attempts to obtain sufficient appropriate audit evidence by performing audit procedures themselves on component financial information using the remote-work approach instead of visiting the component, the auditor should consider alternative audit procedures. Alternative audit procedures will vary depending on the audit evidence that the auditor is trying to obtain. In some cases an auditor working in a remote work environment may obtain the necessary information in an electronic medium or through an electronic process, or by means of images taken using a camera, while in other cases an auditor may obtain it by using the telephone or remote meeting tools.

However, in cases where it is obtained by converting information on a paper medium to PDF format, or where it is obtained from a camera in image form, it is easy to falsify the information during the process of converting the original to PDF format or at the stage at which the image data is created, and such falsification is difficult to detect. Information derived from electronic processes and interactions conducted in electronic form also involve a higher risk of information leakage or impersonation. The auditor must recognize that expected risks for audit procedures performed using the remote-work approach, such as audit risks arising from digitalization of audit evidence (detection risk), are different from the risks for audit procedures performed during a site-visit by the auditor themselves, and that the authenticity of the information thus obtained must be confirmed (refer to Remote Work Series No.3 “Audit Considerations in Relation to Authentication of Documentation Converted to PDF Format”). For example, for information obtained from the component in PDF format, the auditor might instruct the component auditor to provide the original for comparison purposes. In addition to this, the auditor may assess whether there is sufficient appropriate audit evidence in relation to the authenticity of the information in question, by performing procedures such as questioning persons involved in its creation, checking for contradictions with audit evidence obtained through other audit procedures, checking directly with the person issuing the original (in cases where the issuer is an external entity), and checking the information in the properties of the PDF (creator, time and date of creation, time and date modified, etc.).² Furthermore, in cases where the auditor obtains information

² In the major package of tax revisions scheduled for FY2021, it has been indicated that there will be amendments to

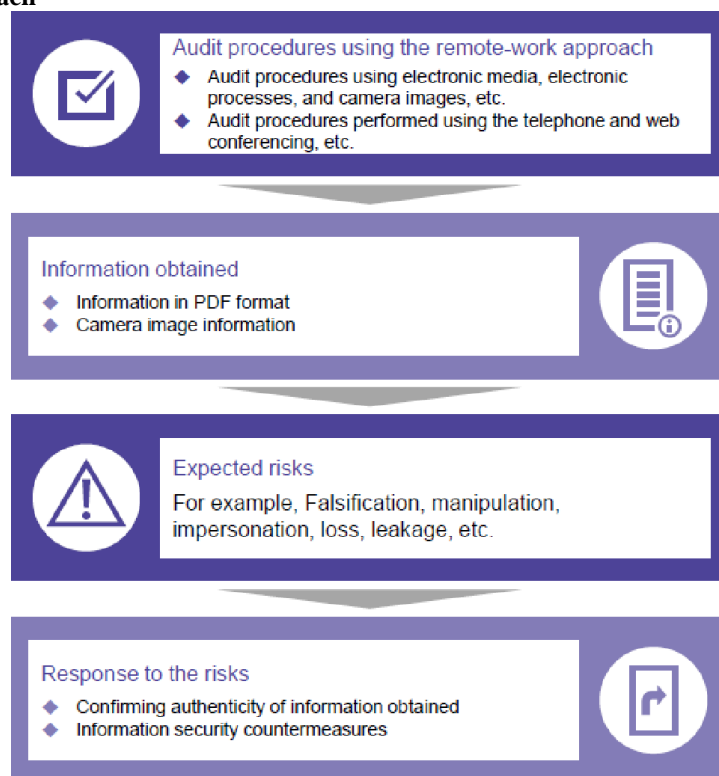
necessary for performing audit procedures under the remote-work environment, auditors should be aware of risks associated with information security, to take fully into account the possibility of loss or leakage, and also consider information security countermeasures that reflect advances in information technology (refer to Remote Work Series No.5 “Remote Meetings and the Use of Remote Meeting Tools”).

