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February 1, 2021

Mr. Willie Botha  
Technical Director  
International Auditing and Assurance Standards Board  
International Federation of Accountants  
529 5th Avenue, 6th Floor  
New York, NY 10017, USA

Dear Mr. Botha,

Re: JICPA Response to the Discussion Paper, *Fraud and Going Concern in an Audit of Financial Statements*

The Japanese Institute of Certified Public Accountants (JICPA) is grateful for the opportunity to comment on the Discussion Paper, *Fraud and Going Concern in an Audit of Financial Statements* (the “Discussion Paper”).

The attached are our comments on “Questions for Respondents.”

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

Sincerely yours,

Sayaka Shimura  
Executive Board Member – Auditing Standards  
The Japanese Institute of Certified Public Accountants

## Comments on “Questions for Respondents”

### 1. In regard to the expectation gap (see Section I):

- (a) What do you think is the main cause for the expectation gap relating to fraud and going concern in an audit of financial statements?
- (b) In your view, what could be done, by the IAASB and/or others (please specify), to narrow the expectation gap related to fraud and going concern in an audit of financial statements?

### Comments on Fraud

(Comments on (a))

We think that the main causes of the expectation gap relating to fraud in an audit of financial statements are as follows:

There are actual cases in which the auditor was unable to detect material misstatement of the financial statements due to fraud.

An auditor is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error, and expressing an opinion. However, there are actual cases in which material misstatement of the financial statements due to fraud is subsequently discovered although the auditor expressed an unmodified opinion. This has triggered discussions as to whether the audit was properly conducted.

The roles of management, those charged with governance, and auditors in the financial reporting ecosystem need to be reaffirmed.

In order to achieve fair financial reporting, it is essential that all participants in the financial reporting ecosystem, in particular management, those charged with governance, and auditors, fulfil their respective roles. The extant International Standard of Auditing (ISA) 240 “The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements” (ISA240) paragraph 4 states “the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management.” ISA240 paragraph 5 also states “an auditor conducting an audit in accordance with ISAs is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error.” Under the current financial reporting system, it is considered that the social consensus is to set the objectives and scope of an audit of financial statements as obtaining “reasonable assurance” that the financial statements are free from material misstatement, taking into account social benefits and costs. Detecting non-material fraud committed by employees and responding to cyber risks that do not cause material misstatement of the financial statements, which are described in the discussion paper, should not be included

within the scope of an audit of financial statements, taking into account social benefits and costs.

In order to ensure that the financial reporting ecosystem as a whole responds more appropriately to fraud, we believe that there should be sufficient dialogue and reaffirmation among the participants on their roles and responsibilities of management, those charged with governance, and auditors.

(Comments on (b))

Here, we describe what could be done by those other than IAASB. See the comments on question 3 for information on enhancing audit standards.

Enhancement of the disclosure system about the responses of management and those charged with governance for preventing and detecting fraud

Management and those charged with governance are responsible for corporate governance of the entity, including preventing and detecting fraud. Corporate governance matters may be disclosed as non-financial information in a section outside the financial statements of the annual report. Disclosing the efforts of management and those charged with governance for preventing and detecting fraud could lead to reaffirmation of their respective roles and encourage the establishment of enhanced corporate governance.

**Comments on Going Concern**

We are aware of cases overseas where the entities went bankrupt in the accounting period immediately after the audit report was issued without any reference to going concern, triggering discussions as to whether the audit was properly conducted.

On the other hand, we are not aware of any significant issues in Japan that require consideration regarding audit procedures of a going concern.

First of all, for Japanese entities that publish annual securities reports (listed entities, etc.), if events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern are identified but there is no material uncertainty related to them, it is required by laws and regulations (Cabinet Office Ordinance on Disclosure of Corporate Affairs, etc.) for the entity to disclose the information in its annual report outside of financial statements as business risks. In addition, when management is aware of material uncertainties, the entity shall disclose those uncertainties in its financial statements. In either case, it is required respectively by the Financial Instruments and Exchange Act for the entities to properly disclose the information and for the auditors to perform appropriate procedures on the disclosure. With regard to auditor reporting, the Japanese Auditing Standards have been revised in response to IAASB's New and Revised Auditor Reporting Standards issued in 2015. In addition, Auditing Standards Committee Research Report No. 6, "Q&A in regard to Audit Reports," which is a guidance document issued by the JICPA in 2019, explains the details of considerations required for the auditors in light of the above-mentioned Japanese disclosure system. Furthermore, in Japan, the preparation of quarterly financial statements and a quarterly review by auditors of

those reports are required for listed entities. Therefore, an entity's ability to continue as a going concern is assessed by management and examined by auditors every three months, and the information is disclosed in a timely manner when a new event occurs.

