

Summary of the Exposure Draft of the Revision of the Audit Standards (Introduction of KAMs)

○ Introduction of Key Audit Matter(s) (KAM(s)) to independent auditor's reports

The Audit Standard Committee of the Business Accounting Council has deliberated on the introduction of KAMs since October 2017, and has published the Exposure Draft of the revision of the Audit Standards.

1. Background

- Introducing KAMs to independent auditor's reports is beneficial to enhance transparency of the audit and augment informational value of the report. Various positive effects are to be expected, such as:
 - Providing users of the financial statements with information on the nature of the audit, and thereby facilitating the evaluation of the quality of the audit and enhancing confidence in the audit
 - Facilitating dialogue between corporate management and users
 - Promoting closer communication between auditors and those charged with governance (typically, Kansayaku in Japan) as well as in-depth risk-focused discussion between auditors and management, thus enhancing corporate governance and realizing more effective audits

2. Definition of KAMs

- KAMs are defined as those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. KAMs are selected from matters communicated with those charged with governance in the process of the audit.

3. Determining KAMs

- The auditor shall determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit. In making this determination, the auditor shall take into account the following:
 - Significant risks identified by the auditor, or areas of higher assessed risk of material misstatement,
 - Significant auditor judgments relating to areas in the financial statements

that involved significant management judgment, including accounting estimates that have been identified as having high estimation uncertainty,

- The effect on the audit of significant events or transactions that occurred during the period.
- The auditor shall determine which of the matters determined in accordance with the above paragraph were of most significance in the audit of the financial statements of the current period and therefore are KAMs.

4. Describing KAMs in the independent auditor's report

- The auditor shall describe each KAM, using an appropriate subheading, in a separate section of the auditor's report under the heading "Key Audit Matters." The description of each KAM in the section of the auditor's report shall include a reference to the related disclosure(s), if any, in the financial statements and shall address:
 - (a) Identification of the KAMs;
 - (b) Why the matter was considered to be one of most significance in the audit and therefore determined to be a KAM; and
 - (c) How the matter was addressed in the audit.

5. Scope of the introduction

- The reporting of KAMs is to be required for independent auditor's reports issued on the basis of the Financial Instruments and Exchange Act (FIEA).
- Voluntary application for other auditor's reports (including those on the basis of the Companies Act) is allowed.

○ Effective date

- The requirements of KAMs are effective for audits of financial statements for periods ending on or after March 31, 2021. Voluntary application for earlier periods is allowed and encouraged for listed companies on the TSE first section.