

Progress Report for “Improving Internal Audits of Financial Institutions” (Interim Report)

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I. Introduction

In June 2019, the Financial Services Agency has published the “Current Situation and Issues for Improving Internal Audits in Financial Institutions” (hereinafter referred to as “Current Status and Issues”). In this document, in order for financial institutions to ensure the appropriateness of their operations and financial soundness and contribute to the stability of the financial system by building sustainable business models, governance must function effectively through internal audit function’s appropriately fulfilling its mission¹.

Specifically, under the “Current Status and Issues”, the FSA requires for the internal audit function to evaluate the effectiveness and other aspects of organizational activities from a risk-based and forward-looking perspective, and to improve internal audits in response to changes in the environment.

The “Current Situation and Issues” shows that the level of internal audit can be evaluated according to phases. Large financial institutions² are positioned in the 2nd to 3rd phases, and the FSA requires them to first develop a system at the 3rd stage level, and then further improve their systems with reference to advanced initiatives by overseas G-SIFIs and other organizations. Furthermore, it also indicates that there is a phase beyond the 3rd phase called “trusted advisor” (4th phase), based on the advanced initiatives of overseas [Chart 1].

The improvement of internal audits is becoming increasingly important for all financial institutions as risks become more diversified and complex in response to changes in the environment, and as grouping and globalization progresses.

The FSA has continued to monitor financial institutions to improve their internal audits even after the publication of the “Current Situation and Issues”, and for large banking groups³, as part of full-year inspections for them, the FSA has held discussions with the heads of internal audit functions regarding the status of their initiatives for improving internal audits and the challenges they face. At the same time, the FSA are also exchanging opinions with external experts (consulting companies and auditing firms) regarding the performance of internal audit functions in the financial industry and advanced examples from overseas.

Based on the above monitoring, etc., the FSA has organized the status of internal audit initiatives and issue recognition in large banking groups, and has compiled this document as a progress report (interim report). The FSA publishes this in the hope that it help not only major banking groups but also other financial institutions to improve their internal audits.

From now on, the FSA will encourage the sophistication of internal audits through continuous monitoring of internal audit functions of financial institutions, while taking into account international trends regarding internal audits, and consider the need to update the “Current Status and Issues”

¹ The Institute of International Auditors (IIA) states that the mission of internal audits is to “to enhance and protect organizational value by providing risk-based and objective assurance, advice, and insight.”

² The three megabank groups (Mizuho Financial Group Inc., Mitsubishi UFJ Financial Group Inc., and Sumitomo Mitsui Financial Group Inc.), other large banking groups (Resona Holdings Inc., Sumitomo Mitsui Trust Holdings, Inc., SBI Shinsei Bank, Limited, Aozora Bank, Ltd., The Norinchukin Bank, and Japan Post Bank Co.,Ltd.), large life insurance companies (Nippon Life Insurance Co., Dai-ichi Life Insurance Inc., Meiji Yasuda Life Insurance Co., and Sumitomo Life Insurance Co.), large non-life insurance companies (Tokio Marine Group, MS&AD Insurance Group Holdings, Inc., and Sampo Japan Nipponkoa Insurance Group), and large securities companies (Nomura Securities Co. Ltd. and Daiwa Securities Co. Ltd.)

³ Refers to the three megabank groups and other large banking groups.

(including necessity of reconsideration of each phase).

[Chart 1] Level of Internal Audits (Conceptual Diagram)

	1st phase (Ver. 1.0) (Administrative deficiency audit)	2nd phase (Ver. 2.0) (Risk-based audit)	3rd phase (Ver. 3.0) (Management audit)	4th phase (Ver. 4.0) (Trusted advisor)
Role Mission	Exercising a check function on each business office by discovering administrative deficiencies, violation of rules, etc.	Raising issues for business processes in high-risk areas based on risk assessment	Providing assurances that contribute to management in response to internal and external environmental changes, etc.	In addition to providing assurances and resolving issues associated with them, providing advice that contributes to management strategies to management teams and other executives and employees within the organization.
	Past/Form/Element by element		Future/Substance/Holistic	

(Source) Financial Services Agency

II. Monitoring Results

1. Overall Evaluation (Progress)

In the monitoring of large banking groups, the FSA confirmed that generally they were actively working to improve internal audits even after the publication of the “Current Situation and Issues” [Chart 2]. However, there were certain differences among large banking groups in their self-assessments regarding the level of internal auditing.

