



**ICGN**

International Corporate Governance Network

Audit Standard Committee of the Business Accounting Council  
Financial Services Agency  
Tokyo  
Japan

By email

4 June  
2018

To the Audit Standard Committee of the Business Accounting Council

**ICGN Response to the Financial Service Agency's public consultation  
on the Exposure Draft of the Revision of the Audit Standards**

The International Corporate Governance Network (ICGN) is pleased to respond to the Financial Service Agency's (FSA) public consultation on the Exposure Draft of the Revision of the Audit Standards.

Led by investors responsible for assets under management in excess of US\$34 trillion, ICGN is a leading authority on global standards of corporate governance and investor stewardship. Our membership is based in more than 45 countries and includes companies, advisors and other stakeholders. ICGN's mission is to promote high standards of professionalism in governance for investors and companies alike in their mutual pursuit of long-term value creation contributing to sustainable economies world-wide. Our policy positions are guided by the ICGN Global Governance Principles<sup>1</sup> and the ICGN Global Stewardship Principles<sup>2</sup>, both of which have been developed in consultation with ICGN Members and as part of a wider peer review. For more information on ICGN please see: [www.icgn.org](http://www.icgn.org).

ICGN is actively involved in the dialogue regarding corporate governance and investor stewardship in Japan along a wide range of issues, including our recent responses to consultations on stewardship and governance by the FSA, the Tokyo Stock Exchange (TSE), Ministry of Economy Trade and Industry (METI) and the Ministry of Justice (MOJ). As one of the world's leading equity markets, with over 30% of TSE market capitalisation owned by overseas investors, the quality of corporate governance and investor stewardship practices in Japan is important to ICGN members.

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<sup>1</sup> See: Japanese language version of Global Governance Principles:  
[http://icgn.flpbks.com/icgn\\_global\\_governance\\_principles\\_jpn/](http://icgn.flpbks.com/icgn_global_governance_principles_jpn/)

<sup>2</sup> See: Japanese language version of Global Stewardship Principles  
[https://www.icgn.org/sites/default/files/ICGN\\_Global\\_Stewardship\\_Principles\\_JPN\\_1.pdf](https://www.icgn.org/sites/default/files/ICGN_Global_Stewardship_Principles_JPN_1.pdf)

As a general matter, ICGN is supportive of enhanced audit reporting as an important means of helping to inform investor decisions (whether to buy or sell, valuation and voting decisions) and to identify areas for informed engagement between investors and companies. The audit function is fundamental to robust transparency and shareholder protection, and ICGN has traditionally encouraged enhanced reporting and the use of Key Audit Matters (KAMs) in our regulatory outreach to both the International Auditing and Assurance Standards Board (2013)<sup>3</sup> and to the US Public Accounting Oversight Board's (2016).<sup>4</sup> It is positive to see this emphasis on enhanced reporting develop globally, and we believe it is entirely appropriate for Japanese audit reporting to head in this direction. Auditor reporting is a key objective for investors that will further strengthen their protections when using financial statements in making informed investment decisions.

In this context, we offer our comments on the Summary of the Exposure Draft of the Revision of the Audit Standards. Since we are working with only a very short English summary document, our comments will not be detailed. In short, we are supportive of what is being suggested by the Audit Standard Committee of the Business Accounting Council, and we encourage the revision of Japanese audit standards to include the introduction of KAMs. The summary of the English language exposure draft does a good job of addressing the basic elements of KAMs and how they can be introduced in independent auditor reports.

As a specific point related to this question, we would note that the clustering of annual general meetings (AGMs) in the last seven days of June in Japan leads to a crunch on information gathering which can impact the ability of investors to qualitatively analyse investee company governance. This may include the analysis of KAMs from the enhanced audit report. In Japan most companies have a financial year end of 31st March and tend to set the record date at the same time. However, from the work METI has done on this, it seems that it is possible to set a record date after the year-end simply by changing the company's Articles. Therefore, AGMs could be held beyond the traditional June period if companies were willing to do so. We encourage you to consider this, as we believe that this additional flexibility would be beneficial

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<sup>3</sup> ICGN comment letter on IAASB Exposure Draft Reporting on Audited Financial Statements, Proposed new and Revised International Standards on Auditing (ISAs) – Auditor Reporting (2013): [https://www.icgn.org/sites/default/files/IAASB%20-%2026.11.2013\\_0.pdf](https://www.icgn.org/sites/default/files/IAASB%20-%2026.11.2013_0.pdf)

<sup>4</sup> ICGN comment letter on Public Accounting Oversight Board's report on an Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion proposal (2016): <https://www.icgn.org/sites/default/files/PCAOB%20Auditors%20Report%201282016.pdf>

for companies in their reporting, and would also allow investors more time to assess KAMs or other relevant information ahead of their voting decisions.

In the appendix to this letter we share with you relevant sections of ICGN's past comment letters to the PCAOB and the IAASB relating to KAMs which provide a bit more detail on this point. We hope this may be useful in your deliberations as you make final decisions on these proposed revisions.

If you would like to follow up with us with questions or comments, please contact our Policy Director George Dallas: [george.dallas@icgn.org](mailto:george.dallas@icgn.org)

Yours sincerely,



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## **Appendix: Past ICGN Commentary on enhanced audit reporting and Key Audit Matters**

**ICGN letter to PCAOB (2016):** “The key to determining the right number of Critical Audit Matters (CAMs) is the balance between too little and too much information. ICGN believes the definition of a CAM as a matter communicated or required to be communicated to the audit committee that: (1) relates to accounts or disclosures that are material to the financial statements and (2) involved especially challenging, subjective, or complex auditor judgment is appropriate and aligns the scope and definition with the Key Audit Matters under the UK and IAASB models.

**ICGN letter to IAASB (2013):** Key Audit Matters (KAMs) We recommend the auditor consider the following in determining key audit matters:

- Key financial statement, business, operational and audit risks the auditor has considered when conducting the audit, and the extent, if any, as to how the auditor addressed those risks;
- The auditor’s assessment of the key estimates and judgments made by management that materially affect the financial statements, whether those assumptions are at the low or high end of the range of possible outcomes and how the auditor arrived at that assessment;
- The quality and appropriateness of the accounting policies and practices adopted by management including accounting applications and practices that are uncommon to the industry;
- Unusual transactions and significant changes to accounting policies that have a significant impact on the financial statements;
- Methods and judgments made in valuing assets and liabilities;
- Identification of any matters obtained in the course of their audit that the auditors believe are incorrect or inconsistent with the information contained in the financial statements or in other information (such as the Management Discussion and Analysis);
- Key audit issues and their resolution, which the audit partner documents in a final audit memo to the Audit Committee or those charged with governance;
- The quality and effectiveness of the governance structure of the board and risk management (including internal controls), and;
- Completeness and reasonableness of the Audit Committee report.

The substance and explanation of why the auditor considered these matters to be the most significant, why a matter was determined to be a key audit matter, and its effect on the audit are also necessary to provide a more complete and accurate representation on how the auditor concluded their opinion. KAMs would also provide investors with an understanding of areas of significant management judgment which were areas of focus during the audit, thereby providing a more substantial basis for engagement and dialogue.

KAMs may be the cornerstone basis for a qualified or adverse opinion. Key audit matters would tie to related financial statement disclosures and may provide suitable audit evidence for an auditor to modify their audit plan. We are cognizant of the challenges in communicating sensitive information relating to fraud, risks or significant deficiencies in internal control. However, the external auditor is well- positioned to judge objectively a company’s approach to risk and control.