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JICPA Comments on the Consultation Paper “Matters to Consider in a Revision of International Standard on Review Engagements 2400, Engagements to Review Financial Statements”.

The Japanese Institute of Certified Public Accountants (“we”, “our”, and “JICPA”) is pleased to provide you with our comments on the Consultation Paper “Matters to Consider in a Revision of International Standard on Review Engagements 2400, Engagements to Review Financial Statements”. Based on our review, we have the following comments:

1. Is the concept of a ‘moderate level of assurance’ meaningful for practitioners?

Comment:

The concept of a ‘moderate level of assurance’ is meaningful for practitioners, since practitioners who perform the engagements to review of financial statements are able to understand the level of assurance which is required to obtain in the review engagements, by comparing the expression ‘moderate level of assurance’ with the definition of ‘reasonable assurance’, being ‘a high, but not absolute, level of assurance’.

2. How should a practitioner determine what constitutes a moderate level of assurance for a review of financial statements?

Comment:

The practitioner should determine what constitutes a moderate level of assurance for a review of financial statements by considering factors such as:

- the fact that the engagement risk for the limited assurance engagement is higher than the engagement risk for the reasonable assurance engagement (i.e. audit);

- the fact that in the limited assurance engagement, the combination of the nature, timing and extent of evidence-gathering procedures is at least sufficient for the practitioner to obtain a meaning level of assurance as the basis for a negative form of expression:
- engagement circumstances (for example, the needs of the intended users and the characteristics of the historical financial information which is covered by the review engagement).

Since the level of assurance appropriate for a ‘moderate level of assurance’ is different for review engagements, especially for the reason mentioned in the third bullet above, it is not possible to describe the level of assurance for the review engagements by specific point or range (such as certain percentage). This also applies in the case of the reasonable assurance. Although there is wider range in practitioners’ interpretation about review engagement than audit engagement as indicated in paragraphs 24 and 26, this will be diminished by the following:

- the review engagement being more widely used in practice;
- updating the review standards and establishing more guidance regarding the nature, timing and extent of evidence-gathering procedures;
- clear communication in the engagement report.

3. Should ISRE 2400 contain requirements and guidance to assist practitioners’ judgments at the pre-acceptance stage as to whether a request to undertake a review of an entity’s financial statements is:

(a) practicable; and

(b) appropriate, in the sense of being likely to meet the needs and expectations of the engaging party and those parties who are intended users of the report?

Comment:

ISRE 2400 should contain requirements and guidance to assist practitioners’ judgments at the pre-acceptance stage as to whether a request to undertake a review of an entity’s financial statements is practicable. Similar considerations in ISA 210 and ISA 220 are also relevant for the review engagements. However, ISRE 2400 should not contain requirements and guidance to assist practitioners’ judgments at the pre-acceptance stage as to whether a request to undertake a review of an entity’s financial statements is appropriate, in the sense of being likely to meet the needs and expectations of the engaging party and those parties who are intended users of the report. Neither ISREs nor ISAs and ISRSs include such requirements and guidance. Although the practitioner may provide an explanation to the entity about the nature of review and audit to assist the entity’s understanding, determination whether to accept the engagement should be made mainly by practical considerations (i.e. point (a)). Where there are no statutory audit requirements, the determination about which type of engagement (audit or review) is more appropriate for the entity should be made primarily by the entity.

4. Should ISRE 2400 explicitly describe the respective obligations of the entity's management and those charged with governance, and of the practitioner performing the review of the entity's financial statements?

Comment:

ISRE 2400 should explicitly describe the respective obligations of the entity's management and those charged with governance, and of the practitioner performing the review of the entity's financial statements. The description should take into account the fact that the respective obligations may be different between jurisdictions.

5. To achieve the objective of a review engagement, what factors influence the practitioner's assessment of the work effort required to provide a reasonable basis for reporting the practitioner's conclusion(s) on the financial statements? To what extent are the illustrative detailed procedures contained in Appendix 2 to ISRE 2400 used in practice?

Comment:

The practitioners' assessment of the work effort is influenced by factors mentioned in paragraph 44. Especially, first and second bullets have strong influence on it. The first bullet corresponds to 'understanding the entity and its environment' in audit of the financial statements.

Although the illustrative detailed procedures contained in Appendix 2 are used in practice as necessary in the circumstances of the engagements, there are no cases where all the procedures contained in Appendix 2 are used in one specific review engagement.

6. How should a practitioner performing a review of financial statements address engagement risk when performing the review?