Most of the large banking groups with international operations evaluated themselves as being at the level of 3rd phase, and the FSA confirmed that they were working on the introduction of “the use of IT and data analysis” and “auditing methods for corporate culture”⁴, which were indicated as large initiatives to realize 4th phase internal audits in the “Current Status and Issues” [Chart 3].

It was confirmed that other large banking groups self-assessed themselves as being on the way from 2nd to 3rd phase, and were working to improve their internal audits.

Regarding the status of efforts at financial institutions other than large banking groups, the main points recognized through continuous monitoring by the FSA were as follows:

- Companies whose top management strongly recognizes the importance and usefulness of internal audits are proactive in allocating human resources, etc., as well as discussing the results of internal audits (important findings, etc.) at board of directors, etc. and utilize that to strengthen internal controls.
- Companies with weak management base prioritize human resources into sales departments, etc., and postpone the assignment of human resources into internal audit functions. As a result, they have not been able to work on improvement.
- In addition, although some regional banks are switching to risk-based audits (second phase) and advocating management audits (third phase), many of them still emphasis on compliance audits (first phase), traditional audit function of regulation, that check compliance with the regulations after the fact.

Based on the monitoring of large banking groups, to ensure the appropriateness of operations and financial soundness through effective internal audits that accurately respond to the surrounding environment and business status, and to improve corporate value, financial institutions require that I.

⁴ In the “Current Status and Issues”, the main initiatives to achieve the fourth phase (trusted advisor) internal audit are “flexible audit methods,” “utilizing of IT, data analysis, etc.,” “audit methods for corporate culture” and “(4)forecasts in response to changes in the business environment and advice based on them.”

management teams, audit committee members, and corporate auditors⁵ strongly recognize the importance and usefulness of internal audits and actively support them; II. the internal audit function improves internal audits in response to changes in the environment; III. management teams, audit committee members, corporate auditors, and the internal audit function promote to understand and disseminate internal audits and to foster risk ownership in audited departments.

In monitoring large banking groups, the FSA confirmed examples of initiatives in which management teams, audit committee members, and corporate auditors are thought to understand the importance and usefulness of internal audits, and they expect further improvement.

In addition, the FSA confirmed that the internal audit function is working to improve internal audits, as well as to promote understanding of internal audits and to foster risk ownership in audited departments. On the other hand, the FSA also confirmed issues regarding the audit system, audit infrastructure (audit human resources), etc. that the internal audit function is aware of. The FSA expects further ingenuity management teams, audit committee members, corporate auditors, and the internal audit function to improve internal audits and maximize their functions.

2. Status of Initiatives of large Banking Groups After Publication of “Current Situation and Issues”

(1) Support for the internal Audit Function by Management Teams, Audit Committee Members, and Corporate Auditors

At large banking groups, management teams, audit committee members, and corporate auditors are increasingly recognizing the importance and usefulness of internal audits.

For example, regarding the importance of internal audits, there are cases where management teams and the internal audit function have been discussing the role of internal audits and future images for a year with the next medium-term audit plan, and cases where the number of executives and employees has increased and the budget has increased in the internal audit function. Additionally, in relation to the usefulness of internal audits, there are cases where chairpersons of various meeting bodies have asked the internal audit department for opinions more often.

Furthermore, in order to proactively incorporate outside knowledge into internal audits, there are cases of frequent exchanges of opinions and information with audit committee members and outside corporate auditors, as well as cases where receiving advice from audit committee members regarding the area that should be focused on from an outside perspective, validity of the audit perspective for individual audit and the content of audit procedures, etc.

