

III. Operation of Audit Firms

III. Operation of Audit Firms

A. Operations Management System

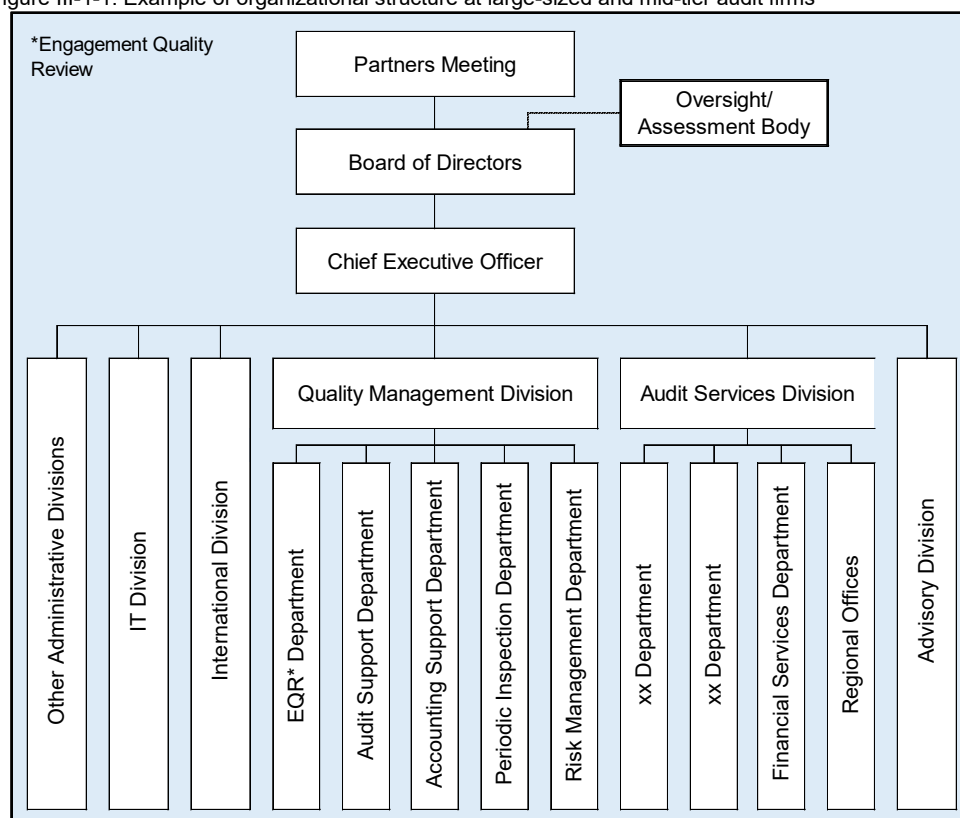
1. Organizational Structure of Audit Firms

The characteristics of the organizational structure of each type of audit firm, as categorized by size, are shown below.

Large-sized and mid-tier audit firms have a board of directors and the Management Committee, which are established under the partners meeting, the highest decision-making body composed by all partners, to make important decisions and administer corporate operations. There is also an oversight/assessment body to oversee and assess the effectiveness of management functions from a standpoint independent of the firm's management. The audit services division is divided into several departments that serve different regions or handle different services, and there is also a quality control division that supports audit services. Large-sized and mid-tier audit firms have structures more focused on functions than those seen at small and medium-sized audit firms. (Figure III-1-1).

Large-sized audit firms have established sector-specific divisions within their audit services division that conduct audits of listed financial institutions, such as the Financial Services Department.

Figure III-1-1: Example of organizational structure at large-sized and mid-tier audit firms



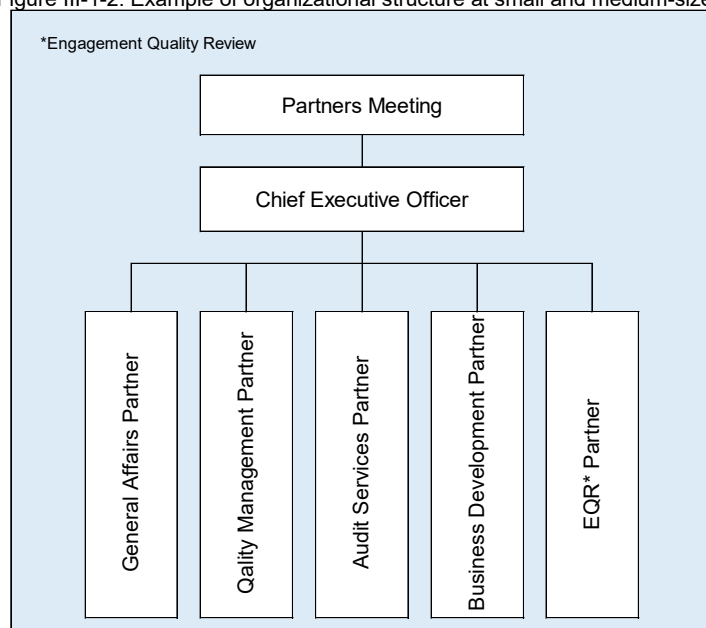
(Note) The organizational structure of mid-tier audit firms is often simpler than the structure shown in the above figure.

(Source) Prepared by the CPAAOB

On the other hand, the majority of small and medium-sized audit firms do not have subdivided audit engagement division, and their organizational decisions are made by partners meeting without the establishment of the board of directors or oversight/assessment body due to the human resource

constraint. Similarly, they manage quality management by assigning a person in charge instead of establishing a department for the purpose. However, with this management, the level of quality control depends on the ability and involvement time of the person in charge, and knowledge and experience are less likely to be accumulated in the organization in the audit firm. Therefore, the system of quality management of small and medium-sized audit firms are weaker than that of large-sized audit firms (Figure III-1-2).

Figure III-1-2: Example of organizational structure at small and medium-sized audit firms



(Source) Prepared by the CPAAOB

Characteristics of organizational structure based on audit firm size are as follows: (Figure III-1-3)

Large-sized audit firms strategically assign full-time staff members to sections divided in accordance with their operations and are promoting efforts to improve the quality of audits through the specialization and hierarchization of operations, such as transferring certain quality management functions to a section in charge of audit engagements. As a recent trend, principal responsibility for quality management is shifting from the quality management section at the headquarters to the audit services section, which is closer to audit team. There are cases in which the audit services division sets up a quality management committee, and this committee monitors audits conducted by the audit services section in cooperation with the quality management section at the headquarters. There are also cases where an independent monitoring section is established, and this monitors the development of the system of quality management and the effectiveness of its operation.

At mid-tier audit firms, head-office functions are being strengthened through, for example, increases in the headcount of the head-office as a way of responding to rises in the number of audited companies. At some firms, however, the operations system has not been adequately modified to ensure that consistent quality is maintained as the business operations expand.

At small and medium-sized audit firms, staff members have dual caps of audit engagement as well as quality management. However, there are some cases where partners and full-time staff sometimes do

not devote adequate time to quality management, due to the situation where the partners are also often allowed to engage in their side job such as operating their own accounting office and/or proportion of part-time staff are relatively high.

Figure III-1-3: Characteristics of each type of audit firm

	Large-sized audit firm	Mid-tier audit firm	Small and medium-sized audit firms
Number of partners	Approx. 240 to 570	Approx. 40 to less than 100	Up to approx. 50 (Note)
Number of full-time personnel	Approx. 3,300 to 7,700	Approx. 210 to over 950	Up to approx. 110 (Note)
Decision-making bodies	- The highest decision-making body is the partners meeting - A board of directors and an executive committee are set up under the partners meeting	- The highest decision-making body is the partners meeting - A board of directors is set up under the partners meeting	- Most decisions are made at the partners meeting - Larger firms have a board of directors beneath the partners meeting
Oversight/assessment bodies	- A body is established to supervise/assess business execution bodies such as the board of directors and management committee - Subcommittees are established for "nomination" (nominations of chief operating officers and other executives), "compensation" (evaluation of executives/partners, compensation decisions, etc.), and "audit" (accounting and audit areas other than accounting). A public interest subcommittee is also established to monitor business execution from a public-interest standpoint - Third parties with independence ("independent third parties") serve as members of oversight/ assessment bodies and subcommittees	- Oversight/assessment bodies are established but their powers are limited compared with those at large-sized audit firms - Many firms do not establish subcommittees for nomination, compensation, and audit - While audit firms use independent third parties as constituent members of oversight/assessment bodies, there are some situations where the involvement of the independent third parties is limited to advice and suggestions to executive bodies.	- Due to being small in scale, many firms have systems of checks and balances between partners without establishing oversight/assessment bodies. - Many firms appoint independent third parties to participate in business operations meetings, etc. and utilize them as members of management councils, management oversight committees, supervisory boards, etc.
Design of business operation departments	- Multiple audit services departments are established, and firm-wide operation including regional offices is also conducted - A department specializing in financial services has been established - Departments in charge of quality management and risk management are established	- Management of firms, including regional offices, in addition to the establishment of multiple audit engagement sections - Departments in charge of quality management are established	- Many firms appoint partners to handle the particular services without establishing particular departments - Larger firms have set up organizations that resemble those of mid-tier audit firms
Number of offices	There are many cases of setting up regional offices on a nationwide scale in addition to the three big cities (Tokyo's 23 wards, Osaka City and Nagoya City).	Besides the firm's main office, there are often also offices in metropolises (Tokyo, Osaka and Nagoya)	Many firms only have a main office
Design of quality control divisions	- A quality management division comprises various departments for functions such as revising and distributing audit manuals, providing advice on accounting procedures, IFRS and US accounting standards, conducting engagement quality reviews and periodic inspections in relation to its system of quality management - A risk management department, which is responsible for monitoring audit contracts, independence, and audit risks, has been established - Audit services departments also often have quality management functions	Under the quality management division, a department in charge of risk management, accounting consultations, engagement quality reviews and periodic inspections is generally established.	- Many firms appoint partners to handle both quality management and audit engagements without establishing quality management divisions - In some small firms, representatives are also in charge of quality management

(Note) Excluding an audit firm whose number of partners and full-time staff members is much higher than others.

(Source) Prepared by the CPAAOB from CPAAOB inspections, collected reports and operational reports

2. Efforts in Response to Audit Firm Governance Code

The Audit Firm Governance Code was formulated in March 2017, and subsequently in response to a

series of government ordinances (published in January 2023 and put into effect in April) accompanying revisions to the CPA act (May 2022), which mandated audit firms that audit listed companies to establish a framework for conducting operations in line with the Code and requiring enhanced information disclosure. In line with these developments, the Code was revised in March 2023 with the aim of accompanying acceptance of small and medium-sized audit firms. The obligation to establish a system in line with the Code was effective from the accounting period of the audited company that began on or after July 1, 2024 (for large-sized audit firms, from July 1, 2023).

The Audit Firm Governance Code has been formulated with the organizational management of audit firms that audit listed companies in mind. It is expected that the Code will be applied in a “comply or explain” manner (either implement the principles or explain the reasons for not implementing the principles). Audit firms are required to put the five principles into practice in ways suited to their own distinct circumstances in order to implement it and achieve effective organizational administration.

Principle 1: The Role to Be Accomplished by an Audit Firm

An audit firm has the public interest role to ensure the credibility of corporate financial information through the audits, seek to protect stakeholders such as participants in the capital market and thereby contribute to the sound development of the national economy. In order to accomplish this role, the audit firm should encourage its members to have frank and open-minded dialogue, enhance mutual development, promote their full competence, and continuously enhance the audit quality on a firm-wide basis.

Principle 2: Organizational structure (management functions)

An audit firm should have effective management in order to develop its organizational operations as a whole for the continuous enhancement of the audit quality.

Principle 3: Organizational structure (oversight/assessment functions)

An audit firm should have a function to oversee and assess the effectiveness of its management from the independent viewpoint and thereby support to enhance the effectiveness of the management.

Principle 4: Operation

An audit firm should develop an operational structure to effectively manage its operations. An audit firm should also strengthen the people retention and development and proactively engage in a dialogue and discussion within the firm and with audited companies about the possible enhancement of audit quality.

Principle 5: Ensuring transparency

An audit firm should ensure full transparency to allow stakeholders in the capital market to appropriately assess its audit quality, by explaining the status of the Code's implementation. The audit firm should also effectively utilize the internal and external assessment of its efforts for improvement in its management and operations.

When it comes to the status to adopt each principle of the Code from the viewpoint of the firms' scalability, large-sized and mid-tier audit firms have adopted all the principles. Some small and medium-sized audit firms do not adopt all of the principles, with oversight/assessment functions within organizational structure (Principle 3) and ensuring transparency (Principle 5) often not being adopted, in particular.

As described above, because of the situation where there is size-based variation in the application of oversight/assessment functions within organizational structure (Principle 3) and ensuring transparency (Principle 5), we examine the efforts that audit firms are making with respect to these two principles.

- a. Oversight/assessment functions within organizational structure (Principle 3)
 - i. Strengthening oversight/assessment functions through the utilization of independent third parties

- (i) Large-sized audit firms

Large-sized audit firms are taking steps to incorporate a public interest perspective and the knowledge of independent third parties in order to strengthen their oversight/assessment bodies. As methods of achieving this, two patterns have been observed: A pattern of including independent third parties as outside committee members in existing oversight/assessment bodies (Pattern 1) and a pattern of setting up separate and independent bodies such as a public interest committee (Pattern 2) (Figure III-1-4).

Pattern 1: independent third parties are directly involved as outside members in the processes pursued by nomination, compensation, and audit subcommittees.

Pattern 2: independent third parties are not directly involved in these processes by setting up separate and independent bodies such as a public interest committee comprising outside members.

Note that all large-sized audit firms state whether independent third parties are involved in each of the processes of “nomination,” “compensation,” and “audit” in the reports etc. concerning audit quality that they publish annually.

- (ii) Mid-tier audit firms

The publication of the Audit Firm Governance Code has prompted mid-tier audit firms to make efforts to establish independent bodies, such as public-interest committees that are comprised of independent third parties as oversight/assessment bodies. However, with the exception of some firms, they have not established subcommittees for “nomination,” “compensation,” and “audit,” so involvement by independent third parties in nomination, compensation, and audit processes is more limited than at large-sized audit firms.

- (iii) Small and medium-sized audit firms

Of the 52 small and medium-sized audit firms implemented collection of reports, 38 have not established oversight/assessment bodies on the grounds that they could exercise mutual supervision.