In addition, as described in the Discussion Paper, many of the going concern issues should primarily be addressed by the financial reporting framework.

As such, currently we are not aware of any significant expectation gap with respect to going concern or the need to enhance requirements. Although there is a possibility that an entity might suddenly go bankrupt when fraud is discovered, we believe that this should be considered as a response to fraud rather than going concern.

**2. This paper sets out the auditor's current requirements in relation to fraud in an audit of financial statements, and some of the issues and challenges that have been raised with respect to this. In your view:**

**(a) Should the auditor have enhanced or more requirements with regard to fraud in an audit of financial statements? If yes, in what areas?**

**(b) Is there a need for enhanced procedures only for certain entities or in specific circumstances? If yes:**

**(i) For what types of entities or in what circumstances?**

**(ii) What enhancements are needed?**

**(iii) Should these changes be made within the ISAs or outside the scope of an audit (e.g., a different engagement)? Please explain your answer.**

**(c) Would requiring a "suspicious mindset" contribute to enhanced fraud identification when planning and performing the audit? Why or why not?**

**(i) Should the IAASB enhance the auditor's considerations around fraud to include a "suspicious mindset"? If yes, for all audits or only in some circumstances?**

**(d) Do you believe more transparency is needed about the auditor's work in relation to fraud in an audit of financial statements? If yes, what additional information is needed and how should this information be communicated (e.g. in communications with those charged with governance, in the auditor's report, etc.)?**

(Comments on (a))

The IAASB should determine whether to enhance the requirements. Specifically, we recommend that the following areas should be thoroughly considered, which are included in the "Standard to Address Risks of Fraud in an Audit" (hereinafter referred to as the "Standard to Address Risks of Fraud") that have already been

introduced in an audit of financial statements of publicly traded companies in Japan.

#### Enhancing and adding requirements depending on circumstance in relation to fraud

It should be clarified that auditors must differentiate responses depending on the differences in circumstances in relation to fraud, when designing and performing audit procedures to respond to the risks of material misstatement due to fraud. For example, the standard may differentiate the circumstances in relation to fraud as follows:

- Circumstances that indicate the possibility of a material misstatement due to fraud are not identified (normal circumstances);
- Circumstances that indicate the possibility of a material misstatement due to fraud are identified (Standard to Address Risks of Fraud section II paragraph 10); and
- After evaluating the identified circumstances that indicate the possibility of a material misstatement due to fraud, the auditor determines that a suspicion of a material misstatement due to fraud exists (Standard to Address Risks of Fraud section II paragraph 12)

Since the responses to risks of material misstatement due to fraud and the level of professional skepticism vary significantly depending on the circumstances in relation to fraud, we believe that such differentiation of circumstances are useful. When an auditor determines that a suspicion of a material misstatement due to fraud exists, we believe that it would be effective to require the auditor to exercise increased professional skepticism and perform more in-depth audit procedures.

In order to introduce this framework effectively, it is crucial that auditors be able to identify an indication of fraud. To this end, we believe that the firm needs to implement policies to foster such a mindset enable auditors to identify an indication of fraud, deliver training programs on fraud cases, establish the firm's quality control system that address fraud issues, and consider audit methodologies that effectively respond to fraud. In this regard, the Standard to Address Risks of Fraud requires that the firm establish appropriate quality control policies and procedures taking into consideration the risks of fraud (Standard to Address Risks of Fraud section III paragraph 1). In relation to education and training on fraud, the JICPA mandates audit quality and fraud risk training in the continuing professional education (CPE) system for the members who are engaged in an audit engagement.

For professional skepticism, see also the comments on question 2(c).

#### Using the work of an expert

The auditor should be required to determine whether the skill and knowledge of an expert is needed during the audit, for example, to perform assessments of risks of fraud, perform audit procedures, or evaluate audit evidence, according to the nature and significance of the risks of fraud (Standard to Address Risks of Fraud section II paragraph 14). In this context, "expert" means, for example, forensic and IT experts.

### Consultation when the auditor determines that a suspicion of a material misstatement due to fraud exists

It would be useful for the firm to establish policies and procedures for consultation so that the members of the engagement team undertake consultation with others at the appropriate level within or outside the firm (e.g. appropriate resources of the firm who have relevant technical expertise and experience), as necessary, when the auditor has identified a circumstance that indicates the possibility of a material misstatement due to fraud or the auditor has determined that a suspicion of a material misstatement due to fraud exists (Standard to Address Risks of Fraud section III paragraph 6).