(2) Initiatives for improvement of the Internal Audit Function

- Large banking groups are working for I. audit from a management perspective, II. flexible response to changes in risks, and III. improvement of audit quality. For example, the following

⁵ In addition to audit committee members and corporate auditors, this includes audit and supervisory committee members, auditors, etc. The same hereinafter.

cases were observed.

I. Audit from a management perspective

- The internal audit function defines “recommendations that contribute to management” and shares this understanding with management teams.
- Audit themes are selected based on the issues and risk awareness of management teams, audit committee members, corporate auditors, business department managers, etc.
- Strengthening root cause analysis in order to identify the root causes of management issues and suggest improvement measures.
- Persons with experience in the corporate planning department who understand business models and management strategies are assigned to the internal audit function.

II. Flexible response to changes in risks

- Introducing off-site monitoring and a method for making timely recommendations to responsible departments regarding concerns identified through this monitoring.
- Approaching trials of agile audits⁶.

III. Improvement of audit quality

- A dedicated team of quality evaluation consisting of veteran auditors evaluates the implementation status of individual audits in an accompanying manner.
- Based on the results of the quality evaluation, discussing measures to improve internal audit from the next year onward with audit committee members.

In addition, large banking groups that assessed themselves to be at the level of the 3rd phase are conducting risk assessments, formulation of audit plans, quality evaluation activities, etc. on a group/global basis, introducing a group/global common audit support system and stabilizing audit methods.

(3) Understanding of Internal Audits for Audited Functions and Fostering Risk Ownership

Large banking groups are working I. to promote understanding of internal audits for audited departments and II. to foster risk ownership in audited departments [Chart 4]. For example, the following cases were observed.

I. Promoting understanding of internal audits for audited departments

- Explaining the role and work of internal audits in business content briefings and stratified training sessions.
- Explaining the purpose of the internal audit (such as the difference between an “audit” and an “inspection”) to the branch staff, when visiting a branch for an audit.

⁶ Although there is no fixed definition, a common example is to subdivide the audit area and implementation period, and conducting the audit while flexibly changing the plan based on the implementation status of small-scale audits.

II. Fostering risk ownership in audited departments

- Large banking groups that self-assessed themselves to be at the level of the 3rd phase have introduced
 - A system in which audited departments report self-recognized issues and improvement measures to the internal audit function,
 - Based on the above report, a system in which the internal audit department evaluates the risk awareness among the management and the approach to establishing internal controls of the audited department and provides follow-up and advice until operations become established.

[Chart 2] Examples of Initiatives by Large Banking Groups to Sophisticate Internal Audit Following Publication of “Current Status and Issues”

- (Legend) ● Cases of Initiatives Related to Large Banking Groups
 ■ Cases of Initiatives Related to Large Banking Groups That Self-assessed to Be at the Level of the 3rd Phase
 *The Following Charts Are the Same