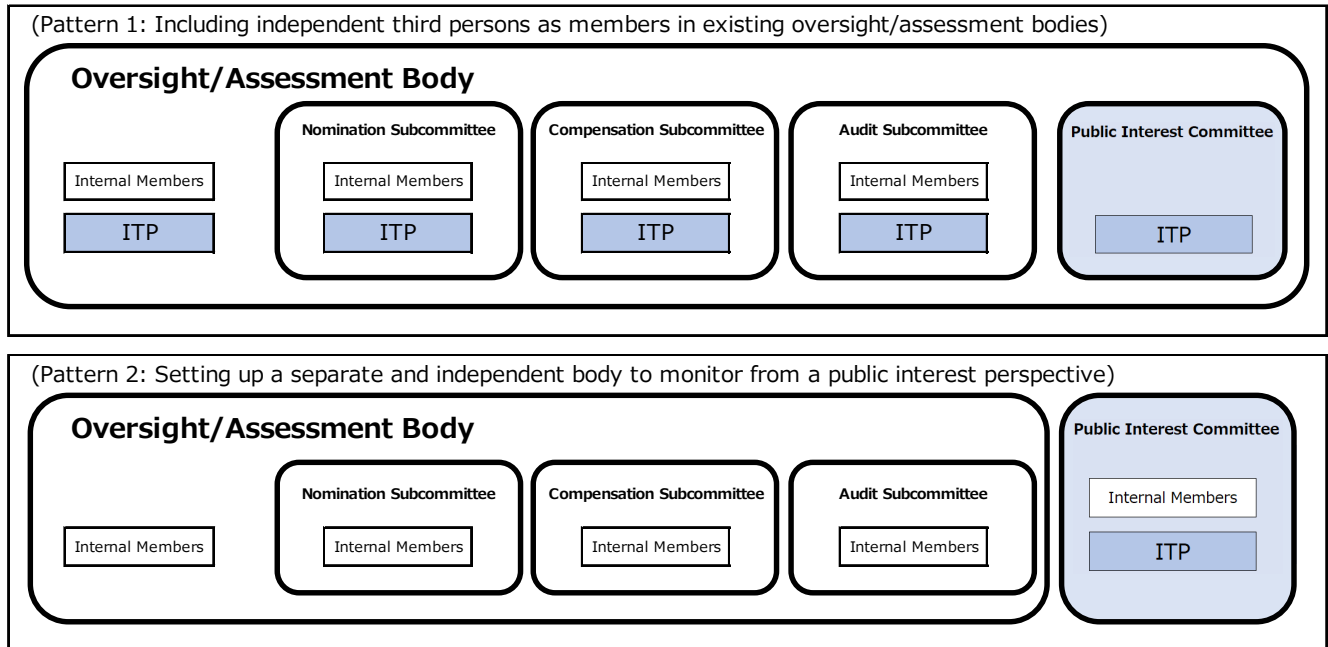
However, of the firms that have not established oversight/assessment bodies, 19 firms have independent third parties that take part in meetings relating to business operations. Also, there is a case where an audit firm published continuous consideration of the necessity of independent third parties’ involvement from the perspective of fulfilling the public interest of audit firms.

On the other hand, the 14 firms that have oversight/assessment bodies make use of independent third parties as members of oversight/assessment bodies such as management

councils, management oversight committees, and supervisory boards.

Note that many firms do not clearly define specific procedures for each process of “nomination,” “remuneration,” and “audit.”

Figure III-1-4: Strengthening oversight/assessment functions at (ITP in this figure means independent third parties)



(Source) Prepared by the CPAAOB

ii. Efforts to utilize the knowledge and experience of independent third parties

(i) Large-sized audit firms

In seeking to incorporate a public interest perspective and the knowledge and experience of independent third parties listed in a. i. above, it is important to provide independent third parties in a timely and appropriate manner with necessary information about audit firms such as organizational administration, nomination and dismissal in members of executive bodies, and matters concerning assessment and compensation. It is also important to seek comments from these independent third parties in a timely manner.

Under the pattern in which independent third parties are included as constituent members of existing oversight/assessment bodies (Pattern 1 in Figure III-1-4), firms provide information to them and receive opinions from them through their participation in meetings of the oversight/assessment bodies. There are also efforts to improve the effective use of independent third parties by raising the ratio of outside members who are independent third parties in the oversight/assessment bodies and subcommittees.

On the other hand, where the independent organizations are set up separately (Pattern 2 in Chart III-1-4 above), the audit firm provides information to independent third parties through internal committees, etc., and receives opinions from independent third parties, and has opportunities to exchange opinions regularly with the CEO. In Pattern 2, since independent

third parties are members of bodies that are independent of existing oversight/assessment bodies, it is particularly important to provide independent third parties with the information they need in a timely and appropriate manner so that effective discussions are conducted. To provide independent third parties with necessary information in a timely and appropriate manner, some firms confer independent third parties the right to attend meetings of executive bodies, including those of group firms, and the power to demand information. Other firms have taken such steps as establishing a secretariat to assist outside committee members, who are independent third parties.

(ii) Mid-tier audit firms

Many mid-tier audit firms have established independent bodies such as public interest committees constituting of independent third person. However, unless the independent third parties are provided with the information they need in a timely and appropriate manner, there are potential risks that the oversight/assessment bodies will not function adequately. With regard to this point, some firms are endeavoring to ensure that required information is provided, for example, conferring on independent third parties the right to attend meetings of executive bodies and the right to demand information. Nevertheless, some firms have not determined the authority that allows independent third parties to obtain information proactively.

(iii) Small and medium-sized audit firms

Oversight/assessment bodies established in small and medium-sized audit firms often consist of in-house partners and few independent third parties. In many cases, the audit firms provide information to independent third parties through the oversight/assessment bodies and exchange opinions at meetings of business execution bodies. The range of information provided to independent third parties and that of business execution bodies' meetings attended by independent third parties differ from firm to firm. The degree of utilization of knowledge of outside experts also varies.

iii. Experience/expertise of independent third parties

When it comes to independent third parties among the members of oversight/assessment bodies, it is necessary to assign persons with the expected knowledge and experience based on the size of audit firm, its governance structure and organizational issues. Furthermore, consideration needs to be given not only to independence from the audit firm, but also independence from companies that the firm audits.

Large-sized and mid-tier audit firms tend to assign people with managerial experience at general business companies, and many of these firms also appoint persons with backgrounds in the legal profession, such as attorneys at law, or former government ministries and agencies. At small and medium-sized audit firms, many of these firms appoint persons with academic backgrounds.

The number of independent third parties assigned is three or four at large-sized audit firms, one to three at mid-tier audit firms, and generally one at small and medium-sized audit firms. Some large-sized and mid-tier audit firms assign independent third parties to chair their oversight/assessment bodies and “nomination,” “compensation” and “audit” subcommittees to improve the effective use of them.

b. Ensuring transparency (Principle 5)

i. Explanations of application of each of the principles of the Audit Firm Governance Code and efforts to improve audit quality

(i) Large-sized audit firms

Large-sized audit firms issue reports regarding the audit quality on annual basis and post on their websites. These reports describe how they apply each of the principles of the Audit Corporate Governance Code and the action they are taking to improve audit quality. These audit quality reports include detailed information about their organizational structure, quality controls, human resources development, their networks and so on. In recent years, they devote considerable space to explanations of compliance with the new quality control standards, in addition to Audit Quality Indicators (AQIs), effective use of technology in auditing, and response to disclosures of non-financial information. Some firms also report the results of action taken to address issues identified the previous year and issues to be tackled in the following year, while others disclose attendance by independent third parties at executive meetings etc.

(ii) Mid-tier audit firms

Mid-tier audit firms issued reports regarding the audit quality, mainly to explain their organizational structure and quality control, and posting them on their websites. The contents of their reports are more simplified than those of large-sized audit firms and some omit the explanations of AQIs, human resource development plan such as educational programs and training curriculums, etc., which are available in the large-sized audit firms' report. On the other hand, some firms explain their measures for effective use of technology in auditing, response to the disclosures of non-financial information, and the explanations of compliance with the new quality control standards. Also, some firms released the current assessment by organizational members for the improvement of audit quality such as the results of in-house questionnaires on quality control.

(iii) Small and medium-sized audit firms

Of the 52 small and medium-sized audit firms implemented collection of reports, 19 firms have released reports on the quality of audit. Regarding the application of the Audit Firm Governance Code, 13 firms provide explanations in their audit quality reports, etc. and 9 firms provide explanations on their websites. Most of the 30 audit firms that have not made public the application of the Audit Firm Governance Code plan to do so in the future through

the issuance of audit quality reports and other publications.

Compared to mid-tier audit firms, the items and content of audit quality reports or explanations on websites relating to audit quality are often less detailed, and some of them do not explain specific organizational frameworks.

ii. Dialogue with stakeholders in the capital market for further improvements in their audit qualities

(i) Large-sized audit firms

Large-sized audit firms have conducted surveys and dialogues related to the quality of audits between Chief Financial Officers (CFOs) and audit and supervisory board members of audited companies. Recently, they have worked on creating opportunities for dialogue with a broader range of capital market participants, such as by holding opinion exchange meetings with institutional investors and analysts, including independent third parties.

In recent years, large-sized audit firms have taken steps to create opportunities for dialogue with a broader range of capital market participants, such as by holding opinion exchange meetings with institutional investors and analysts, including independent third parties.

(ii) Mid-tier audit firms

Some mid-tier audit firms appeared to conduct surveys from CFOs and audit and supervisory board members of audited companies related to the quality of audits. There are also cases in which firms make use of the meetings held for investors by the JICPA or Exchanges instead of hosting dialogue sessions individually.

(iii) Small and medium-sized audit firms

In many of the small and medium-sized audit firms that have disclosed the application status of the Audit Firm Governance Code, it is limited to having an exchange of opinion between engagement teams and the CFOs and audit and supervisory board members of audited companies.

The enforcement of relevant government orders in conjunction with the revision of the CPA Act made it obligatory for audit firms that audit listed companies to have systems in place to conduct operations in line with the Audit Governance Code and systems that require substantial information disclosure. As a result, many small and medium-sized audit firms that had not adopted the Audit Firm Governance Code in the past are now required to deal with the Code. Audit Firms are required to autonomously implement the Audit Firm Governance Code and realize effective organizational management taking into account their own size and characteristics. And the JICPA is expected to leverage its knowledge and experience obtained from self-regulation to provide sufficient guidance and supervision as a professional organization.

■ Disclosure of Audit Quality Indicators (AQI) ■

There is no established definition of audit quality, and it is difficult to measure directly. For this reason, large-sized and mid-tier audit firms and some small and medium-sized audit firms set up AQIs, which quantifies their efforts and results of audit quality improvement according to each firm's situation. They try to understand the audit quality status through continuous monitoring of AQIs. The AQI at the firm level is also disclosed to the public through annual audit quality reports issued by mainly large-sized and mid-tier audit firms.

Comparing the AQIs in the most recent audit quality reports of large-sized and mid-tier audit firms, we found the following points. It should be noted that AQIs are selected by audit firms to show a balanced picture of audit quality improvement based on their own circumstances, so that it is not possible to determine that there is an AQI deficiency just because an audit firm that does not report the AQI reported by other audit firms.

(Large-sized Audit Firms)

- AQIs related to IT (e.g., investment amount, tools adoption rate, etc.) are listed, given that all firms are promoting the use of IT and service delivery centers (*) in their audits.
- In addition to IT-related AQIs, others commonly published are: AQIs related to internal quality control inspections (e.g. number of significant deficiencies identified in periodic inspections), average training hours of partners and staff, AQIs related to responses to globalization (e.g. % of staff with overseas work experience), and AQIs related to diversity (e.g. % of female staff).
- In addition to the above, many firms have posted AQIs related to the systems of quality management (e.g., number of personnel engaged in quality management activities), AQIs related to independence (e.g., results of internal inspection), results of inspections by external organizations, etc.

(Mid-tier Audit Firms)

- Commonly listed AQIs are related to personnel structure and quality control system (e.g. number of personnel), independence (e.g. response rate of independence confirmation forms, number of violations identified), and internal inspection (e.g. number of significant findings).
- Some firms also list AQIs related to the use of IT

AQIs are expected to promote constructive dialogue between audit firms and audit clients and other stakeholders as a common language, and to strengthen audit firms' PDCA cycle regarding audit quality. Audit firms are requested to continuously review the selection of AQIs and the way of disclosure so that they can have constructive dialogues with stakeholders.

Figure: AQIs in audit quality reports of audit firms

	Large-sized audit firms	Mid-tier audit firms
AQIs common to all firms	• Use of IT and service delivery centers for audits - Investment amount, tool adoption rate, etc. • Internal inspection of quality control - Coverage of periodic inspection, results of periodic inspections, etc. • Training - Average hours of training • Globalization - % and No. of staff with overseas working experience, No. of staff with global process experience, etc. • Diversity and inclusion - % of female employees (all employees, by job level), childcare leave usage rate, etc. • Awareness survey of employees • Inspection results by external parties - Administrative action by the FSA, significant deficiencies identified in the JICPA Quality Control Review, etc.	• Personnel Composition – No. of staff by job level • Quality control system – No. of personnel and % of total staff engaged in quality control, etc. • Independence - Response rate for written confirmation, No. of violations identified • Internal inspection - Inspection results (No. of significant findings, etc.)

	Large-sized audit firms	Mid-tier audit firms
AQIs common to several firms	• Average annual working hours of auditors • Personnel Composition • Staff engaging in quality control • Monitoring on independence	• Average annual working hours of auditors • Training - Training hours per staff, attendance rate of mandatory training, and average number of credits earned, etc. • Results of inspections by external parties - Administrative action by the FSA, significant deficiencies identified in the JICPA Quality Control Review, etc.
AQIs found in only one firm	• Sustainability assurance – No. of staff responsible for assurance on reporting, No. of responsible staff in-charge and No. of annual assurance reports issued • No. of audit staff changes – No. of transfers per year • Ratio of recruitment - Ratio of mid-career recruits, ratio of mid-career recruits other than CPAs and CPA passers • Retirement rate - No. of support provided by specialist departments, etc.	• Use of IT - Investment amount, tool adoption rate, percentage of investment to operating revenues • Diversity and inclusion - % of female employees (all employees, by job level), childcare leave usage rate, etc. • Paid leave usage rate, etc. • Acceptance and renewal of audit engagements – No. of listed audited companies • Awareness survey, etc.

(*) Delivery center: An organization in which audit assistants who do not have CPA qualifications perform check services, etc. that do not require expert judgment, in order to focus on services that require expert judgment by CPAs, etc.

3. Human Resources of Audit Firms

a. Partners and full-time personnel

In most large-sized audit firms, most CPA exam passers are hired immediately after passing the essay exam, while only a small proportion of CPAs and CPA exam passers are recruited mid-career. In general, the CPA exam passers hired become CPAs at the audit firm concerned, and some of them are internally selected for promotion to managerial positions. Furthermore, some of them are later promoted to partner (for details, see [“I. Overview of the Audit Sector, B. Audit Firms, 1. Organizational Structure of Audit Firms”](#)).