### Engagement quality control review when the auditor has determined that a suspicion of a material misstatement due to fraud exists

It would be useful for the firm to establish policies and procedures requiring an engagement quality control review to be conducted as to whether the modified audit plan and audit procedures are appropriate and whether sufficient appropriate audit evidence has been obtained when the auditor has determined a suspicion of material misstatement due to fraud exists (Standard to Address Risks of Fraud section III paragraph 7). When the auditor has determined that a suspicion of material misstatement due to fraud exists, the engagement quality control review may be different from that under circumstances where no suspicion of material misstatement due to fraud has been identified, in terms of the scope of the review, as well as the experience and authority of the reviewer.

### Responses when identifying non-immaterial fraud or a circumstance that indicates the possibility of non-material misstatement due to fraud

In the course of an audit, when the auditor identifies a non-material fraud or a circumstance that indicates the possibility of a non-material misstatement due to fraud, it should be required to determine whether there is a suspicion of material misstatement due to fraud by understanding the fraud, its causes and relevant internal control and performing additional audit procedures even if the fraud itself is not material (cf. Standard to Address Risks of Fraud section II paragraph 10).

(Comments on (b))

Enhanced requirements regarding fraud should be applied only to an audit of financial statements of a particular type of entity, such as public interest entities (PIEs). Enhanced requirements regarding fraud would entail social costs, but from a public interest perspective, we believe that the benefits outweigh the social costs when those enhanced requirements are applied to an audit of the financial statements of entities whose financial statements and auditor's report are used by a large number and wide range of stakeholders. In addition, as mentioned above, we believe that effective and efficient audits can be achieved by applying the enhanced requirements according to phases.

In response to the implementation of the Standard to Address Risks of Fraud in 2013, the JICPA conducted a questionnaire survey on the impact of the standard in the second year of its application (fiscal year ending

March 2015) and published a report on the results in May 2016. The report analyzed the responses from 713 persons involved in audit engagements of listed entities as engagement partners. The largest number of respondents answered that the Standard to Address Risks of Fraud had positive effects on reducing the risk that auditor overlook the material misstatements due to fraud. The respondents also noted that required auditors' work efforts related to risk of fraud was increased. . IOverall, 55% of the respondents gave a positive rating on the Standard to Address Risks of Fraud. Please refer to the appendix of this letter for the results of the questionnaire survey.

(Comments on (c))

The Standard to Address Risks of Fraud does not use the term "suspicious mindset." When identifying circumstances that indicate the possibility of a material misstatement due to fraud, however, the auditor shall exercise increased professional skepticism, determine whether there is any suspicion of a material misstatement due to fraud, and perform the audit procedures to address such a suspicion. We believe it is appropriate to require the level of professional skepticism to be raised in certain phases when the likelihood of fraud has become higher.

However, we do not agree that "suspicious mindset" be implemented as a basic stance of audits, requiring audit procedures to be performed based on the assumption that fraud exists in all circumstances. If audits were conducted on the assumption that fraud exists in all circumstances, the performance of audits might be hindered, such as difficulty in obtaining information during the course of audits, and the quality of audits would decline as a result.

In addition, we believe it is necessary to carefully consider whether it is appropriate to introduce the different term "suspicious mindset" in addition to "professional skepticism." If the new different term is introduced even though the term "professional skepticism" already exists in ISAs, it may cause confusion.

(Comments on (d))

Under the current framework, the work of an auditor in areas where the risk of material misstatements is assessed as high or a significant risk, including a risk of material misstatement due to fraud, can be stated in the auditor's report as a key audit matter. We therefore believe that transparency to the users of financial statements can be ensured under the current framework. As for the transparency to those charged with governance, significant findings from the audit are also subject to communication with those charged with governance in ISA260 "Communication with Those Charged with Governance" paragraph 16. Therefore, we believe that transparency to those charged with governance can also be ensured.

**3. This paper sets out the auditor's current requirements in relation to going concern in an audit of financial statements, and some of the issues and challenges that have been raised with respect to this.**

**In your view:**

- (a) Should the auditor have enhanced or more requirements with regard to going concern in an audit of financial statements? If yes, in what areas?**
- (b) Is there a need for enhanced procedures only for certain entities or in specific circumstances?  
If yes:**
  - (i) For what types of entities or in what circumstances?**
  - (ii) What enhancements are needed?**
  - (iii) Should these changes be made within the ISAs or outside the scope of an audit (e.g., a different engagement)? Please explain your answer.**
- (c) Do you believe more transparency is needed:**
  - (i) About the auditor's work in relation to going concern in an audit of financial statements? If yes, what additional information is needed and how should this information be communicated (e.g., in communications with those charged with governance, in the auditor's report, etc.)?**
  - (ii) About going concern, outside of the auditor's work relating to going concern? If yes, what further information should be provided, where should this information be provided, and what action is required to put this into effect?**

As stated in the comments on question 1, we are aware that in other jurisdictions, there are discussions on whether the audit was properly conducted due to the issues of going concern. On the other hand, we are not aware of any significant issues in Japan that require consideration regarding audit procedures of going concern. Therefore, we do not acknowledge the need to enhance or add requirements in regard to going concern.