In the following cases, auditors should consider visiting the component or having the component auditor perform audit procedures:

- (1) A considerable number of years has elapsed since the time of the previous site-visit and it is considered necessary to update the information obtained from the previous site-visit.
- (2) Material changes have occurred at the component compared to previous fiscal years (including cases where they might reasonably be expected to have occurred).
- (3) Audit evidence obtained as a result of performing procedures in the current year in a remote work environment conflicts with audit evidence obtained during visits to the component in previous fiscal years.

the system for preserving electronic ledgers, with the requirement for appropriate administrative procedures being abolished, enabling the original paper documents to be disposed of without performing certain procedures. These are scheduled to be applied on January 1, 2022. JICPA is planning to consider a separate response to audit considerations in relation to this development.

[Figure 3] Managing expected risks when performing audit procedures using the remote-work approach

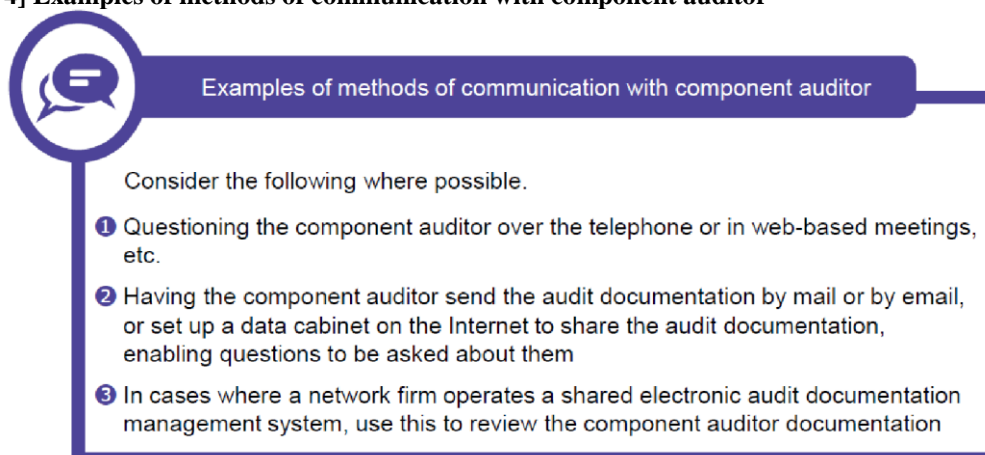


3. Reviewing the method and content of communications with component auditor

When involved in the work performed by the component auditor using the remote-work approach, for the auditor to communicate effectively with the component auditor as the group audit team, it is important to ensure timely communications with group management and those charged with governance of the group (hereinafter, “group management, etc.”). In particular, in cases where a component auditor who does not belong to the same network as the group auditor performs work related to the component’s financial information, communication with the component auditor can be weaker than cases where the auditor visits the component. Even in cases where the component auditor belongs to the same network, communication between the group audit team and the component auditor can be formal consisting of brief messages containing only a statement of conclusions. For that reason, as the group audit team, the auditor should seek to communicate more effectively with group management, etc. and take into account the need to establish an environment in which sufficient appropriate audit evidence can be obtained for work performed in relation to the component financial information.

Also, when involved in the work performed by the component auditor using the remote-work approach, the auditor may adopt the following methods of communication with the component auditor, instead of the group audit team giving instructions regarding audit procedures to the component auditor, or visiting the component auditor to ask questions about the results of audit procedures performed to review audit documentation.

[Figure 4] Examples of methods of communication with component auditor



Examples of methods of communication with component auditor

Consider the following where possible.

- 1 Questioning the component auditor over the telephone or in web-based meetings, etc.
- 2 Having the component auditor send the audit documentation by mail or by email, or set up a data cabinet on the Internet to share the audit documentation, enabling questions to be asked about them
- 3 In cases where a network firm operates a shared electronic audit documentation management system, use this to review the component auditor documentation

Furthermore, in cases where the component auditor performs audit procedures related to component financial information in a remote working environment, in order for the auditor as group audit team to be able to be involved in and fully assess the appropriateness of the work performed by the component auditor, it is particularly important for the auditor to communicate with the component auditor about material changes in the component's business and business environment, and about specific audit procedures, before the procedures are performed.

In addition, even in cases where the auditor communicates as required with the component auditor in a remote working environment, the auditor should bear in mind the need to manage risks associated with information security (refer to Remote Work Series No.5 "Remote Meetings and the Use of Remote Meeting Tools").