Many mid-tier audit firms and small and medium-sized audit firms, meanwhile, find it difficult to recruit enough CPA exam passers and thus tend to have a larger portion of CPAs hired midcareer. The recruits are mainly CPAs who have left large-sized audit firms, and these firms are endeavoring to secure the necessary headcount for audit engagements etc.

In many cases, new audit firms are also established by CPAs who have left large-sized audit firms.

The number of partners and full-time staff members, analyzed by scale, has generally leveled off at large-sized audit firms since FY2020, but increased since FY2023. For mid-tier audit firms, there has been increasing trend since FY2020, however, it decreased in FY2024 due to the merger of PwC Kyoto with PwC Aarata in FY2023. The same increasing trend has been observed for small and medium-sized audit firms since FY2019, partly due to the establishment of new firms.

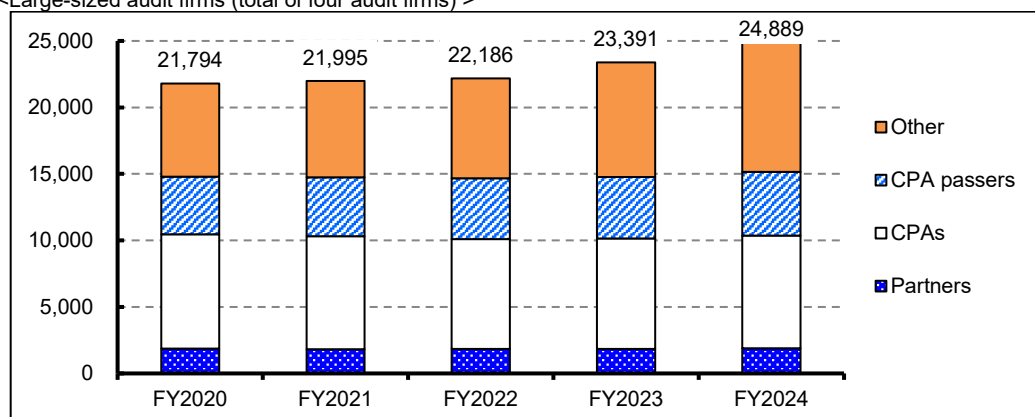
As far as the structure of manpower is concerned, the number of CPA exam passers, etc. tends to increase in or after FY2020 at all audit firms in disregard of scale. The number of staff members other than CPAs and CPA examination passers, has also been on the rise at all audit firms in recent years. According to the latest data, non-CPA staffs account for 39% of the total workforce at large-sized audit firms, 27% at mid-tier audit firms, and 25% at small and medium-sized audit firms. Compared to FY2020 (FY2019 for small and medium-sized audit firms), the ratio was increased for only large-sized audit firms (34%), while the ratio decreased for both mid-tier audit firms (30%) and small and medium-sized audit firms (27%) (see Figure III-1-6).

Audit firms have increased their staff members other than CPAs and CPA exam passers, to deal with the audited companies promoting IT, to improve operational efficiency, to address personnel shortages, and to facilitate CPAs to focus more on tasks requiring professional judgements, and so on. Among these personnel are IT experts who conduct IT audits with the use of technologies and support engagement teams in carrying out audit procedures using IT, and audit assistants who support engagement teams by sending/receiving balance confirmation letters, preparing various reports, and sorting data.

Some large-sized audit firms have improved their operations by establishing specialized

organizations to centrally manage such as the work/procedures of audit assistants, skill development, and job allocations.

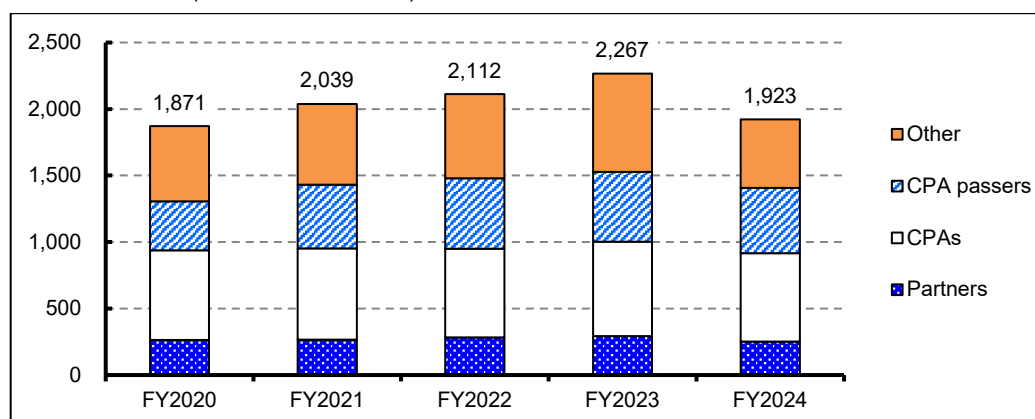
Figure III-1-5: Change in the number of partners and full-time personnel (unit: persons)
<Large-sized audit firms (total of four audit firms) >



(Note) The number of PwC Kyoto in FY2023 is included in the mid-tier audit firms.

(Source) Prepared by the CPAAOB based on operational reports submitted by audit firms.

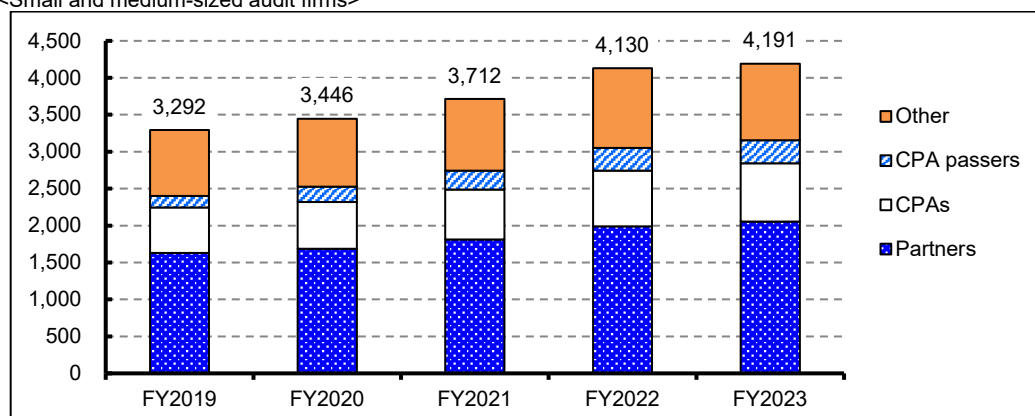
<Mid-tier audit firms (total of four audit firms)>



(Note) The number of PwC Kyoto in FY2023 is included in the mid-tier audit firms.

(Source) Prepared by the CPAAOB based on operational reports submitted by audit firms.

<Small and medium-sized audit firms>



(Note1) The data are aggregates of personnel for each fiscal year based on audit firm's operational reports. The book-closing months of small and medium-sized audit firms vary widely, so figures for FY2024 have not yet been compiled. As a result, the figures for small and medium-sized audit firms only cover the period to up to FY2023.

(Note2) The number of small and medium-sized audit firms varies from year to year, but 273 such firms are included in the figures for FY2023.

(Source) Prepared by the CPAAOB based on operational reports submitted by audit firms.

b. Side businesses by partners

Large-sized audit firms do not permit dual work by partners at tax accountant offices or solo private accountant offices in principle.

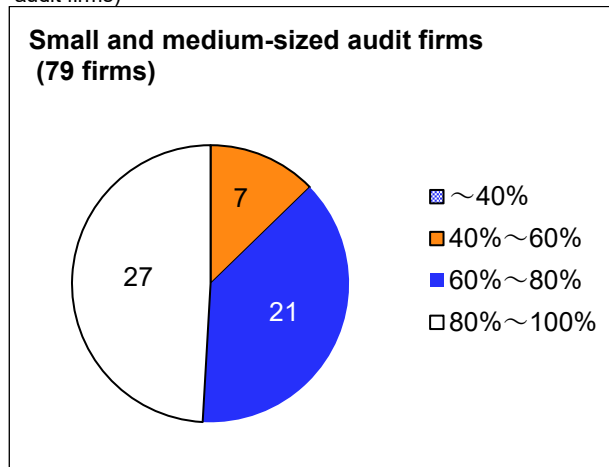
As with large-sized audit firms, some mid-tier audit firms that do not permit dual work by partners. However, at some mid-tier audit firms, the number of partners having dual work accounts for around 50% of the total number of partners. Those partners work for the JICPA and for tax business at their own offices as dual work.

Furthermore, when we calculate the percentage of time spent on work in audit firm that accounts for the total working hours of each partner on a per-partner basis, we find that even at mid-tier audit firms that allow partners to engage in dual work, the percentage of time that partners, including those that engage in dual work, spend on work in audit firm exceeds 90%.

Most small and medium-sized audit firms permit dual work as many partners are already operating a tax accountant office on their own when they join them.

Figure III-1-6 shows the ratio of time engaged in work in audit firm to the total working hours of each partner, calculated on a per-partner basis, as ascertained through inspections and the collection of reports from small and medium-sized audit firms.

Figure III-1-6: Number of audit firms by percentage of time spent by partners engaged in the audit firm's operations (unit: audit firms)



(Source) Prepared by the CPAAOB based on partner's declarations collected through the inspections and collection of reports in PY2023.

c. Part-time personnel

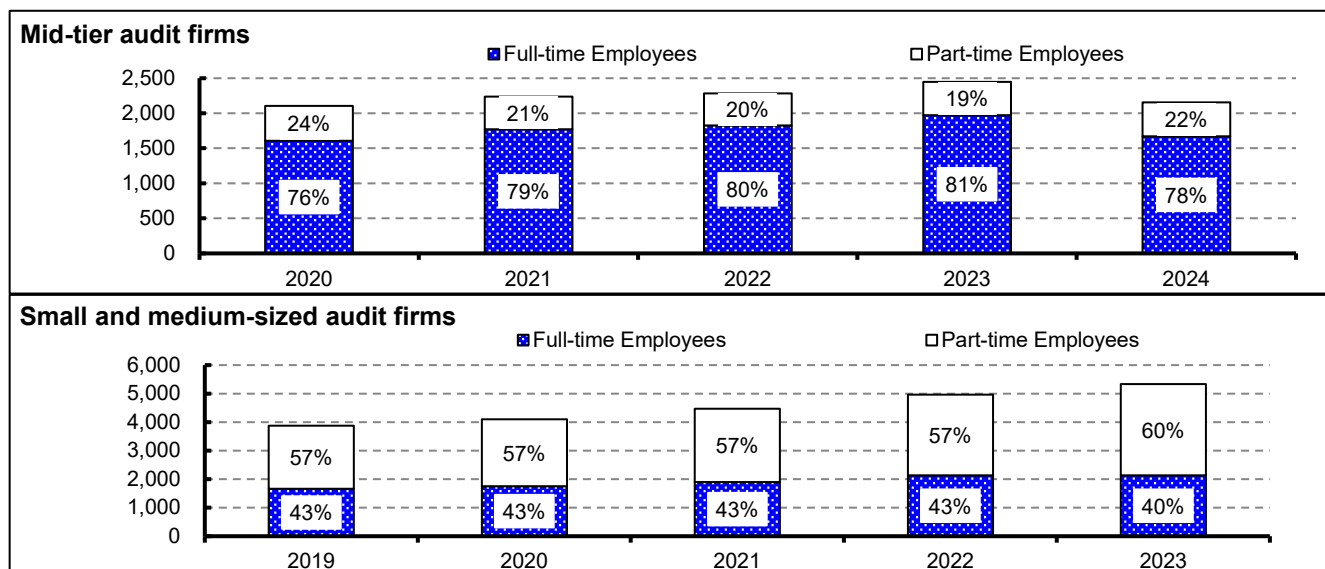
Part-time staff members account for an extremely low; around 3% to the total headcount at large-sized audit firms.

The ratio of part-time staff to total staff at small- and medium-sized audit firms has been on a decreasing trend, and in the last three years, the ratio has remained at around 20% in total for each firm.

The ratio of part-time staff members was around 60% at small and medium-sized audit firms,

indicating that they rely mainly on the audit assistants to support their operation (see Figure III-1-7). In particular, at audit firms with a full-time staff of four or less which occupies around 70% of small and medium-sized firms, the ratio of part-time staff to total staff is about 90% (see Figure III-1-8).

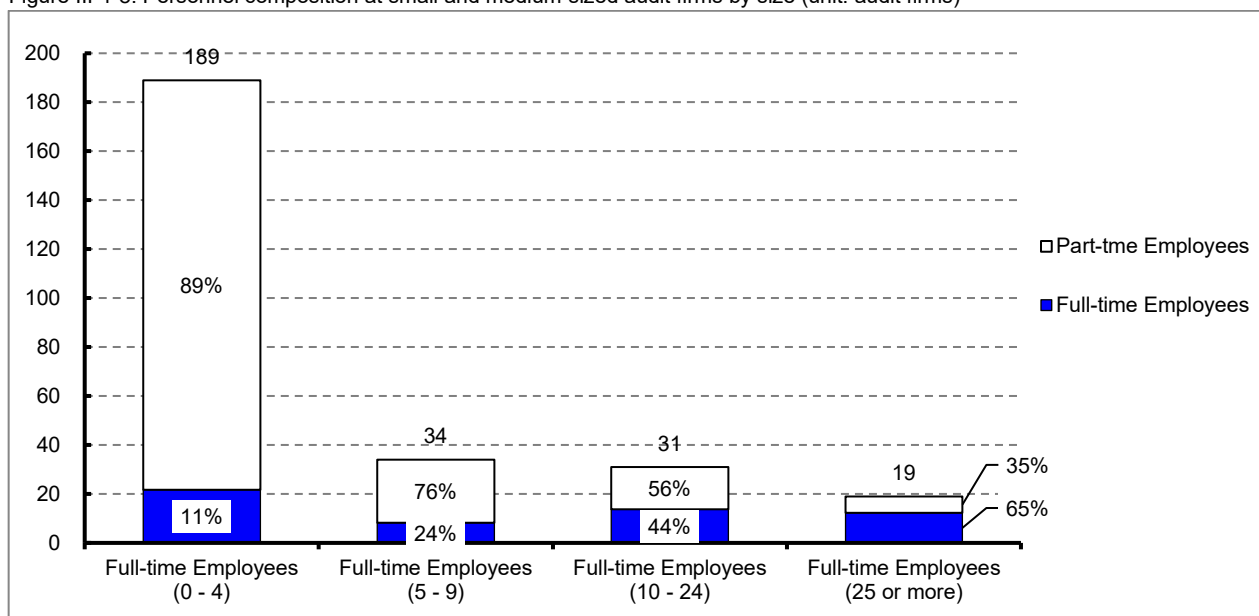
Figure III-1-7: Number of full-time and part-time personnel (unit: persons)



(Note) The data is based on operational reports submitted by audit firms. The number of PwC Kyoto in FY2023 is included in the mid-tier audit firms

(Source) Prepared by the CPAAOB based on operational reports submitted by audit firms.