**4. Are there any other matters the IAASB should consider as it progresses its work on fraud and going concern in an audit of financial statements?**

In response to fraud, it is essential that all participants in the financial reporting ecosystem, in particular management, those charged with governance, and auditors, fulfil their respective roles, as described above. In this regard, we think it is effective to conduct research from the perspective of the entire financial reporting ecosystem. While the Discussion Paper explains that a number of corporate failures and scandals across the globe have occurred, we do not believe that such significant fraud has occurred in all jurisdictions. For example, in the US, we understand that there have been no such significant incidents in recent years, compared with other jurisdictions. Therefore, in jurisdictions where the financial reporting ecosystem is considered to be functioning



effectively in relation to fraud, it is worth considering what systems (e.g. disclosure systems, penalty provisions for management and/or auditors) exist and how they function for the prevention and/or detection of fraud.

## [Appendix] Questionnaire Survey Results on Applicability of the Standard to Address Risks of Fraud

The following is an excerpt of the description of “2. Impact of the Standard to Address Risks of Fraud on audit practices (1) total responses” included in the “Fact-finding Survey Report on Inconsistency of Opinions on Audited Companies in Fraudulent Financial Reporting and Audit – Summary Version” published by the JICPA in May 2016.

Regarding the impact of the Standard to Address Risks of Fraud on audit practice, 35.7% of respondents answered #4 that the Standard to Address Risks of Fraud had positive effects on reducing the risk that auditor overlook the material misstatements due to fraud. The respondents also noted that required auditors’ work efforts related to risk of fraud was increased. The answer was followed by #1 (21.9%) that the audit practice was not changed that much, because suggested procedures have been already conducted in accordance with the extant Audit Standards Committee Statements in Japan. Then, #5 (21.3%) that the required auditors’ work efforts related to risk of fraud had increased, whereas the Standard had limited effects on reducing the risk that auditor overlook the material misstatements due to fraud. 16.2% of the respondents (#2 and #3) stated that the Standard to Address Risks of Fraud had significant positive effects on audit practice. The reason why the number of respondents chose #2 and #3 was limited to 16.2% because the Standard to Address Risks of Fraud did not fundamentally change the previous audit methodology. Overall, we found that 55% of the respondents gave positive rating on the Standard to Address Risks of Fraud, which consist of #2 and #3 that noted significant positive effects, #4 that noted positive effects and some responses in #6 that noted positive effects.

Response	Number of responses	Percentage of total
1. The suggested procedures have been already conducted in audit practice in accordance with the extant Audit Standards Committee Statements in Japan. As such, the audit practice was not changed that much by the Standard to Address Risks of Fraud.	155	21.9%
2. The Standard to Address Risks of Fraud had significant positive effects to reduce the risk that auditor overlook the material misstatements due to fraud, because the Standard raised auditors’ awareness for risks of fraud. Although many elements of the Standard were included in the extant Audit Standards Committee Statements, specifying the requirements in new and separate standards resulted in the significant positive effects.	66	9.3%
3. The Standard to Address Risks of Fraud had significant positive effects on reducing the risk that auditor overlook the material misstatements due to fraud, because the Standard enabled auditors to perform audit procedures that have not been conducted before. This is because the	49	6.9%

Standard clarified that an auditor has to inquire management and perform certain additional procedures, when auditor identifies the circumstances that indicated the possibility of a material misstatement due to fraud.		
4. The Standard to Address Risks of Fraud had positive effects to reduce the risk that auditor overlook the material misstatements due to fraud. In addition, the required auditors' work efforts related to risk of fraud was increased at many audit engagements of listed entities. The additional work efforts include procedures and documentation that may/may not be directly related to material misstatement due to fraud.	253	35.7%
5. The Standard to Address Risks of Fraud had limited effects on reducing the risk that auditor overlook the material misstatements due to fraud. In addition, the required auditors' work efforts related to risk of fraud had increased at many audit engagements of listed entities, including procedures and documentation that may/may not be directly related to material misstatement due to fraud.	151	21.3%
6. Others (Please describe them specifically.)	35	4.9%
Total	709	100%