Items	Overview of cases
Audit System	
Purpose and role of internal audit	<ul style="list-style-type: none"> ● Clearly stating in the purpose, mission, basic policy, etc. of internal auditing that “contributing to the sustainable improvement of corporate value” and “helping achieve organizational goals” through internal audits. ● Organizing the roles and the way of the 1st, 2nd, and 3rd line departments, as part of governance reform and strengthening of group governance (e.g. Transferring administrative deficiency audits of business offices to 1st and 2nd line departments) ■ In line with the next mid-term audit plan, discussing with the management team for over a period of one year regarding the role of internal audits and the ideal state it should be. ■ Defined “recommendations that contributing to management” to be implemented by the internal audit function and shared this understanding with the management team. Expanding it to affiliated group companies
Medium-term audit plan	<ul style="list-style-type: none"> ● Developing a medium-term audit plan* (approx. 3 years) based on the management team’s expectations for the internal audit department, internal and external environments, medium-term management plan, etc. <p>*The medium-term audit plan includes measures to improve the audit system over the medium-to-long term, personnel plans, human resource development plans, areas to be watched over the medium-to-long term, priority items for verification, etc.</p>
Risk assessment	<ul style="list-style-type: none"> ● Aiming to conduct audits from a management perspective, exchanging opinions with management teams, audit committee members, corporate auditors, business department managers, etc., understanding issues and risk recognition (macro approach), integrating the internal audit department’s risk recognition (micro approach) and selecting important items for verification (audit themes) ● Conducting risk assessment and reviewing audit plans during the period; The frequency of the reviews varied depending on the bank group: monthly, quarterly, or semi-annually. <p>*For initiatives on a group/global basis, see “Group/Global Audit” below.</p>
Off-site monitoring	<ul style="list-style-type: none"> ● Gathering and analyzing information on a daily basis (off-site monitoring) by attending various meetings, viewing minutes and related materials, accessing various information systems, and exchanging opinions with 1st and 2nd lines, and confirming detected concerns with the relevant department in a timely manner. ● Off-site monitoring results are used to review risk assessments, and consider the necessity of extraordinary audits, and are reflected in audit procedures for each audit.
Root cause analysis	<ul style="list-style-type: none"> ● Analyzing past (multiple years) audit findings, identifying the underlying root cause, and reporting and making recommendations to management.

Items	Overview of cases
	<ul style="list-style-type: none"> ■ Analyzing factors attributable to corporate culture, management strategy, etc. in root cause analysis of problematic events identified in each audit. ■ Introducing evaluation indicators for findings (depth level of root cause analysis and value added level of improvement recommendations) in order to conduct in-depth root cause analysis and make recommendations with high added value.
Quality assurance	<ul style="list-style-type: none"> ■ Utilizing “International Standards for the Professional Practice of Internal Auditing” as quality evaluation standards, as well as relevant regulations and guidelines in regions where business was conducted internationally. ■ Established a quality evaluation specialist team made up of veteran auditors to enhance quality of internal audit by coaching and supporting individual audits. (e.g. Accompany individual audits and evaluate the status of audit implementation) ■ Based on the results of the quality evaluation, discussing measures with the audit committee to improve sophistication in the next fiscal year and beyond. <p>*For initiatives on a group/global basis, see "Group/Global Audit" below.</p>
Group/global audit	<ul style="list-style-type: none"> ■ Developing group-based risk assessments and audit plans. In developing the plan, opinions and perspectives are exchanged at the Group Audit Manager Meeting, Group Risk Assessment Meeting, etc. ■ Establishing specialist area teams* for areas across the Group and the world and requiring specialized knowledge, and this team conducts and supports audits of domestic and overseas bases (the team also develops specialist human resources). *Teams specializing in AML/CFT, cyber, global IT, global securities operations, and ESG ■ Introducing a group/global common internal audit support system⁷ and sharing audit status and results ■ Establishing global common audit procedures based on best practices in each region ■ In order to conduct audits flexibly with business changes, internal audit function members from banks, trusts, and securities departments concurrently hold posts in the holding company's internal audit department. ■ In order to revitalize communication within domestic groups, the internal audit functions of the holding company, bank, trust, and securities moved into the same office building. ■ Conducting collaborative audits and monitoring among domestic group companies regarding various domestic group-based issues, and operations and projects across group companies ■ Improving audit quality of the entire group by participating of holding company's dedicated teams for quality evaluation in individual audits of affiliated group companies, and verifying with focusing on specific audit processes (e.g. risk assessment, root cause analysis)
Audit Infrastructure	
Securing human resources	<ul style="list-style-type: none"> ● Conducting internal recruitment for people wishing to transfer to the internal audit function (At some large banking groups, the number of applicants has been increased year by year.) ● Actively hiring external human resources to secure specialized human resources (especially in the IT, AML/CFT fields) ● Developing a “skills assessment” to understand areas where specialized skills need to be expanded. Strengthening recruitment, personnel rotation, and trainings mainly in areas where specialized skills are lacking ■ In order to conduct management audits, assigning people with experience in the corporate planning department to the internal audit function
Human resource development	<ul style="list-style-type: none"> ● Clarifying the level of "skills" and "work knowledge" required for each level, and building a detailed and systematic training and education system ■ Setting and managing the number (percentage) of people who have acquired specialized qualifications* as a departmental goal

⁷ By managing a series of audit processes (risk assessment, audit planning, audit resource allocation, audit implementation, report creation, and follow-up) on a system, being able to effectively conduct risk assessments based on a common axis across the groups, share knowledge, etc.