Figure III-1-8: Personnel composition at small and medium-sized audit firms by size (unit: audit firms)



(Note) The 271 audit firms were classified by the number of full-time personnel based on the operational reports submitted by small and medium-sized audit firms in FY2022, after which the number of employees was totaled and the composition ratios of full-time and part-time personnel calculated.

(Source) Prepared by the CPAAOB based on operational reports submitted by audit firms.

4. Organizational Structure for Providing Audit Services

An audit engagement team, as an audit service provider, is required to exercise professional skepticism¹⁶, carry out appropriate risk assessments and risk-response procedures and perform proper audit procedures for improving audit quality. The CPAAOB endeavors to understand the engagement team's status through its inspections of audit engagements, and to ascertain the status of the conduct of audit services through other monitoring activities. This section elaborates on the status of engagement teams.

An engagement team consists of an executive partner who takes primary responsibility, CPAs serving as audit assistants and other audit assistants. Other audit assistants include CPA exam passers and other audit assistants (staff members who are not qualified to be involved in the audit of financial statements by CPAs, etc.). If the business activities of an audited company are complicated and extensive in scale, IT, tax and other in-house experts join the team. As occasion demands, experts of corporate value assessment and fraud response within a group audit firm may also join the team. The general job classification-based formation of an engagement team (Note 1), formed by a large-sized audit firm to audit a big domestic listed company, is shown in Figure III-1-9.

Large-sized audit firms are implementing measures to reduce clerical work by CPAs at audit sites (where auditing services are performed), as mentioned in 5. Organizational Structure for Supporting Audit Services. As a result, the number of members and job classification-based formation of engagement teams may change depending on the progress made in the measures.

Figure III-1-9: Example of the composition and main roles of engagement team members at a large-sized audit firm

		Position	Principal roles
Three engagement partners		Partner	Control of audit services, communication with the senior management of the audited company
Assistants to the engagement partners	One senior manager/ Manager	Senior manager/Manager	Management of engagement team, management of audits
	One senior manager/ Manager	Senior manager/Manager	Management of foreign component audits
	10 CPAs	Manager/Senior staff	Performance of audit procedures in significant audit areas
	13 qualified assistants (CPA exam passers, etc.)	Staff	Performance of audit procedures other than important audit procedures
	Four unqualified assistants	Assistant	Data processing, reconciliation of administrative vouchers, other tasks not requiring significant judgements, management of sending/ collection of balance confirmation letters, administration of engagement documentation
	Seven in-house experts (Note 2)	Partner, manager, senior staff, etc.	Assessment of IT control, verification of corporate tax, etc. treatment and of adequacy of retirement benefit obligations at audited companies

(Note1) An example of an engagement team auditing a company having consolidated sales of approximately 1.6 trillion JPY that requires approximately 15,000 hours for audit engagements.

(Note2) In-house experts are assigned to engagement teams as needed

(Source) Prepared by the CPAAOB based on information obtained through the CPAAOB inspections

¹⁶ An attitude with a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence.

The general features of the composition of engagement teams were as follows.

At large-sized audit firms, experienced CPAs exert audit procedures for key audit areas under the instruction and supervision of engagement partners. Inexperienced CPAs, CPA examination passers, etc. usually cover audit procedures for audit areas other than important audit areas. Audit assistants help with audit services by performing such administrative tasks as sending balance confirmation letters. As mentioned above, furthermore, large-sized audit firms consolidate services done by audit assistants at a separately established service delivery center for enabling CPAs to concentrate on work requiring professional judgment by reducing their workload.

At mid-tier audit firms, although the number of personnel on the audit team is limited, the composition of the team is similar to that at large-sized audit firms, with work basically allocated according to the abilities of the audit team members. Some mid-tier audit firms continue to strengthen the recruitment of audit assistants.

Small and medium-sized audit firms often have audit assistants on a part-time basis due to limited human resources for audit teams, although in some firms it is difficult to assign enough audit assistants to their teams. Compared with large-sized audit firms, therefore, the members with primary responsibility for auditing tend to play larger roles, for example, the audit manager needs to engage in audit procedures (Figure III-1-11).

<Structure of the engagement team in an audit of a financial institution>

To audit listed financial institutions subject to accounting and auditing procedures greatly different from those applicable to ordinary business enterprises, large-sized audit firms have set up mechanisms capable of performing an audit based on professional knowledge and experience, such as the establishment of financial business sections destined to audit the financial institutions. An engagement team to audit a listed financial institution involves knowledgeable members about the financial institution audit in such manners as forming a team mainly from a financial business section or deploying a primary responsible member from the section.

<Structure of the engagement team in an IPO audit>

In recent years, no audit firm has established an organization specializing in IPO audits, but in June 2024, some large-sized audit firms set up specialized departments for IPO audits. At some other audit firms, IPO audits are conducted by their existing audit departments. Among these, large-sized and mid-tier audit firms have taken measures to appropriately address the risks inherent in IPOs (such as vulnerabilities in internal controls) by prioritizing the assignment in members with extensive IPO audit experience to audit divisions and audit teams.

Furthermore, many large-sized and mid-tier audit firms have established special organizations to support IPO-related services. These departments serve as contact points for general business companies seeking IPO-related services and act as special organizations responsible for maintaining and improving audit quality in IPO audits.

Figure III-1-10: Typical engagement team composition and main roles of team members

		Large-sized audit firms	Mid-tier audit firms	Small and medium-sized audit firms
Engagement partners		- Setting material audit areas and assessing audit risks - Reviewing audit procedures performed by assistants - Communicating with management and the audit and supervisory boards	- Setting material audit areas and assessing audit risks - Reviewing audit procedures performed by assistants - Conducting audit procedures in material audit areas - Communicating with management and the audit and supervisory boards	- Setting material audit areas, assessing audit risks, and drafting audit plans - Reviewing audit procedures performed by assistants - Conducting audit procedures (including material audit procedures) - Communicating with management and the audit and supervisory boards
Assistants to the engagement partners	CPAs (Note)	- Drafting audit plans - Conducting audit procedures in material audit areas - Reviewing audit procedures performed by other audit assistants	- Drafting audit plans - Conducting audit procedures (including material audit procedures) - Reviewing audit procedures performed by other audit assistants	- Conducting audit procedures (including data analysis and sending, collection and management of balance confirmation documents) - Reviewing audit procedures performed by other audit assistants
	CPA exam Passers, etc.	Conducting audit procedures other than material audit procedures	Conducting audit procedures other than material audit procedures	- Conducting audit procedures other than material audit procedures - Not employed in most of smaller firms
	Unqualified assistants	- Data processing, reconciliation of administrative vouchers, other tasks not requiring significant judgements - Administration of sending/ collection of balance confirmation letters, administration of audit documentation	- Data processing, reconciliation of administrative vouchers, other tasks not requiring significant judgements - Administration of sending/ collection of balance confirmation letters, administration of audit documentation	Not employed in most of firms

(Note) CPAs at small and medium-sized audit firms are often part-time.

(Source) Prepared by the CPAAOB based on the CPAAOB inspections

5. Organizational Structure for Supporting Audit Services

With audited companies becoming larger in scale and promoting the sophistication and internationalization of operations, audit firms need to not only provide expertise and develop IT-driven tools and systems but also support engagement teams through such means as setting up environments that contribute to efficient and effective implementation of operations.

Accordingly, the CPAAOB monitoring focuses not only on audit engagements but also on whether audit firms take measures to ensure the appropriateness of audit services (the environment for supporting audit services) tailored to the firm's scale and characteristics. This section provides an overview of the system for supporting audit services. We will also provide some examples, mainly from large-sized audit firms, of systems for identifying audit risk and efforts to promote the development of IT-driven tools and systems and separate a clerical task.

a. Overview of support system

To ensure appropriate services, large-sized audit firms have assigned over 100 full-time personnel to their quality control divisions, and have established various departments: contract management, periodic review in relation to a system of quality control, accounting support, audit support, engagement quality review, IT, international services, and risk management (Figure III-

1-11). See "[B. Engagement Quality Reviews](#)" and "[C. Monitoring of System of Quality Management](#)" for information on engagement quality reviews and periodic reviews. A number of large-sized audit firms are strengthening quality control functions within their audit operation divisions and are taking steps to gather information on the firm's quality control in a timely manner and to provide support to engagement teams. Audit firms, especially large ones, have introduced, in addition to digitizing audit working papers, analytical tools to recognize unusual figures in journal entry data, tools to identify fraud risks, communications tools to facilitate the online exchange of information and reference material between audited companies and engagement teams, etc. (For progress in the digitization of auditing services, see "[6. Usage of Technology in Audit and Cybersecurity Efforts, a. Progress with the Adoption of IT in Audit Engagements](#)").

In addition, there is a case where large-sized audit firms establish organizations in charge of not only menial tasks, such as sending and collecting balance confirmation documents, checking the descriptions of securities reports, and entering and processing data for use by CPAs, etc. in audits but also confirmation work in certain audit services, such as management assessment procedure related to internal control, in order to enable CPAs and others to concentrate on tasks requiring their professional judgement. Organizations of such kind are located within an audit firm's existing office or newly established near Tokyo and regional cities. While their workload is done mainly by audit assistants at the organizations, audit firms carry out the provision of guidance and supervision in order to ensure a certain level of quality for the work, such as providing training programs for audit assistance and CPAs' check process for their works. With regard to the confirmation of balances, Audit Confirmation Center GK, jointly founded by large-sized audit firms in November 2018, has jointly developed a system to confirm receivables and obligations, provided an online platform related to the confirmation of balances, and is being entrusted with operations to send balance confirmation documents, etc. As such, large-sized audit firms, which are relatively stable financial-wise and have adequate human resources, are further reinforcing support in recent years to streamline operations by engagement teams through the development of various IT-based tools, division of clerical work and so forth.

Despite being smaller in scale than large-sized audit firms, mid-tier audit firms have similarly established quality control divisions. Furthermore, they have also started digitalization of audit documentations by, for example, adopting the audit-paper management systems used by their affiliated overseas member firms. There are many cases where small and medium-sized audit firms do not have a quality control section and instead appoint a person in charge of quality control or CEOs concurrently take charge of quality control. Note that most small and medium-sized audit firms have not digitalized audit papers, and instead are producing audit papers using, for example, widely available software. Notably, in October 2024, the Audit Confirmation Center LLC established the "Audit Firm Council for Expanding the Digitalization of Balance Confirmations," aiming to promote system development and expand usage among mid-tier and

small and medium-sized audit firms.

Figure III-1-11: Example of a support system at a large-sized audit firm

Support departments		Roles
Quality management division	Contract management department	Approving acceptance and continuance of audit engagements
	Accounting support department	Responding to technical inquiries concerning accounting standards, procedures, etc.
	Audit support department	Responding to technical inquiries concerning audit standards, manuals, and procedures
	Monitoring department	Ongoing monitoring and implementing periodic review, and monitoring and review of quality control system
	Engagement quality review department	Performing engagement quality review as well as the higher-level reviews against material or high-risk issues
IT division		Auditing IT areas of audited companies, supporting engagement teams with the use of IT audit tools
International division		Collecting/providing local information overseas and liaising with overseas member firms, etc.
Risk management division		Responding to inquiries concerning professional ethics and independence, collecting and analyzing risk information, supporting responses to risk of fraud, etc.

(Source) Prepared by the CPAAOB based on the CPAAOB inspections

b. Management of risk information

Audit firms develop and maintain the firm-wide management of risk information to handle high-risk audit engagements and to respond to the risk of fraud.

Specifically, large-sized audit firms handle this as follows (Figure III-1-12).

Figure III-1-12: Examples of management of risk information at large-sized audit firms

[Actions taken by risk management department] • Developing a database of past fraud cases and sharing that information within the audit firm • Selecting high-risk audit engagements through gathering information for past and current years and implementing continued monitoring and support to engagement teams • Establishing a procedure to obtain internal or external expert advice when a situation which indicates material fraudulent misstatement or a suspicion of material misstatement caused by fraud is identified, Issuing instructions for the launch of higher-level review • Organizing a team of experts for investigating fraud within an audit firm or its group firms • Establishing and operating a desk for receiving reports from whistleblowers inside or outside the audit firm [Actions taken by engagement teams] • Addressing the risk of fraud through the use of data analysis tools • Seeking expertise from the quality control division and undergoing a high-level engagement quality review in the risk of fraud or considering high-risk matters
--

(Source) Prepared by the CPAAOB based on the CPAAOB inspections

6. Usage of Technology in Audit and Cybersecurity Efforts

a. Progress with the adoption of IT in audit engagements

In recent years, the use of IT in audit engagements, including AI, by audit firms, mainly large-sized audit firms and mid-tier audit firms, has been increasing significantly. This is partly because audited companies are rapidly digitizing their accounting records, transaction records, etc. with the society digitalized, and in conjunction with this, audit firms also need, as “workstyle reforms” are introduced, to perform audit engagements more efficiently and effectively. This is affecting the nature of audits, and large-sized and mid-tier audit firms are moving proactively, either jointly with their global networks or independently, to deploy or develop IT-driven audits.

Here we elaborate audit firms’ strategies at present; how audit firms are developing their audits.

i. Unification of audit tools

Audit firms that are members of the global networks use audit tools provided by the global networks (for more details, see [“7. Responses to Overseas Expansion of Companies b. Ties with Global Networks”](#)). Audit tools in question not only have the function of preparing and storing working papers but also include audit support tool functions, such as those for safe transfer of data and materials to and from audited companies, and timely tracing of progress in auditing, including work by the team of auditing subsidiaries.

Unified R&D and IT operation of the global networks promotes the efficiency of IT investment, and feedback from their member firms on remedies or requests of audit tools may be beneficial to the global networks enabling them to improve security and refine functions of the audit tools.

