

March 2, 2021

To JICPA members

The Japanese Institute of Certified Public Accountants

Audit Considerations related to COVID-19 (Part 7)

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

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

This year, the Japanese government declared state of emergency again for 11 prefectures¹, including Tokyo and Osaka, and it continues to be extremely difficult to predict how the COVID-19 pandemic will develop in the future and when it will be brought under control. In light of such circumstances, the Accounting Standards Board of Japan (ASBJ) issued the Summary of the Discussions at the 451st Board Meeting² (hereinafter, the “451st Board Meeting Summary”) on February 10, 2021 to continue to promote the approach presented in the Summary of the Discussions at the 429th Board Meeting: “Incorporating the Effects of the Novel Coronavirus Pandemic when Making Accounting Estimates under Japanese GAAP³” (hereinafter, the “429th Board Meeting Summary”) issued on April 10, 2020.

In response to the issuance of the 429th Board Meeting Summary, JICPA released on April 10, 2020 Audit Considerations related to COVID-19 (Part 2)⁴ (hereinafter, the “Audit Considerations (Part 2),” which summarizes what should be considered during audits under the high degree of estimation uncertainty. This time, JICPA has released “Audit Considerations related to COVID-19 (Part 7)⁵” (hereinafter the “Audit Considerations (Part 7),” following the issuance of the 451st Board Meeting Summary.

The Audit Considerations (Part 7) once again publicize what should be still considered during the audits of accounting estimates as stated in the Audit Considerations (Part 2). Also, through this notice, JICPA calls upon its members who are engaged in audit engagements to communicate with management and those charged with governance in a timely and appropriate manner⁶, with

¹ The declaration of the state of emergency was lifted in one prefecture on February 7, 2021 and subsequently in six prefectures, including Osaka, on February 28, 2021.

² 451st Board Meeting Summary: https://www.asb.or.jp/en/wp-content/uploads/20210210_e.pdf (ASBJ website)

³ 429th Board Meeting Summary: https://www.asb.or.jp/en/wp-content/uploads/20200413_e.pdf (ASBJ website)

⁴ Audit Considerations (Part 2) was updated on May 12, 2020 in response to the issuance of the Summary of the Discussions at the 432nd Board Meeting “Incorporating the Effects of the Novel Coronavirus Pandemic when Making Accounting Estimates under Japanese GAAP (Addendum)” issued on May 11, 2020 https://jicpa.or.jp/english/files/0-99-0-2e-20200512_1.pdf (JICPA website).

⁵ The Audit Considerations (Part 7) should be read together with the 451st Board Meeting Summary and Audit Considerations (Part 2).

⁶ Paragraph 7 of the Auditing Standards Committee Statement (ASCS) No. 540 “Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures” (Report No. 44, revised on May 29, 2015) and Paragraph 16 of ASCS No. 701 “Communicating Key Audit Matters in the Independent Auditor’s Report”

consideration given to the facts that the effects of the COVID-19 pandemic on operating results and financial position vary widely by company and that the deadline for the mandatory adoption of key audit matters (KAM) from the fiscal year ending March 31, 2021 is only days away.

Matters stated in the Audit Considerations (Part 2) are summarized below. For further details, refer to the original text of the Audit Considerations (Part 2).

- Unless the certain assumptions made by the entity is clearly unreasonable, estimated amounts as a result of developing the best estimates would not be considered “errors,” even when the estimated amounts turn out to be different from the subsequent results.
- It is inappropriate for the auditor to accept overly optimistic accounting estimates made by management, or regard management’s estimates as material misstatement based on overly pessimistic auditor’s assumptions.
- If the uncertainty associated with the accounting estimates has a significant impact on the judgement of the users of the financial statements, the auditor considers whether useful information is provided to the users through disclosure of information on accounting estimates.

1. Approach to incorporating effects of COVID-19 in accounting estimates publicized in the 451st Board Meeting Summary

The 451st Board Meeting Summary issued by the ASBJ identifies the COVID-19 pandemic as an event that has far-reaching effects on the economy and business activities, and states that because it is difficult to predict how this pandemic will develop in the future and when it will be brought under control, “it has become extremely difficult for management to make accounting estimates, particularly to predict future cash flows” for the impairment of fixed assets and the recoverability of deferred tax assets. JICPA members are asked to once again give due consideration to what should be noted when making accounting estimates presented in the meeting summary as below. In addition, for the information required by ASBJ Statement No. 31 “Accounting Standard for Disclosure of Accounting Estimates,” which will be applied to consolidated and standalone financial statements for fiscal years ending on or after March 31, 2021 in relation to (4) below, please refer to the text of the 451st Board Meeting Summary.

- (1) When “determining the reasonable amount based on all available information,” it is necessary to develop the best estimates after making certain assumptions, even though there may be high uncertainty in the event. Such event with high uncertainty includes the novel coronavirus pandemic.
- (2) In making the certain assumptions, it is desirable to use objective information based on external sources to the extent possible. However, in the context of the effects of the novel coronavirus pandemic, there is no past experience that can be used for reference to make accounting estimates, and there is no uniform view as to how the pandemic will develop in the future and when it will be brought under control. Accordingly, in most cases, objective information based on external sources will not be available. In this situation, for the effects of the novel coronavirus pandemic, an entity will need to make the certain assumptions on its own, including how the pandemic will develop in the future and when it will be brought under control.
- (3) Unless the certain assumptions made by the entity is clearly unreasonable, estimated amounts as a result of developing the best estimates would not be considered “errors,” even when the estimated amounts turn out to be different from the subsequent results.
- (4) The certain assumptions made regarding the effects of the novel coronavirus pandemic when developing the best estimates may differ among entities and, accordingly, the amounts estimated under the similar conditions may differ. For accounting estimates made in these circumstances, it is necessary to disclose specific information that enables users of the financial statements to understand the assumptions that were made to make the accounting estimates. If such information is material, entities appear to be required to disclose “additional information” in the financial statements.

2. Communication with management and those charged with governance in a timely and appropriate manner

In the fiscal year ended March 31, 2020, many listed companies had to prepare their financial statements under the state of emergency. Nevertheless, the COVID-19 seemed to have a limited impact on their operating results and financial position back then because the pandemic was still in its early stages. However, as more than 10 months have passed since the declaration of the state of emergency on April 7, 2020, a considerable number of companies have reportedly been severely affected in their operating results and financial position, especially those in certain industries, such as restaurant industry, which have been asked to shorten operating hours in accordance with the law under the second state of emergency declared in January 2021. In preparing financial statements and conducting audits of such companies, there may be cases where both management and the auditor are forced to make extremely difficult decisions on accounting for estimates and the audits. Under such circumstances, the auditor is expected to make further professional efforts to make fair decisions and act with integrity. It is therefore important that the auditor recognizes the effects of the COVID-19 pandemic on corporate results and assess audit risks appropriately, while paying more attention than usual to communicate with management and those charged with governance of the audited entity in a timely and appropriate manner. In doing so, it is not appropriate for the auditor to accept overly optimistic accounting estimates made by management. It is also inappropriate for the auditor to regard management's estimates as material misstatement based on overly pessimistic auditor's assumptions that deviate from the reality.