Items	Overview of cases
	<p>*CIA (Certified Internal Auditor), CISA (Certified Information Systems Auditor), etc.</p> <ul style="list-style-type: none"> ■ Promoting acquisition of qualifications throughout the internal audit function, such as supporting to acquire qualifications by a team in charge of that and providing necessary knowledge and skills from qualified persons to auditors ■ Holding the idea “producing governance human resources*” as one of developing human resources missions of the internal audit function and promoting human resource development based on planned personnel transfers between the first, second, and third lines <p>*Human resources with management skills and a risk mindset</p>
<p>Introduction of audit system & tools</p>	<ul style="list-style-type: none"> ■ Introducing a group/global common internal audit support system ● Introducing an internal audit support system ● Introducing tools to analyze and visualize data

[Chart 3] Initiatives toward 4th Phase and Case Studies of Characteristic Initiatives

Items	Overview of Cases
Initiatives toward the 4th phase	
Flexible audit	<ul style="list-style-type: none"> ■ Conducting accompanying audits targeting formulation of a medium-term management plan and large-scale projects ■ Partially introducing the following agile audit elements into thematic audit <ul style="list-style-type: none"> ➢ Limiting the scope of verification (minimize the audit) ➢ Conducting audits in a shorter time period than usual ➢ During the audit, sequentially proposing findings to the audited department to and encouraged to promptly conduct improving measures
Utilization of IT, data analysis	<ul style="list-style-type: none"> ■ Building a model* that utilizes AI when selecting audit locations and beginning trials *Making AI learn risk assessment data and past audit results as training data to score the risk level of each location ■ Developing a questionnaire analysis using text mining and analyzing the trends and relevance of the questionnaire results from multiple angles ■ Utilizing analysis methods for unstructured data such as voice, email, and chat text in advance preparation for domestic base audits ■ Collecting and processing data by utilizing RPA (Robotic Process Automation)
Audit method for corporate culture	<ul style="list-style-type: none"> ■ Positioning a corporate culture as an important theme for audits, and conducting audits targeting the status of establishment and penetration of corporate culture ■ Conducting audits targeting the status of initiatives to visualize the penetration of culture (= setting standards that allow you to feel the degree of improvement) ■ Conducting audits targeting "risk culture" and expanding the scope of verification to include "corporate culture" based on operational status ■ Setting "culture-related initiatives" as priority verification items (audit theme) and conducted multiple culture-related initiatives over several years (e.g., status of promotion of culture reform, status of initiatives to disseminate code of conduct, etc.)
Forecasts in response to changes in the business environment and advice based on them	<ul style="list-style-type: none"> ● In order to select audit themes that respond to future risk changes, developing processes of selecting audit themes that combine assumptions of risk structure changes such as future balance sheets and risk assets, with risk scenarios, and stress scenarios ■ Continuously monitoring business strategies, measures, projects, etc. from their formulation and initial stages, and making timely recommendations to the responsible department if there are any findings ■ Monitoring the status of measures and risk management of the first and second line on a daily basis, and if there are any concerns, making timely recommendations to the responsible department
Characteristic Initiatives	
Proposals for strategically securing and developing human resources	<ul style="list-style-type: none"> ■ Proposing a planned personnel rotation of mid-career and young employees between the first and second lines to management teams and the human resources department aiming at strategically assuring and developing human resources with necessary experiences and abilities to be responsible for "audits that contribute to management"
Setting KPIs	<ul style="list-style-type: none"> ■ Setting KPIs (e.g. progress rate for an audit plan, audit report creation time, acquiring rate of audit-related professional qualification, etc.) to understand the status of audit activities and improve quality
Reorganizing the internal audit function to align with the business unit and CxO structure	<ul style="list-style-type: none"> ■ Reorganizing the roles and responsibilities of groups within the internal audit department to align with the operations department system and CxO system to understand risks related to response omissions and overlaps in areas across business departments and new risk areas and, make recommendations