However, there are also cases of Japanese audit firms independently developing/deploying analytical tools and implementing them as forecasting system on accounting fraud.

ii. Task automation (RPA¹⁷)

While CPAs have conventionally conducted standardized work for the implementation of audit procedures, such as processing and collection of data, by themselves, the introduction of audit support tools has advanced in recent years. The tools in question include a one-stop function from the extraction to analysis of data. With the function, the automatization of work, such as processing data and drafting working papers, is making headway. For example, it has become possible to automatically extract information needed for analytical work from data, collected in a lump from an audited company's core operation system, and produce findings inside an audit support tool.

iii. Sophistication and expansion of data analytics

Amid the increasing introduction of audit support tools, the improvement of their functions has made it possible to multilaterally analyze all accounting data of an audited company. Findings

¹⁷ RPA is short for robotic processing automation and represents efforts to streamline and automatize office work by means of artificial intelligence and other technologies. It is realized by software robotics that operates software and other programs like humans. It is also called “digital labor” and “virtual knowledge worker.”

by a broad-ranged analysis, many of which are currently used to assess risks at the time of working out an audit plan, are expected to be used in the entire auditing process through the formation of audit opinions.

In the past, audit firms performed risk analysis that involved the measurement of indications of fraudulent accounting etc. in audited companies' financial information. Recently, however, the advancement of AI has been facilitating the development and introduction of tools to predict future fraud using non-financial information and means to detect abnormal transactions that may lead to fraudulent accounting from among large amounts of accounting records, which enables audit judgements to be made based on more sophisticated analysis. Accordingly, integrating the results of analysis of non-financial information such as reputation about audited companies, audit firms are expected to be able to analyze a broader range of risks.

iv. From ex post facto audit to real-time audit

At present, most audit work are centered on the period after the date of the fiscal year end, but with the aim of setting up a more comfortable working environment by leveling audit work throughout a period, and making audits more sensitive to risks and more likely to uncover frauds at an early stage, by the use of the aforementioned IT tools, audit firms are exploring the applicability of audit techniques for the day-to-day analysis of transactions etc. (real-time audit).

i., ii., and iii. above are fields in which progress is being made with deployment in large-sized audit firms, while iv. is an area expected to be applied in the future. The introduction of these advanced audit techniques requires that the originals of transaction records etc. of audited companies are kept in electronic form, and the handover of the data also requires the consent of the audited company concerned. Additionally, time is required for data cleansing to enable utilization of data for RPA and data analytics. Due to these problems, progress is gradual. Regarding iii. above, although the accuracy of fraud detection tools is becoming better than before, individual audit firms are developing tools that can detect abnormal transactions with higher fraud risks and fraud employing more complicated means.

Figure III-1-13 presents information on the adoption of the audit tools, etc. discussed above based on the size of the audit firm. It shows that large-sized audit firms, which audit numerous large companies, which possess vast amounts of data, are taking the lead in the adoption of audit tools in audit engagements.

On the other hand, regarding the use of audit tools by small and medium-sized audit firms, according to the responses of collection of report from 52 small and medium-sized audit firms, 22 firms have already implemented electronic audit documentation, and 11 firms have considered the possibility of implementing such tools. In addition, 12 firms replied that they had already introduced journal analysis tools (analysis of transaction details (journal entries) and detection of abnormal journal entries), indicating that small and medium-sized audit firms are

also making use of IT in auditing, although not to the same extent as large and medium-sized audit firms.

As the improvement of IT skills on the part of partners and staff, who operate auditing tools, is indispensable to promote the use of IT, audit firms, especially large-sized ones, are nurturing IT experts through the introduction of auditing tools and training about data analyses. At the same time, they are recruiting experienced IT engineers from outside to develop their IT systems earlier.

Figure III-1-13: Utilization of IT in audit operations at large-sized audit firms and mid-tier audit firms

Status	Large-sized audit firms	Mid-tier audit firms
Installed	▪ Electronic audit documentation system (audit paper preparation and audit procedure management) ▪ Journal analysis tools (analysis of transaction details (journal entries) and detection of abnormal transactions) ▪ Evidence reconciliation tools (precise methods for cross-checking data from outside with all sales data at audited companies) ▪ File exchange system (used for exchanging data with audited companies) ▪ RPA (automation of data input and manipulation) ▪ Debit/credit balance confirmation system (automation of the external confirmation of the existence/accuracy of transactions)	▪ Electronic audit documentation system (audit paper preparation and audit procedure management) ▪ Journal analysis tools (analysis of transaction details (journal entries) and detection of abnormal transactions)
Being installed/ introduced at some firms	▪ AI (for forecasting potential fraudulent transactions using historical financial information, generative AI for internal information (rules and audit manuals etc.) to respond to internal inquiries) ▪ Audit databases (storing knowhow etc. on an in-house database to disseminate it)	▪ Evidence reconciliation tools ▪ File sharing systems ▪ RPA (automation of data input and manipulation)
Under development	▪ AI (fraud forecasting using non-financial information) ▪ Drones (improved efficiency in physical inventory count) ▪ Utilization of blockchains ▪ Text analysis (digitalization and analysis of documents)	▪ AI (forecasting potential fraudulent transactions using historical financial information)

(Source) Prepared by the CPAAOB based on information obtained through the collection of reports, etc.

■ Effective audit using AI ■

Due to the rapid advancement in the capabilities of generative AI (*1), the use and consideration of AI, including generative AI, is increasingly permeating the financial reporting ecosystem. Through monitoring audit firms, the CPAAOB is working to understand the impact of IT adoption in auditing, including the use of AI. In the auditing industry, particularly among large-sized audit firms, there is a growing trend toward introducing or considering AI tools, including generative AI, from the perspectives of operational efficiency and enhanced data analytics. The use of AI is expected to enable auditors to focus more on tasks that require evaluation and professional judgment, thereby contributing to improvements in audit quality and the overall attractiveness of audit work.

To strongly support sound AI utilization by financial institutions, including audit firms, the Financial Services Agency (FSA) conducted a survey on the actual use of AI among financial institutions and, based on the results, compiled use cases and initial discussion points into the “AI Discussion Paper,”¹⁸ which was published in March 2025.

The survey results also revealed that, within the audit industry, conventional AI (*2) is being used in tools for anomaly detection in transaction and journal entry data, identification and assessment of fraud risks, and searching internal documents such as audit standards and manuals. Furthermore, to achieve greater efficiency and sophistication, some firms are incorporating generative AI into these tools, either through implementation or pilot testing. Generative AI is also increasingly being considered for tasks such as summarization, translation, and proofreading of documents to assist auditors.

On the other hand, several challenges have been identified in the use of AI, including the lack of standardized data and insufficient accumulation of data related to fraudulent accounting. In particular, generative AI presents more complex issues than conventional AI, such as difficulties in ensuring explainability of the output process and the risk of hallucinations (phenomena where outputs are generated that are not based on actual data). Audit firms are working to address these challenges by developing and introducing technologies to supplement AI utilization, verifying results through backtesting to improve response accuracy and explainability. They are also establishing governance frameworks, including additional internal policies and usage restrictions for generative AI tools, while proceeding with their adoption or consideration of such tools.

The development and implementation of AI tools is also progressing at a global level through initiatives within global networks. The impact of AI advancements on audit quality continues to be discussed at the IFIAR (For IFIAR, refer to the column “International Forum of Independent Audit Regulators (IFIAR)” on page 95). In the report titled “*Use of Technology Including AI in Auditing*,”¹⁹ published in March 2025, the following key points were emphasized to ensure that audit firms can utilize AI and other technological tools in ways that enhance audit quality:

- Improve and redesign operational processes at all levels—including global networks, national audit firms, and audit teams—to better understand and monitor the impact of technology on audit quality.
- Prioritize the development and implementation of technological tools that have a significant positive impact on audit quality.
- When utilizing AI including generative AI, establish appropriate governance and monitoring frameworks, ensuring transparency and explainability of input and output processes and verifying that tools function as intended.
- Take necessary measures to control technological tools used in audit work and ensure that audit firms and audit teams receive proper training and take responsibility for judgments related to audit results derived from such tools.

As further advancements in AI are anticipated, it remains essential for audit oversight authorities in each country to continue coordinating and cooperating in monitoring developments related to AI utilization.

¹⁸ “AI Discussion Paper - Preliminary Discussion Points for Promoting the Sound Utilization of AI in the Financial Sector” https://www.fsa.go.jp/en/news/2025/20250304/aidp_en.pdf

¹⁹ IFIAR “Use of technology in audits – observations, risks and further evolution” <https://www.ifiar.org/?wpdmdl=18273>

**1 Generative AI refers to models with a vast number of parameters, such as large language models (LLMs), which are trained on unstructured data (e.g., text, images) from the internet and are capable of generating new content such as documents, images, audio, and video.*

**2 Conventional AI refers to systems that use machine learning to learn patterns and characteristics from pre-provided data and generate responses based on input data.*

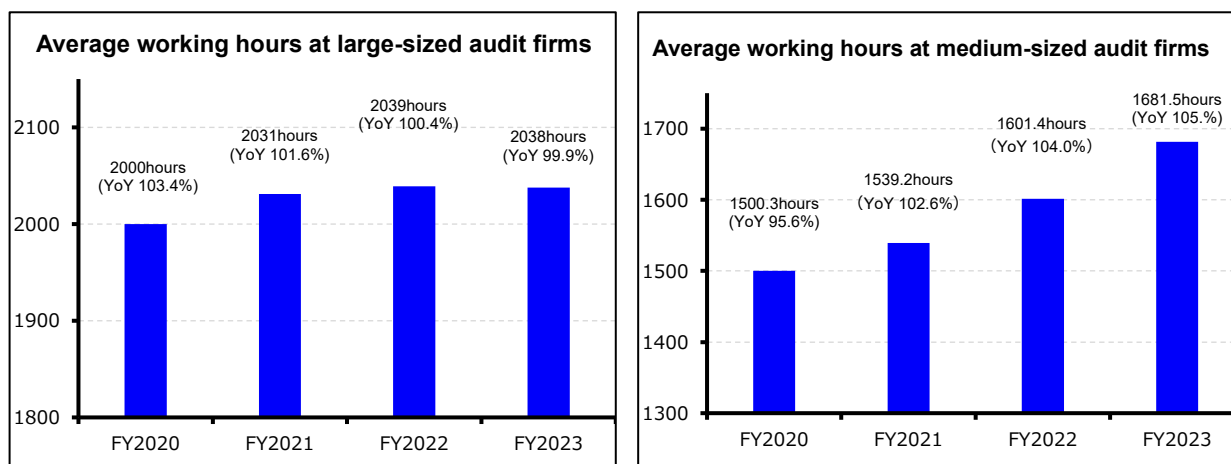
*Both *1 and *2 are extracted from the “AI Discussion Paper”.*

■ IT tool adoption and its impact on average working hours at large-sized and mid-tier audit firms ■

Some audit firms state the average annual working hours of partners, staff, etc. in their audit quality reports. The following table shows the average annual working hours and the average year-on-year rate of change for which we were able to confirm the information provided in the audit quality reports of large-sized audit firms and mid-tier audit firms over the last four years.

Although the average working hours of large-sized audit firms are longer than those of mid-tier audit firms, the rate of change from the previous year was lower for large-sized audit firms than for mid-tier audit firms, with the exception of FY2020.

Although this is a comparison of simple averages and is not a detailed analysis, it is possible that in addition to the transfer of audit services from large-sized audit firms to mid-tier audit firms and small and medium-sized audit firms, the introduction of IT tools in audit services and the transfer of operations to service delivery centers, which large-sized audit firms are actively promoting, are having an effect.



(Source) Prepared by the CPAAOB based on the audit quality report of each audit firm.

Going forward, particularly among mid-tier audit firms, the increased use of IT tools and service delivery centers by audit teams may lead to downward trend in average annual working hours. Furthermore, the introduction of AI-based tools is expected to further enhance the effectiveness of these efforts.

b. Cybersecurity efforts

As mentioned earlier, large-sized audit firms in particular are embedding audit tools and exchanging data with audited companies via e-mail and file exchange systems. These use cases have been permeating as data volume has risen, and transaction data has become more digitized.

At the same time, the risks posed by information leaks due to cyberattacks and other factors have risen, as seen in the damage inflicted by cyberattacks on audit firms overseas. Now that the information leaks in audited companies, in particular, cause serious damage to the audit firm's trust, bolstering cybersecurity steadily is a must. Accordingly, the CPAAOB has been focusing on the following.

[Monitoring of audit firms]

The CPAAOB reviews audit firms' cybersecurity measures through periodic collection of reports, hearings and dialog. These approaches have enabled it to identify the following efforts common to large-sized audit firms and some of mid-tier audit firms.

- Establishing basic information security policies and promoting information protection inclusive of cybersecurity across the global network as a whole
- Setting up organizations responsible for cybersecurity (CSIRT²⁰) and, as necessary, recruiting experts in-outside the audit firm
- Identifying the data held by the audit firm, rating the materiality, and developing policies for data use as well as contingency plans for information security incidents and cyberattacks
- Undergoing reviews by the global network to confirm the effectiveness of the audit firm's information security system, making improvements in the system, collecting information on cyberattacks and information security countermeasures, and utilizing this information to develop and improve the information security system.

In general, cyber-attacks are said to target vulnerabilities in security systems. Among small and medium audit firms, there are cases where the rules and regulations on information security are not aligned with actual situations. Furthermore, in responses on cybersecurity initiatives in collection of reports from 52 small and medium-sized audit firms, some firms have not developed basic cybersecurity policies or implemented anti-virus software. On the other hand, more than half of the firms have undertaken initiatives such as acquiring and analyzing communication logs and establishing incident reporting procedures. These efforts have significantly increased compared to the previous fiscal year.

On April 1, 2023, the "Registration System for Auditors of Listed Companies, etc." was launched. Under this system, a qualification assessment is conducted to determine whether audit firms

²⁰ CSIRT (Computer Security Incident Response Team) is the collective term for the organizations responsible for dealing with incidents pertaining to computer security.

have an adequate framework to conduct audit and attestation services for listed companies fairly and appropriately (“confirmation of eligibility”). To serve as a concrete guideline for conducting these assessments, the JICPA formulated and published the "Guidelines for confirmation of eligibility of audit firms engaged in the audit of listed companies". In August 2024, this guideline was revised. Following the revision, audit firms conducting audits of listed companies are now urgently required to strengthen their information security systems, including the protection of confidential information handled in audit services, centralized data management, and ensuring the safety of external access. Small and medium-sized audit firms have been conducting self-assessments using the guideline, evaluating whether their circumstances align with those described in the guidelines. If they are found to be applicable, they are expected to voluntarily implement improvements. As a result, it is believed that progress has been made in enhancing their information security systems.

■ CPA and Anti-Money Laundering and Countering the Financing Terrorism (AML/CFT) ■

Legal and accounting experts have a high level of expertise in law and accounting, etc., and have high social credibility. Therefore, transactions conducted through their duties and related operations can be abused as a means of money laundering and terrorist financing.

The "Act for Partial Revision of the Act on Special Measures Concerning the Freezing of Property of International Terrorists and Other Measures Implemented by Japan in Response to United Nations Security Council Resolution 1267 and Other Resolutions, etc., in Response to International Traffic in Illicit Funds and Other Transactions" ("Revised Act") enacted on December 2, 2022, newly established the following provisions for legal/accounting experts.