Comment:

Basically, a practitioner performing a review of financial statements should address engagement risk based on the risk assessment. As described in our response to question 7 below, in practice, even if the review engagement is based on performance of procedures without an explicit assessment of risk of misstatement in the financial statements, such review engagement is based on an implicit assessment of such risk. Therefore, it is not necessary to include detailed requirements and guidance regarding risk assessment which are needed in the case of the audit of the financial statements.

7. Would the nature, timing and extent of review engagement procedures be significantly different between a review engagement based on performance of procedures without an explicit assessment of risk of misstatement in the financial statements, and a review engagement where a risk-based approach is applied to assess and respond to those risks? Would the costs of the engagement differ significantly?

Comment:

There may be some difference in the nature, timing and extent of review engagement procedures, such as for documentation. However, procedures for performing a review are mainly comprised of inquiries and analytical procedures and a review ordinarily does not require tests of the accounting records through inspection, observation or confirmation (ISRE 2410 Paragraph 20). In practice, even if the review engagement is based on performance of procedures without an explicit assessment of risk of misstatement in the financial statements, such a review engagement is based on an implicit assessment of risk of misstatement in the financial statements (for example, paragraph 14 of ISRE 2400 implicitly requires obtaining an understanding of the entity and its environment). Therefore, the nature, timing and extent of review engagement procedures, and related costs would not be significantly different.

8. In general terms, what procedures are needed to obtain an understanding of the entity's internal control over financial reporting for purposes of performing a review of financial statements?

Comment:

Generally, the practitioner obtains an understanding of the entity's internal control over financial reporting by making inquiries. Although this approach is different from the audit of the financial statements (see paragraph 13 of ISA 315 (redrafted)), it is appropriate considering the difference of the required level of assurance between the review engagements and audit engagements. Usually, the practitioner who performs the review of entity's financial statements obtains an understanding of only those controls that relates to financial reporting process.

9. If the entity does not have internal controls that would prevent or detect occurrence of misstatements in the entity's financial statements, what are the implications for the practitioner regarding the entity's internal controls for the purpose of the review?

Comment:

If the entity does not have internal controls that would prevent or detect occurrence of misstatements in the entity's financial statements, the practitioner performs procedures for the review engagement without basing on it an understanding of the internal controls. As mentioned in paragraph 52, this approach resembles the approach applied for an audit of a small entity.

10. Does ISRE 2400 place appropriate emphasis on the use of enquiry as a source of evidence in a review engagement? To what extent, if at all, do you think use of enquiry in an engagement to review financial statements should differ from its use in an audit?

Comment:

We believe ISRE 2400 places appropriate emphasis on the use of inquiry as a source of evidence in a review engagement. The extent of the use of inquiry in a review engagement is wider than in an audit engagement. This is because the practitioner performing a review engagement obtains sufficient appropriate evidence through performing procedures which are mainly comprised of inquiries and analytical procedures, while the auditor performing an audit engagement ordinarily corroborates audit evidence from inquiries by performing other audit procedures.

11. Does ISRE 2400 provide sufficient guidance on how to apply analytical review procedures effectively in an engagement to review financial statements? If not, what additional guidance might be provided to assist practitioners?

Comment:

We believe ISRE 2400 does not provide sufficient guidance on how to apply analytical review procedures effectively in an engagement to review financial statements. It would be helpful for practitioners if additional guidance, such as following, were to be provided:

- explanation about the difference of analytical procedures between audit engagements and review engagements:
- examples of the analytical review procedures to be applied as necessary in the circumstances of the engagements.

12. To what extent, if at all, do you think use of analytical review procedures in a review engagement should differ from that in an audit engagement?

Comment:

Similar to our response to question 10, the extent of the use of analytical review procedures in an engagement to review financial statements is wider than in an engagement to audit financial statements, since the practitioner performing the review engagement obtains sufficient appropriate evidence through performing procedures which are mainly comprised of inquiries and analytical procedures.

13. What situations might require a practitioner performing a review to consider, based on the results of procedures performed to obtain evidence for the conclusion on the financial statements, whether performance of additional procedures is necessary to ensure that the engagement risk is reduced to an acceptable level?

Comment:

The practitioner is required to consider whether performance of additional procedures is necessary if a matter comes to the practitioner's attention that leads the practitioner to question whether a material adjustment should be made for the financial statements as a result of performing inquiries and analytical procedures. For example, in performing analytical review procedures, if the practitioner identifies the fluctuation or relationship that is inconsistent with other relevant information, or deviates significantly from predicted amounts, and the entity's management does not provide sufficient explanation, the practitioner is required to consider whether performance of additional procedures is necessary.

14. What factors should the practitioner consider to determine the nature and extent of further procedures required to reduce the engagement risk sufficiently to be able to express the conclusion on the financial statements?