Responding to new themes	<ul style="list-style-type: none"> ■ In order to provide management suggestions on new themes such as ESG*, DX, diversity & inclusion, etc., understanding the actual situation and organizing issues from the perspective of each country's authorities and investors. *Regarding ESG, setting climate change response as a priority verification theme
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[Chart 4] Cases of Initiatives to Promote Understanding of Internal Audit and Foster Risk Ownership in Audited Departments

Items	Overview of Cases
Internal public relations activities	<ul style="list-style-type: none"> ● Utilizing business content briefings, stratified training sessions, in-house roundtable discussions within a company, video news, etc. to explain the role and work of internal audits, and conducting actively internal public relations to widely promote the appeal of the internal audit department such as introducing messages from the audit staff themselves, etc. ● Explaining the purpose of the audit (such as the difference between an “audit” and an “inspection”) to the branch staff, when visiting a branch for an audit
Initiatives to foster risk ownership	<ul style="list-style-type: none"> ■ Introducing a framework for audited departments to report self-recognized issues and improvement measures to the internal audit function. In addition to the conventional evaluation of headquarters audits and base audits, the internal audit function evaluates the risk awareness among the management and the approach to establishing internal controls of the audited department. Through providing awareness to audited departments and follow-up and advice until operations become established, supporting them to approach issues autonomously and change in actions

3. Recognition of Issues by Large Banking Groups That Assessed Themselves to Be at the Level of the 3rd Phase

Management teams, audit committee members and auditors of large banking groups that self-assessed themselves to be at the level of the 3rd phase expect the internal audit department to conduct of flexible audits and audits targeting management strategies, etc. Additionally, expectations from outside directors to management teams have been clarified.

On the other hand, the internal audit function recognizes efforts toward the 4th phase, such as audits that are conscious of a stakeholder perspective, identification of the root causes concerning management issues from a company-wide perspective, realizing a virtuous cycle of human resources between the first, second, and third lines, trials of agile auditing, etc., as issues.

(1) Expectations and Issues of Management Teams, Audit Committee Members, and Corporate Auditors

I. Main Expectations of the Internal Audit Function from Management Teams, Audit Committee Members, and Corporate Auditors

- Conduct of flexible audits that capture risks occurring in accordance with sudden changes in the business environment
- Conduct of audits targeting management strategies, etc., including the status of development,

execution and instilling of management strategies, and the adequacy and appropriateness of management resource allocation

- In addition to pointing out defensive perspectives such as compliance issues, proposal that include offensive perspectives of strategic issues and perspectives of operational efficiency
- Proposal of solutions about the root causes of management issues

II. Expectations from Outside Directors to the Management Team

- Explanation and dissemination of the significance of “audits that contribute to management” from management and internal audit functions to audited departments
(Supplementary note) In order to practice “audits that contribute to management,” audited department needs to understand its significance.