1. The purpose of the transaction and the beneficial owner of the corporation are added to the items to be confirmed in certain transactions (Financial consultation business for the sale and purchase of residential land and buildings, management and disposal of property, etc.) conducted by CPAs, etc.
2. CPAs have been added to the list of entities subject to the suspicious transaction report (STR) obligation.

Based on the Revised Act, the FSA published in December 2023 a partially amended draft of "Points of Attention Regarding the Act on Prevention of Transfer of Criminal Proceeds" and "Guidelines for Anti-Money Laundering and Combating the Financing of Terrorism for CPAs and Audit Firms," which have been applied since April 2024.

The revised guideline provides more concrete explanations of the obligations required under the amended law, including items (i) and (ii), as well as how to respond to them. In addition, the guidelines state that CPAs are required to adopt a risk-based approach in responding effectively to risks associated with money laundering and terrorist financing. This means they should identify and assess these risks appropriately and then take flexible and prioritized actions—such as building or improving internal systems—to effectively reduce the risks within acceptable levels.

7. Responses to Overseas Expansion of Companies

a. Group audits

Many listed companies have established subsidiaries or affiliated entities overseas and operates their business locally. M&A targeting overseas businesses are also on the rise in recent years. For this, companies are necessitated to address many issues, such as establishing a system to

manage overseas subsidiaries, examining complicated economic transactions, and dealing with different accounting standards. Furthermore, serious accounting fraud incidents often come out at overseas subsidiaries. With the importance of group audits growing under the circumstances, audit firms are strengthening measures to address them.

ASCS 600 “Special Consideration for Group Audits” was revised in January 2023, and its application begins with audits of financial statements for fiscal years beginning on or after April 1, 2024. Therefore, a brief overview of group audits and auditing procedures are stated based on the revised ASCS 600 “Group Audits” as follows.

i. Overview of group audits

When auditors at a parent company ("group auditors") perform an audit attestation of group financial statements, the work covers the parent as well as consolidated subsidiaries and head offices and branches, etc. (each company and other entity that serves as a unit for preparation of financial information included in group financial statements is called a "component unit"). For example, an internationally operating manufacturer has many component units (subsidiaries) not only in Japan but also overseas, such as subsidiaries set up in countries with reasonable labor force and sales subsidiaries.

Group auditors are required to identify and assess the risks of material misstatement of the group financial statements and determine audit procedures based on those assessed risks (ASCS 600 para 13. (b)). Also, group auditors evaluate whether sufficient appropriate audit evidence has been obtained from the audit procedures performed, including with respect to the work performed by component auditors, as a basis for forming an opinion on the group financial statements (ASCS 600 para 13. (d)).

ii. Risk assessment of the group financial statements

Based on the understanding of the group and its environment, the applicable financial reporting framework and the group's system of internal control, the group auditor takes responsibility for the identification and assessment of the risks of material misstatement of the group financial statements (ACAS 600 para 30 and para 33). Key members of the group auditors need to discuss the possibility of there being a material misstatement in the financial statements of the group caused by fraud or error and must focus in particular on the risks of material misstatements resulting from fraud (ACAS 240 para 14, ACAS 315 para 16, and ACAS 600 para 30, para A91 and para A92).

In recent years, there have been many cases of fraud etc. discovered after the fact at overseas subsidiaries that would seriously affect group financial statements. It has therefore become more important to perform risk assessments based on an adequate understanding of the group management system such as establishing a department at a head office tasked with managing foreign subsidiaries or performing internal audits to foreign subsidiaries and group environment including internal control of overseas subsidiaries.

iii. Responding to the Assessed Risks of Material Misstatement

Group auditors take responsibility for the nature, timing and extent of further audit procedures to be performed, timing and extent of the work to be performed at the components at which to perform further audit procedures and the nature (ACAS 600 para 37).

In response to the assessed risks of material misstatement, the group auditor may determine the following scope of work to be appropriate at a component. Component auditors can be, and often are, involved in all phases of the group audit, including in the design and performance of further audit procedures.

- Design and perform further audit procedures on the entire financial information of the component;
- Design and perform further audit procedures on one or more classes of transactions, account balances or disclosures; or
- Perform specific further audit procedures.

The approaches to group audit procedures taken by audit firms of different sizes are as follows (Figure III-1-16).

Figure III-1-14: Approach to group audit procedures taken by audit firms of different sizes

	Large-sized audit firms	Mid-tier audit firms	Other
Group audit manual	Incorporating the global network's group audit manual into the firm's audit manual	Many firms incorporated the global network's group audit manual into the firm's audit manual, but some prepared their own	Many firms prepared their own group audit manual
Audit instructions (Note1)	Using the global network's template for audit instructions	Many firms used the global network's template for audit instructions, but some prepared own templates	Many firms prepared their own templates.

(Note1) Documentation used by the group auditors to communicate its requirements to the component auditors.

(Note2) Regarding "Other" in the figure, of the 52 firms from which reports were collected in PY2024, information is presented for 21 firms conducting audit engagements for which group audit is required in cases where there is any component overseas. Among these, only five firms are affiliated with their global networks and using the group audit manual or audit instructions provided by the global networks.

(Source) Prepared by the CPAAOB based on information obtained through the CPAAOB inspections or the collection of reports

iv. Communication with component auditors

ACAS 600 requires sufficient and appropriate involvement by the group engagement partner or group auditor in the work of component auditors and emphasizes the importance of two-way communication between the group auditor and component auditors (ASCS 600 para 8).

The group auditors therefore not only sent and received audit instructions and reports on the audit results and grasped the situation by phone or e-mail, etc., but also communicated by visiting component auditors and online meetings. Large-sized audit firms and some mid-tier audit firms have established support systems for their group auditors by establishing international business support sections inside of the firm and dispatching Japanese expatriates to key overseas offices. These measures help facilitate communication between group auditors and component auditors and provide group auditors with local information.

b. Ties with global networks

Large-sized audit firms, mid-tier audit firms, and some small and medium-sized audit firms, partnerships, and solo practitioners contracted the member firm agreement and belong to global networks in order to facilitate audits of audited companies exploring overseas operations by leveraging the global network's know-how such as audit manuals.

i. Membership of global networks

All large-sized and mid-tier audit firms as well as some small and medium-sized audit firms, partnerships, and solo practitioners that need to audit the overseas operations of audited companies, belong to global networks, and are moving forward with the establishment of structures for group audit (Figures III-1-15 and III-1-16). However, not all small and medium-sized audit firms, partnerships, and solo practitioners that are expected to conduct group audits belong to global networks (for details, see [“7. Responses to Overseas Expansion of Companies”](#)).

Figure III-1-15: Number of audit firms belonging to global networks²¹ (FY2023) (unit: audit firms)

Large-sized audit firms	4
Mid-tier audit firms	4
Small and medium-sized audit firms	22
Total	30

(Source) Prepared by the CPAAOB based on operational reports

Figure III-1-16: List of global networks to which large-sized and mid-tier audit firms belong

Audit firm	Global network
KPMG AZSA LLC	KPMG International Limited (KPMG)
Deloitte Touche Tohmatsu LLC	Deloitte Touche Tohmatsu Limited (DTT)
Ernst & Young ShinNihon LLC	Ernst & Young Global Limited (EY)
PricewaterhouseCoopers Japan LLC	PricewaterhouseCoopers International Limited (PwC) (Note)
GYOSEI & CO.	NEXIA International Limited (NEXIA)
BDO Sanyu & Co.	BDO International Limited (BDO)
Grant Thornton Taiyo LLC	Grant Thornton International Limited (GT)
Crowe Toyo & Co.	Crowe Global

(Source) Prepared by the CPAAOB based on data from publicly disclosed materials from each audit firm (as of July 1, 2024)

The operating revenues of global networks comprise revenues from audit services, tax related services and advisory services, and a breakdown of the top-ranking global networks in terms of

²¹ Among small and medium-sized audit firms, the firms that have concluded cooperative relations (alliances) with overseas audit firms are included.

operating revenues is shown below (Figure III-1-17). The scale of the Big Four global networks is particularly prominent.

Figure III-1-17: Operating revenues of global networks (unit: billion USD)

	DTT	PwC	EY	KPMG	BDO	GT
Operating revenues	672	553	512	384	150	80
Audit services (Share of operating revenues)	128 (19%)	194 (35%)	173 (34%)	134 (35%)	62 (41%)	35 (43%)
Tax-related services (Share of operating revenues)	113 (17%)	126 (23%)	121 (24%)	87 (23%)	34 (23%)	16 (21%)
Advisory services (Share of operating revenues)	431 (64%)	233 (42%)	218 (42%)	163 (42%)	54 (36%)	28 (36%)

(Source) Prepared by the CPAAOB based on data from publicly disclosed materials of each global network (2024 accounting year).

In Japan, the Big Four global networks'²² share of audit services is 97% of the 225 companies that comprise the Nikkei Stock Average (Nikkei 225). Overseas, they account for even larger shares of audit services as shown below for the 500 companies comprising the S&P 500 index in the U.S. and the 350 companies with the largest market capitalizations on the London Stock Exchange (FTSE 350 index), meaning that the situation in these countries is the same as in Japan (Figure III-1-18)

Figure III-1-18: Big Four global networks' share of audit services for large listed companies in Japan, the U.S., and the U.K.

	Japan	US	UK
Big Four global networks' share (based on number of companies)	97%	99%	89%

(Sources) Japan: Compiled by the CPAAOB from QUICK and exchange data (as of March 31, 2025)

U.S.: Compiled by the CPAAOB from Bloomberg data (as of March 31, 2025)

U.K.: "Key Facts and Trends in the Accountancy Profession, September 2024," Financial Reporting Council

ii. Relationships with global networks

Member firms comprising global networks are responsible for a range of areas including quality control in exchange for enabling to use the networks' logos and brand, to share mutual business and know-how. The nature and degree of these responsibilities vary depending on the scale of the global network. In general, the larger global audit network would be more impactful on its member firms.

(i) Large-sized audit firms

Each of the large-sized audit firms belongs to one of the Big Four audit firms (Deloitte Touche Tohmatsu, Ernst & Young, KPMG, and PricewaterhouseCoopers) and has established close relationships with them. Specifically, they not only have the right to use the networks' logos and brand, but are also involved in the operation performed by the networks. For example,

²² Large-sized audit firms

their CEOs and the Person In Charge Of Quality Control (PICOQC) participate in important meetings of the global network and express Japan's views as members of high-level committees. In addition, members of oversight/assessment bodies attend meetings organized by global network.

Embedding audit manuals and tools prepared by the networks, the large-sized audit firms perform audits in accordance with them subject to the networks' standards. As of other quality control issues including engagement quality reviews, independence, they have adopted the standards and the procedures prepared by the networks.

Some large-sized audit firms, in addition to using the network's manuals and tools, dispatch the personnel like PICOQC etc. to the global firm in order to directly reflect the views of Japan in the initiatives taken at the network level, such as the revision of audit manuals and the development of audit tools.

They also regularly undergo global reviews conducted by the networks in order to confirm that audit quality, particularly for audit engagements, is secured at the level required by the networks (for details, see "[C. Monitoring of System of Quality Management, 2. Utilization of Global Reviews](#)").

Furthermore, some firms have an appetite to manage member firms on a regional basis. In the Asia-Pacific region, large Japanese audit firms tend to play a central role by participating as board members in organizations.

(ii) Mid-tier audit firms

All mid-tier audit firms are affiliated with global audit networks. However, the extent of their ties differs depending on size of the networks. Some have formed alliances that are at the same level of those of the large-sized audit firms, while others maintain moderate ties, only having the right to use the networks' logos and brand, and receiving referral of audit engagements from member firms in other countries, but are not provided with audit manuals and other information or undergo global reviews.

(iii) Small and medium-sized audit firms

Among small and medium-sized audit firms, while some have partnerships with global networks at a level comparable to large-sized audit firms, others have looser affiliations. In such cases, their involvement is limited to using the global network logos and brand and receive referrals for audit engagements from countries where member firms are located, and are not provided with audit manuals or subjected to global reviews.

Established in 2006, the IFIAR is an international organization comprising independent audit regulators that conduct inspections and other tasks on audit firms to improve the audit quality globally through cooperation and collaboration between authorities concerned. (As of March 2024, it had members from 56 countries and jurisdictions, including Japan.) In April 2017, the Secretariat of IFIAR was established in Tokyo, becoming the first headquarters of international organization in Japan.

As the host country of the IFIAR Secretariat, Japan has supported IFIAR's activities and discussions. In addition, the Director-General of the CPAAOB, who also serves as the Deputy Commissioner of the Strategy Development and Management Bureau of the Financial Services Agency, held the position of IFIAR Vice Chair for two years starting in April 2021, and Chair for two years starting in April 2023. Japan has thus taken a leading role in promoting global audit quality as both Chair and Vice Chair of IFIAR.

As the first Chair and Vice Chair country from Asia, Japan has contributed to strengthening IFIAR's functions as an international organization by expanding membership, particularly in Asia, facilitating knowledge sharing among IFIAR members, and engaging in dialogue with global networks. Japan has also responded swiftly to emerging issues such as assurance of sustainability-related information and the use of technology and has enhanced external communication of the outcomes of IFIAR's discussions.

With the globalization of corporate activities, ensuring high-quality audits globally is becoming increasingly important. Even after the end of its term as Chair, Japan will continue to play a leading role in IFIAR's activities and discussions as the host country of the Secretariat and a member of the IFIAR Board Meetings.

8. Treatment of Key Audit Matters

From the perspective of enhancing transparency and the provision of information pertaining to audits conducted under the FIEA, entries of "Key Audit Matters" (KAMs) in audit reports came to be required.

a. Processes and key points for deciding on and reporting KAMs

i. Auditors take into consideration the following matters out of those they discussed with audit and supervisory board members and others in the process of auditing, and decide the matters to which they paid special attention:

- Matters in which risks requiring special consideration were identified or which were deemed to have a high risk of material misstatements
- Degree of judgement by auditors about matters involving material judgment by management, including matters in which high uncertainty of estimate is identified
- Effects on audits from material matters or transactions taking place in the relevant year

ii. Out of the matters to which they paid special attention, auditors as professionals narrow down especially important matters, decide them as KAMs, and mention the following in a section set for them in audit reports.