Comment:

The practitioner should consider the relevant circumstances which give rise to the need to consider performing additional procedures, such as likelihood and magnitude of the potential misstatements and the nature of relevant transactions and account balances. However, we believe that in review engagements, there are only few cases where the practitioner would reduce the engagement risk sufficiently to be able to express a conclusion on the financial statements by performing additional procedures, since the nature and scope of procedures for review engagements is limited compared to audit engagements.

15. How, if at all, should a review of financial statements performed by a practitioner who is the entity's auditor differ from a review of financial statements performed by a practitioner who is not the entity's auditor?

Comment:

A practitioner who is the entity's auditor can perform the review of financial statements more effectively than a practitioner who is not the entity's auditor, since the practitioner who is the entity's auditor can use audit-based knowledge. Therefore, when a practitioner who is the entity's auditor performs the review of financial statements, he or she may be able to narrow the extent of the procedures compared to a practitioner who is not the entity's auditor.

16. How, if at all, should the nature, scope and extent of the work carried out for an engagement to review financial statements differ depending on whether or not the report issued for the review engagement will be made public, or be published together with the financial statements reviewed?

Comment:

The firm may establish policies and procedures which require the engagement quality control review for such engagements considering wider range of intended users. The consideration as to whether the nature and extent of work is different, depending on whether or not the report will be made public, or be published together with the financial statements reviewed, is relevant not only for the review engagements but also the audit engagements. Therefore, it is not appropriate to discuss this matter only for review engagements.

17. What are the key matters a practitioner performing a review of historical financial statements should be required to communicate with those charged with governance of the entity?

Comment:

In many cases, where the practitioner who is not an entity's auditor performs the review of financial statements, the entity operates small business and only one person may be charged with governance, for example, the owner-manager where there are no other owners. Also, requiring practitioners who perform the review engagements to communicate with those charged with governance similar to audit engagements would result in higher costs to the entity obtaining a review. This would significantly weaken market incentives that result in performance of reviews in preference to audits. Therefore, prior to that, there should be careful consideration as to whether the practitioner who performs a review of financial statements is required to communicate with those charged with governance as in the case in audit engagements.

18. How can a practitioner effectively communicate the concept of a level of assurance that is less than high, as obtained in a review engagement, to the intended readers or users of a review report, so that they will be able to properly estimate the level of confidence they can associate with the review conclusion?

19. Can the term 'moderate level of assurance' usefully be restated as a 'plain language' term in order to assist users of review reports to better understand the underlying message conveyed by the conclusion expressed in a review report?

20. What form of expression of the conclusion on the financial statements in the review report

might increase the perceived usefulness of a review as an alternative form of assurance engagement? Would a different expression of the practitioner's conclusion other than in negative terms increase readers' or users' understanding of the level of assurance conveyed and, if so, how should the practitioner's conclusion be expressed?

21. Given the limited work effort ordinarily undertaken for a review engagement (i.e. enquiry and analytical review procedures), what level of detail is appropriate to properly inform readers or users of the review report about the scope of the review engagement and the work undertaken for the engagement? Should practitioners be permitted to use a flexible format for their review reports to communicate the nature of the work undertaken?

Comment to Q18 and Q21:

For example, having a section with a heading 'Inherent Limitation of Review Engagement', containing explanation stated in paragraph 69, may be more effective in communicating the concept of a level of assurance in a review engagement. We believe extant wording in paragraph 69 is sufficient, since adding more explanation would reduce readers' attention and their understanding. Practitioners should not be permitted to use a flexible format for their review reports to communicate the nature of the work undertaken, unless it is required by law or regulation of the relevant jurisdiction to use a specific wording in the review report.

Comment to Q19:

We have no comment.

Comment to Q20:

The negative form of expression of the conclusion on the financial statements in the review report, which has been widely used in practice, should not be changed, since changing the form of expression would give rise to confusion.

22. Do the review engagement standards need to be complete in themselves so that they 'stand alone' as standards separate from the ISAs? If so, which aspects of the ISAs should be incorporated into the review engagement standards?

Comment:

The review engagement standards do not necessarily need to be complete in themselves so that they 'stand alone' as standards separate from the ISAs, as it would make the standards too lengthy. Since there are many requirements and guidance which are relevant for both review and audit of financial statements, there should be consideration as to whether or not there are requirements or guidance in ISAs which could be referenced to ISAs within the ISREs, with some explanation about the adaptation in the review engagements.

In closing, we wish to express our appreciation for this opportunity to comment on this Consultation Paper and hope you will consider our comments.

Sincerely yours

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