III. Own Issues Self-recognized by the Management Team

- Fostering a culture in which the audited department actively accept internal audits and cooperate

(2) Main Issues Related to the Audit System and the Audit Infrastructure Recognized by the Internal Audit Department

I. Audit System

- Conduct of audits that are conscious of perspective of all stakeholders, including shareholders, management, employees, financial authorities, etc.
- Identification of the root causes concerning management issues from a company-wide perspective
- Conduct of audits from the perspective of whether internal controls that support sound business management are developed and operated in “timely”, “appropriate” and “moderate” manner
- Understanding operations and process of subject to be audited, and forward-looking risk identification that emphasis on prevention

II. Audit Infrastructure (Audit Personnel)

- Establishing a virtuous cycle in which auditors who have achieved good results in auditing are promoted without making the internal audit function the end point of their career, and the human resources department continues to assign qualified personnel to the internal audit function
- Developing human resources to improve i) problem-solving ability to analyze the causes of problems and propose solutions; ii) presentation skills to make convincing and reasonable arguments; and iii) communication skills consisting of the ability to listen and communicate

III. Initiatives Related to the 4th Phase

- Flexible response to risks occurring in accordance with changes in the business environment
- For the full-scale implementation of agile audits, promoting understanding throughout the company including audited departments
(Supplementary note) Agile audits need different response from normal audits, such as i) frequent interviews with the audited department; and ii) sequentially proposal of findings and encouraging to conduct improving measures. That requires management teams and audited departments to fully understand the difference from a normal audit.
- For off-site monitoring, improvement in efficiency by shortening data integration time using tools to collect information inside a company (Business Information tools) and further improvement of data collection methods
- Establishment of data analysis methods to detect potential issues and issues of internal management system
- Establishment and improvement of verification methods on audits targeting corporate culture

(3) Issues Related to the Audited Department Recognized by the Internal Audit Function

- Promoting understanding of internal audit to audited departments.

(Supplementary note) Audited departments still recognizes that the role of the internal audit department is to identify administrative deficiencies, etc.

4. Recognition of Issues by Large Banking Groups that Assessed Themselves as Being on the Way to the 3rd Phase

Management teams, audit committee members and corporate auditors of large banking groups that assessed themselves as being on the way to the 3rd phase expect the internal audit function to speak freely based on the facts from a standpoint of a third person and to play assurance functions, etc., and they also recognize the receptivity of audited departments to internal auditing as an issue.

On the other hand, the internal audit function recognizes that transition from compliance audits to audits that verify the developing and operational status of business processes and pursuing the root causes of problems utilizing frameworks for analysis (e.g. logic trees, internal control framework of COSO (Committee of Sponsoring Organizations of the Treadway Commission), etc.) are issues.

(1) Expectations and Issues of Management Teams, Audit Committee Members, and Corporate Auditors

I. Main Expectations of the Internal Audit Function from Management Teams, Audit Committee Members, and Corporate Auditors

- From a standpoint of a third person, speaking freely based on the facts even if it is difficult to say
- Effecting of assurance functions against internal management system
- Audits that capture environmental changes in a timely and appropriate manner
- Organizations that provide solutions such as think tanks

II. Expectations from Outside Directors to the Internal Audit Function

- Audits from a management perspective

III. Own Issues Recognized by the Management Team

- Fostering a culture in which the audited department actively accept internal audits and cooperate

(2) Main Issues Related to the Audit System and the Audit Infrastructure Recognized by the Internal Audit Function, etc.

I. Audit System

- Transition from compliance audits to audits that verify the developing and operational status of business processes

- Pursuing the root causes of problems utilizing frameworks for analysis
- Building a system to comprehensively understand and accurately evaluate the risks of the entire group
- Homogenizing and improving the audit quality across group companies

II. Audit Infrastructure (Audit Personnel)

- Securing and developing human resources responsible for management audits
- Development of auditors who are able to overlook the entire management

III. Attempts to Move Toward the 4th Phase

- Predicting signs of risks through data analysis and visualization using tools to collect information inside a company (Business Information tools), and utilization for internal audit activities (theme selection, etc.)

(3) Issues Related to the Audited Department Recognized by the Internal Audit Function

- Understanding by audited departments that the 1st, 2nd, and 3rd lines are not inherently opposed to each other, but rather work together to achieve a common goal
- Internally disseminating the importance and necessity of internal audits utilizing business briefings and company newsletters, etc.