- Content of KAMs
- Reference to notes in related financial statements where applicable
- Reasons why auditors considered the matter especially important in the audit of financial statements in current fiscal year and determined it as KAMs.
- Auditor's responses in audit

b. Responses by audit firms

Recent monitoring has identified the following responses among large-sized and mid-tier audit firms. In addition to these efforts, systems related to KAMs, including communications with audited companies, have been established (Figure III-1-19). These initiatives have been continuously implemented even after the second year of application, based on the recognition of the need to prevent boilerplate disclosures.

i. Development of guidance for preparation of KAMs

- Preparation and dissemination of guidance and descriptive examples with which audit teams comply when preparing for KAMs

ii. Provision of training

- Training to provide explanation of good examples on KAMs based on analyses of actual application cases
- Training to provide explanation of points to note in drafting KAMs

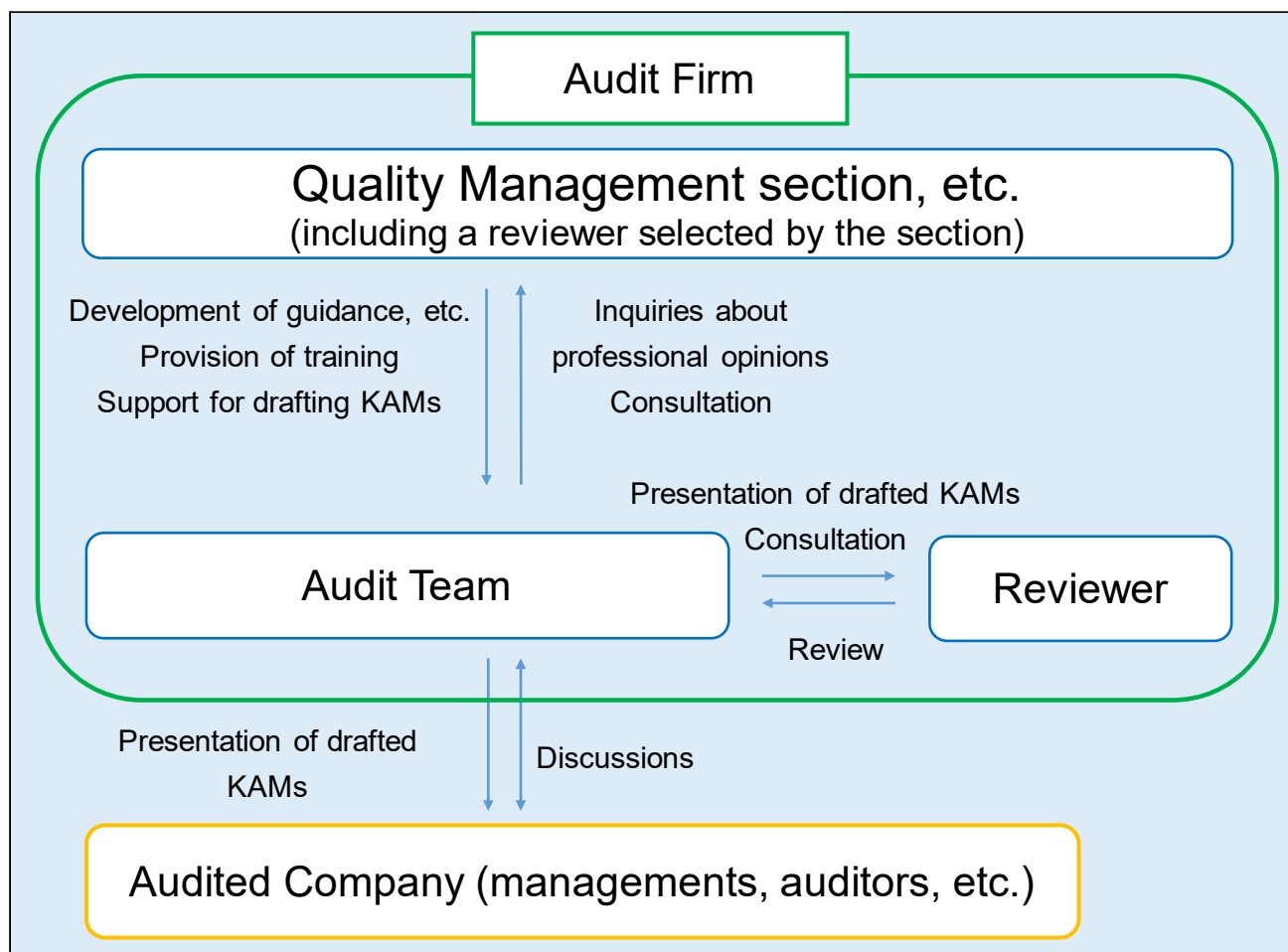
iii. Quality control section's support for audit team

- Clarification of the specific content of communication and schedule to achieve in-depth communication throughout the year with the management, audit and supervisory board members and others of an audited company
- Monitoring and follow-up of audit teams' handling of KAMs
- Review of draft KAMs by a reviewer selected by the quality control section when the audit team drafts new KAMs or makes significant revisions to previously reported KAMs.

iv. Reviews and inquiries of professional opinions

- Request for conference-format reviews by the headquarters and inquiries about professional opinions in specific cases, such as treating the non-disclosure of KAMs or assumption related to a going concern as KAMs

Figure III-1-19: Example of an audit firm's system for reporting of KAMs



(Source) Prepared by the CPAAOB based on information obtained through the CPAAOB inspections or the collection of reports

c. Analyses of KAMs and recommendations

FSA and other related organizations have released documents and other information related to KAMs (Figure III-1-20).

Figure III-1-20: Publication related to KAMs

Organizations that published their analyses, timing of publication, published documents, and web links
Japanese Institute of Certified Public Accountants (April 2023) Auditing Standards Statements 701, Public knowledge document No.2, "Public knowledge document on the third year application of Key Audit Matters (KAMs)" https://jicpa.or.jp/specialized_field/20230403ffh.html Summarizes points to keep in mind from the viewpoint of preventing boiler-plate and improving the usefulness of KAM.
Securities Analysts Association of Japan (February 2024) Good examples of KAMs helpful for securities analysts 2023 https://www.saa.or.jp/account/account/pdf/Kam20240213.pdf - In cooperation with the JICPA, the report introduces 23 'Excellent KAMs' and two 'Special KAMs' as good examples of KAMs, and describes the points that were evaluated and the comments of the analysts in charge. - Released three versions in February 2022, February 2023 and February 2024.
Financial Services Agency (June 2023) Efforts to establish and permeate the practice of Key Audit Matters (KAMs) https://www.fsa.go.jp/news/r4/sonota/20230630-9/20230630-9.html Summarizes the major efforts to establish and permeate the KAM in practice.

- Although "Study Group on KAM" or "Characteristic Examples and Key Points of Key Audit Considerations (KAM)" are not planned to be held after FY 2023, the efforts to further improve KAM practices will be continued through follow-up of KAM publication and collaboration with relevant organizations.

The KAM is expected to promote constructive dialogue between auditors and stakeholders, but it also raises concerns such as boiler-plate and polarization of good and bad cases. The CPAAOB will examine the decision-making process on KAMs, the descriptions of audit responses, and the implementation status regarding audit responses through the inspections based on the Basic Plan for Monitoring Audit Firms.

9. Domestic Audit Firm Groups

a. Structure of domestic audit firm groups

Many large-sized and mid-tier audit firms form their own audit firm groups that use common brand of global networks they join. And within the group, audit firm and other entities cooperate with each other in providing services in Japan ("domestic groups"). Besides the audit firms, these groups generally include consulting companies, financial advisory companies that carry out financial due diligence and provide financial advice on M&A deals, tax accountant firms, and attorney firms ("group companies").

In terms of structure of a domestic group to which large-sized audit firms belong, there are many examples of firms setting up holding company to manage the global brand and place each group company including the audit firm on an equal footing. However, there are also cases where the audit firm directly invest in other group entities (excluding entities of certified experts such as tax accountant firms or attorney firms, etc.), making them subsidiaries.

Domestic groups to which large-sized audit firms belong often establish councils comprising representatives from the major group entities. This structure facilitates coordination of interests among group entities and discussions at joint domestic group initiatives.

b. Group operating revenues

The ratio of non-audit and attestation revenue to operating revenue at groups consisting of audit firms and their subsidiaries, etc. ("audit firm groups")²³ had once decreased to 39% as certain large-sized audit firms spun off non-audit and attestation services and subsidiaries from their group in FY2015 and FY2017. However, it has been on an upward trend in recent years due to increases in revenue of group companies other than audit firms (Figure III-1-21). For audit firms' operating revenue, see "[I. Overview of the Audit Sector, B. Audit Firms, 5. Financial Condition \(Operating Revenue, Proportion of Audit and Attestation Services and Non-audit and Attestation Services\)](#)".

At mid-tier audit firm groups, the ratio of non-audit and attestation revenue in total group revenue has stayed lower than at large-sized audit firm groups, moving roughly in a range between 10% and 13% from FY2015 through FY2024. The revenue structure of mid-tier audit firm groups

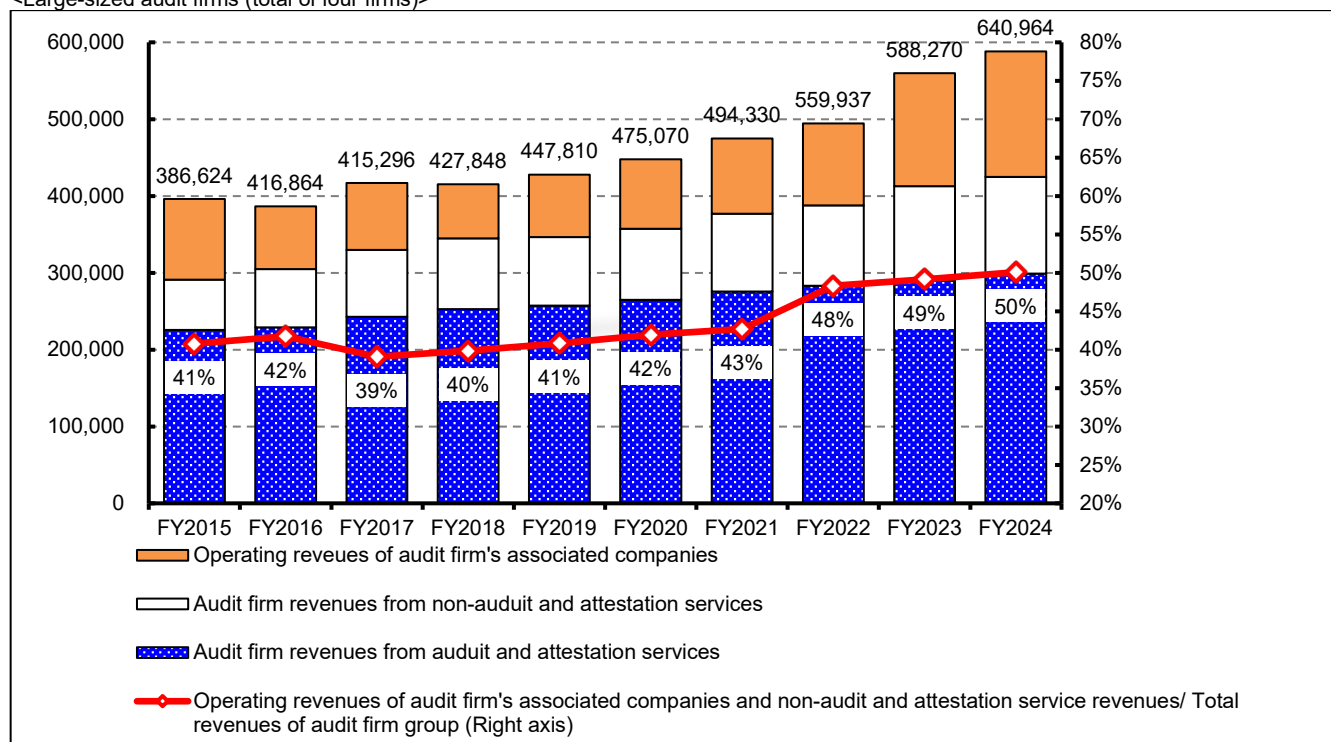
²³ Some group companies that do not have capital relationship with an audit firm have operating revenue of over 100 billion yen.

differs significantly from that of large-sized audit firm groups, as audit and attestation revenue accounts for a significant portion of total group revenue in the former (Figure III-1-24).

Regarding small and medium-sized audit firms, few firms have group entities other than the audit firm itself, and it can be observed that non-audit services are generally provided directly by the audit firms.

Figure III-1-21: Changes in operating revenues of audit firm group excluding audit firm and non-audit and attestation service revenues' share of these operating revenues (unit: million JPY (left axis))

<Large-sized audit firms (total of four firms)>



(Note1) Operating revenues of audit firm groups include revenues of the audit firm itself, as well as in principle, the revenue of group entities that fall under subsidiaries of the audit firm. This also includes the revenues of subsidiaries that provide intra-group services.

(Note2) Non-audit and attestation service revenues are the total of the non-audit and attestation revenue of the audit firm and the revenues of the subsidiaries etc. of the audit firm.

(Note3) One audit firm group changed its fiscal year-end in FY2017, so the FY2017 operating revenues for that audit firm group covers an eight-month period. As a result, FY2017 operating revenues are calculated by extrapolating eight-month operating revenues to one-year periods (by multiplying figures by 12 months/8 months) for the audit firm group that changed its fiscal year-end.