III. Main Issues and Direction for Future Monitoring

Large banking groups, large securities companies, and large insurance companies are becoming increasingly globalized. At the same time, large banking groups have become financial groups that include not only banks but also companies engaged in non-banking businesses, such as securities companies, leasing companies, credit card companies. Similarly, many securities companies and insurance companies other than large banking groups are financial groups that have other types of businesses. In addition, regional banks are also shifting to holding company structures, and some of them have non-banking companies, such as securities companies and advanced banking service companies.

Given these circumstances, in order for financial institutions to ensure the appropriateness of business operations and financial soundness through effective internal audits and to enhance corporate value, the management team must have an accurate grasp of the group's overall business operations and an internal audit system that can respond to changes in the internal and external environment in a timely manner, and the following are required:

1. Management teams, audit committee members, and corporate auditors should actively support the internal audit function;
2. The internal audit function should improve its auditing system and strengthen its auditing infrastructure; and
3. Management teams, audit committee members, corporate auditors, and internal audit departments should promote understanding of internal audits among audited departments, foster risk ownership, and ensure that audited departments are aware of their roles as risk owners and control risks autonomously.

The FSA will continue to carry out in-depth monitoring of not only large banking groups, but also regional banks, securities companies, insurance companies, and other financial industries, mainly based on the following issues, and will encourage to improve internal audits through monitoring. In doing so, the issues and focus points presented in this document and in "Current Status and Issues" will not be used as a formal checklist.

In addition, in order to improve the efficiency of financial administration, the FSA plans to determine the scope and depth of monitoring based on the level of internal audit of each financial institution.

Issue 1. Support for the Internal Audit Function by Management Teams, Audit Committee Members, and Corporate Auditors

Do management teams, audit committee members, and corporate auditors i) consider the way of internal audit based on the own company's/bank's management base, scale, characteristics, management strategy, etc.? ii) support the improvement of internal audits? and iii) utilize the internal audit function?

Issue 2. Improving the System and Strengthening the Infrastructure of the Internal Audit Function

Does the internal audit function i) exchange opinions and information with management teams, audit committee members, and corporate auditors? ii) ensure the independence of the internal audit function? iii) identify risks and narrow down the scope of audits? iv) flexibly respond to changes in risks? v) carry out in-depth audits such as proposing improvements based on root cause analysis? vi) utilize IT and data analysis for audits? vii) continuously work to improve audit quality? and viii) work to develop audit system on a group/global basis?

Furthermore, i) How is the internal audit function working to secure and develop human resources? and ii) what kind of audit systems and tools has the internal audit function introduced?

In addition, securing audit personnel for specialized areas and new areas is a major challenge, and some large banking groups are using outside specialized organizations, so-called co-sourcing. When there is a shortage of personnel to audit specialized areas or new areas, co-sourcing may be an option. In such a case, does the internal audit function i) have a policy on the use of co-sourcing? ii) take responsibility for the final evaluation of audits conducted by co-sourcing, and iii) absorb the knowledge and know-how from co-sourcing?

Issue 3. Understanding of Internal Audits for Audited Departments and Fostering Risk Ownership

Do management teams, audit committee members, corporate auditors, and the internal audit function i) make efforts to promote understanding of internal audits for audited departments? and ii) assess and foster risk ownership in audited departments, and communicate with audited departments?

During this time, the Institute of Internal Auditors (hereinafter referred to as “IIA”) has been working to revise the “International Professional Practices Framework (hereinafter referred to as “IPPF”), which is international guidance on internal audits. Specifically, the IIA will restructure the “Mission of Internal Audits”, “Core Principles”, “Definition of Internal Auditing”, “Code of Ethics”, “International Standards for the Professional Practice of Internal Auditing”, “Implementation Guidance” and “Supplementary Guidance” that constitute the IPPF, and publish new “Global Internal Audit Standards” by the end of 2023.

In the future, the FSA intends to consider the need to update the “Current Status and Issues” (including necessity of reconsideration of each phase), including the perspective of encouraging further sophistication of internal audits on a group/global basis, in light of monitoring of financial institutions and international trends.