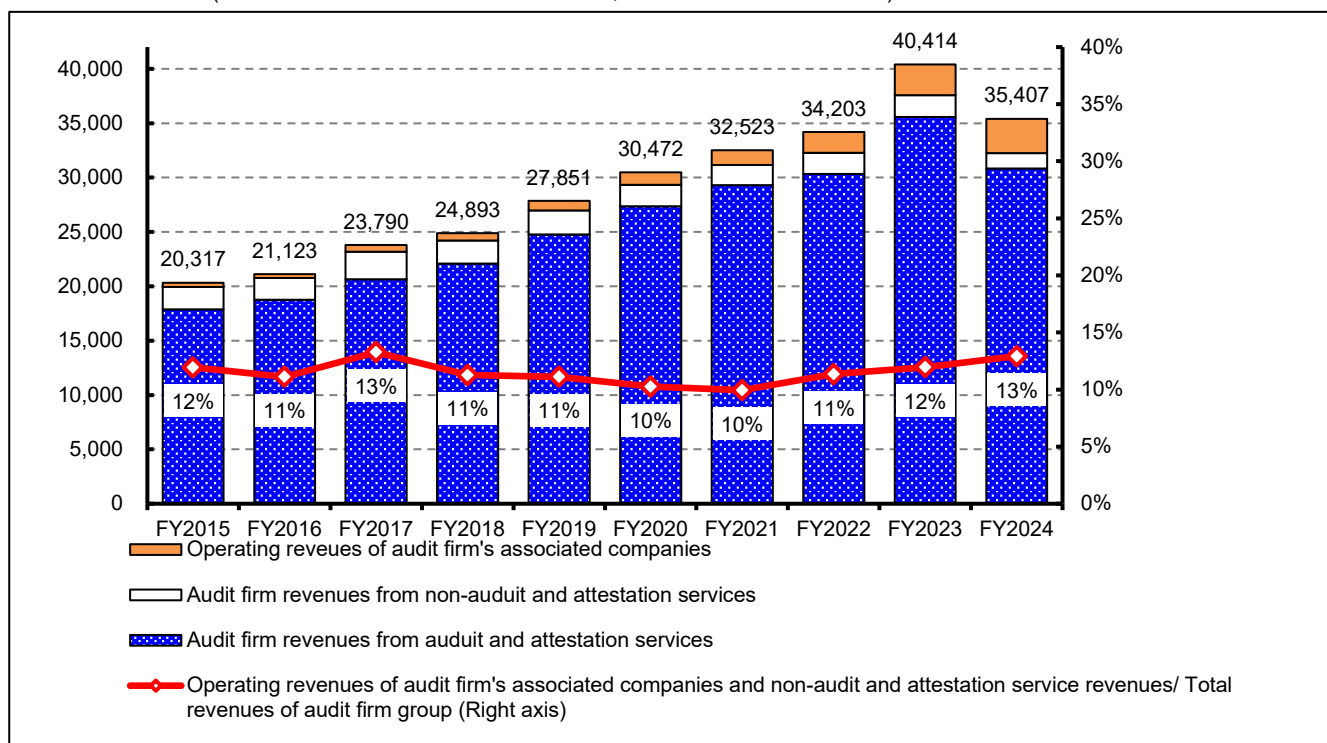
(Note4) In FY2015 and FY2017, certain large-sized audit firms spun off businesses or subsidiaries that perform non-audit and attestation services

(Note5) From FY2015 to FY2023, the operational reports were prepared based on the fiscal year prior to the establishment of PwC Japan. Therefore, the figures include the revenues of PwC Aarata.

(Source) Prepared by the CPAAOB based on operational reports submitted by audit firm

Figure III-1-22: Changes in operating revenues of audit firm group excluding audit firm and non-audit and attestation service revenues' share of these operating revenues (unit: million JPY (left axis))

<Mid-tier audit firms (Total of five firms from FY2015 to FY2023, total of four firms in FY2024)>



(Note1) Operating revenues of audit firm groups include revenues of the audit firm itself, as well as in principle, the revenue of group entities that fall under subsidiaries of an audit firm within the group, in principle.

(Note2) Non-audit and attestation service revenues are the total of audit firm revenues from non-audit services and domestic network firm revenues

(Note3) One audit firm group changed its fiscal year-end in FY2016, and it did not submit its report within the program year, so the FY2016 operating revenues for that audit firm group covers a fifteen-month period. As a result, when aggregating the figure, FY2015 data was used for the FY2016 operating revenues for the audit firm group. Operating revenues for FY2017 represent 15 month worth of operating revenues.

(Note4) From FY2015 to FY2023, the operational reports were prepared based on the fiscal year prior to the establishment of PwC Japan. Therefore, the figures include the revenues of PwC Kyoto. FY2024 does not include the revenue of PwC Kyoto.

(Source) Prepared by the CPAAOB based on operational reports submitted by audit firms

B. Engagement Quality Reviews

The “IV. Reporting Standards 1. General Principles” in Auditing Standards require auditors to be undertaken a review prior to the expression of the audit opinion in order to confirm that their opinion has been formulated appropriately in accordance with audit standards generally accepted as fair and reasonable. The review is therefore the final safeguard for ensuring the appropriate audit opinion. When evaluating the audit procedure implemented by the audit team, material judgement in audit process and audit opinion, objectivity of engagement quality review has significant impact on the audit quality.

There are three main styles of engagement quality reviews adopted by audit firms: a. the concurring review partner style (a review is performed by a partner other than the engagement partner), b. the council style (an engagement quality review is performed by a council), and c. the combination style (both the concurring review partner style and council style are adopted).

a. Concurring review partner style

An engagement quality review normally involves the engagement quality (EQ) reviewer, who is appointed for each audit engagement, performing the entire review from the audit planning stage to the expression of the audit opinion. This means that a deeper review can be possible. For example, efforts are made to accumulate information on the audited company and the engagement team, and throughout the period of the audit, the review examines whether the engagement team is responding appropriately to changes in the circumstances of the audited company.

However, in the case of the concurring review partner style, the quality of the review is heavily influenced by the abilities of specific EQ reviewers. At some small and medium-sized audit firms, the review of all audit engagements is handled by a specific reviewer, and in such cases the quality of review for the audit firm as a whole is affected by the abilities of this specific reviewer.

b. Council style

The council style covers not only cases where engagement quality reviews are conducted by a single council, but also cases where there are multiple levels of councils. In the case of the multi-level councils, important matters etc. involved in the expression of the audit opinion are determined in advance, with a high-level council undertaking the review of these matters.

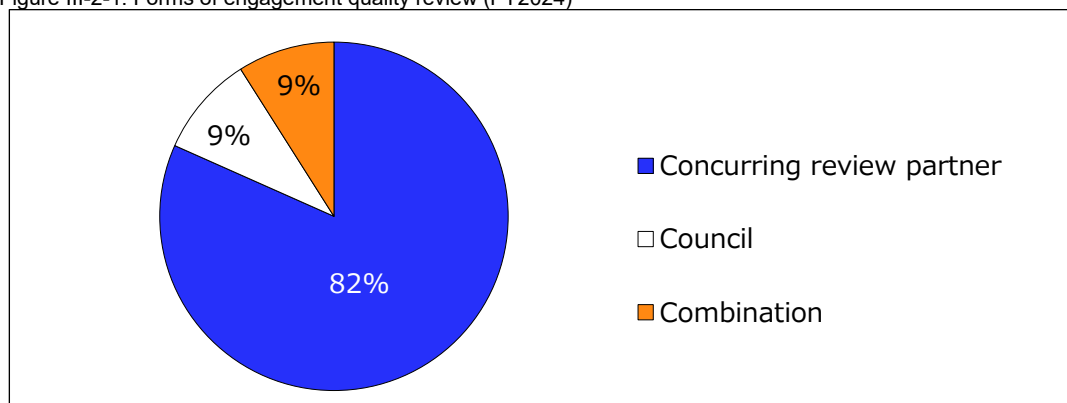
Since reviews of the council style involves the collaboration of several EQ reviewers, it allows for more multi-faceted reviews than the concurring review partner style.

c. Combination style

Under the combination style, the concurring review partner style is used in some cases, while the council style is used when the matter involved in expressing audit opinion falls under predetermined criteria. In another case, either the concurring review partner style or the council style is used, depending on the risk of each audit engagement.

The forms of engagement quality review are shown below (Figure III-2-1).

Figure III-2-1: Forms of engagement quality review (FY2024)



(Note1) Aggregated the status of 278 audit firms based on operational reports submitted by the audit firms

(Note2) As fiscal year-end varies widely among small and medium-sized audit firms, their results in FY2024 have yet to be tallied. This report therefore covers their results through FY2023 (from April 2023 through March 2024).

(Source) Prepared by the CPAAOB based on operational reports submitted by audit firms

Many large-sized audit firms adopt a concurring review partner style, in which a designated partner is responsible for all stages of the audit from planning through to the issuance of the audit opinion. These firms predefine key matters that are critical to forming the audit opinion or involve significant audit judgments, and conduct consultations to obtain expert views on those matters.

Mid-tier audit firms adopt both the concurring review partner style and the council style. For example, a reviewer conducts reviews of risk assessments performed by the audit team, the appropriateness of risk-response procedures, etc., while material matters for investigation are brought up at a review committee at headquarters. Furthermore, during reviews, some firms consult with bodies etc. featuring third parties in the case of important matters that would likely have a substantial social impact to ensure that decisions harmful to public interest are not made.

Around 80% of small and medium-sized audit firms, however, employ the concurring review partner style, though some perform engagement quality reviews using the council style or the combination style.

Regarding the appointment of reviewers, many firms select them among personnel who meet previously defined eligibility requirements for reviewers in terms of knowledge, experience, competence, position, etc., and they are appointed by the review division or the quality management division in consideration of the circumstances of audited companies. At some firms, however, the audit operations department etc. make the list of candidates who are then approved by the review division, the board of directors of the firm, etc.

In large-sized and mid-tier audit firms, the review division and others often monitor the review results, etc. and the time spent by reviewers.

There also are audit firms implementing programs to further improve review functions, such as reinforcing the information shared among reviewers, carrying out review-related compulsory training programs and conducting engagement quality reviews by reviewers belonging to quality management divisions at headquarters in higher risk audit engagements compared to ordinary engagements.

C. Monitoring of System of Quality Management

Audit firms are responsible for maintaining and improving audit quality, and in this sense, it is important for them to positively take the initiative in improving audit quality.

For this, it is important for audit firms to understand the levels of quality control in audit engagements in a timely manner and continuously have remediation in place. The CPAAOB inspects the monitoring of audit firms' system of quality management.

Furthermore, when an audit firm is a member of a global network, sometimes the global network may require member firms to conduct domestic audit engagements in accordance with its global policy to ensure consistent high audit quality across countries. The global network also conducts reviews to verify compliance with these policies by their member firms ("global review"). Given that large-sized and mid-tier audit firms have introduced the global review system into their quality control systems, the CPAAOB describes how those firms utilize global reviews in this section.

1. Periodic Inspections

Once an audit has completed, the audit firm is required to conduct procedures to ascertain whether an engagement team performed audits in accordance with the quality control system prescribed by the audit firm ("periodic inspections"). This inspection must be performed for at least one of the audits that each engagement partner has conducted during a certain period (e.g. three years) (QCSCS (amended in January 2023) para 38, A151 to A154).

Although periodic inspections are being conducted at all audit firms, factors such as the number of inspections, the number of inspectors involved and tools used differ depending on the sizes of the firm. Large-sized audit firms belonging to the Big Four global networks, in particular, are asked to perform periodic inspections based on the network's periodic inspection framework and verification tools (Figure III-3-1).

Furthermore, regardless of their size, the results of the inspections and the identified deficiencies are shared for raising risk awareness to all partners and staff at each firm through in-house training, etc.

Moreover, the inspection results are usually reflected on performance evaluation of engagement partners at large-sized audit firms and some mid-tier audit firms to boost the effectiveness of audit quality improvements.

Large-sized and mid-tier audit firms have set up a section tasked with monitoring audit services to enhance the objectivity and effectiveness of monitoring in their system of quality management. They conduct periodic inspection mainly by members of the section.

Figure III-3-1: Overview of the periodic inspections conducted in FY2024

	Large-sized audit firms	Mid-tier audit firms	Other (Note2)
Number and method of selection of audit engagements to be inspected	Each engagement partner is mandatory inspected at least once every three to four years. Furthermore, additional selections are made depending on the size and complexity of the audited company.	Each engagement partner is mandatorily inspected at least once every three years. Furthermore, additional selections are made depending on the size and complexity of the audited company.	Each engagement partner is mandatorily inspected approximately once every three years.
Inspectors	Under the supervision of partners in charge of quality management, partners and assistants who are not involved in inspected audit engagements (Inspection team is mainly composed of staff belonging to the monitoring division.)	Under the supervision of partners in charge of quality management, partners and assistants who are not involved in inspected audit engagements	Persons not involved in inspected audit services (including those outside the audit firm concerned) are under the supervision of a partner in charge of quality management.
Number of inspectors	Approximately between 20 to 200	Approximately between 15 to 25	Between one and around 20
Number of engagements handled by each inspector	One to two engagements	One to two engagements	One to seven engagements
Inspection framework (procedures, assessment policy), tools to be used	Conducted under the inspection framework and tools provided by the global network. Regarding responses to specifically Japanese auditing standards, many firms have partially tailored the global network's tools, such as adding items.	Some firms conduct under the inspection framework provided by the global network, while others conduct based on each firm's own inspection framework and tools.	Conducted based on each firm's own inspection framework. Many firms use "Checklist for Periodic Inspections" and "Audit Service Review Procedures" provided by JICPA as inspection tools.
Use of inspection results	Inspection results are shared within the firm and reflected in evaluations of partners and staff.	Inspection results are shared within the firm. Some firms reflected them in evaluations of partners and staff.	Inspection results are shared within the firm.

(Note1) The number of engagements per inspector was calculated by dividing the number of audits subjected to periodic inspections conducted in FY2024 by the number of inspectors involved.

(Note2) As fiscal year-end varies widely among small and medium-sized audit firms, their results in FY2024 have yet to be tallied. This report therefore covers their results through FY2023 (from April 2023 through March 2024).

(Source) Prepared by the CPAAOB based on information obtained through the CPAAOB inspections or the collection of reports

2. Utilization of Global Reviews

The Big Four global networks are increasingly focus on whether member firms in each country are delivering high quality audit services. For this reason, global networks require member firms in each country to comply with the detailed quality control provisions and audit manuals they provide. They also conduct global reviews to confirm compliance with these provisions and manuals in periodic inspections and individual audit engagements performed by the member firms. Large-sized and mid-tier audit firms are subject to global reviews conducted by the global networks to which they belong.

Global networks other than the Big Four sometimes require their member firms to comply with the audit manual provided by the global network to the same degree as that of the Big Four, but most of them operationalize more relaxed rules than the Big Four. Given that global networks do not necessarily require their member firms to conform to local or international auditing standards, there is a wide variation in nature and frequency of global reviews. For information on ties with global networks, see [“III. Operation of Audit Firms, A. Operations Management System, 7. Responses to Overseas Expansion of Companies, b. Ties with Global Networks, ii. Relationships with global networks”](#).

While all large-sized and mid-tier audit firms are subject to global review, few of the small and medium-sized audit firms that are part of the global networks are subject to the global review (Figure III-3-2).

Figure III-3-2: Overview of global reviews

	Large-sized audit firms	Mid-tier audit firm	Other
Whether global reviews are performed	All firms are reviewed	All firms are reviewed	Only some firms are reviewed
Frequency of global reviews	Every year	once every three to four years	Typically, once every three years
Global reviewers	In most cases, the global review is performed by global network reviewers.	In most cases, the global review is performed by global network reviewers.	In most cases, the global review is performed by reviewers appointed by the global network.

(Note) Few small and medium-sized audit firms etc. are members of global networks.

(Source) Prepared by the CPAAOB based on information obtained through the CPAAOB inspections or the collection of reports

3. Monitoring Before Expression of Audit Opinions

Monitoring is conducted prior to the expression of audit opinions, especially by large-sized audit firms as a measure to improve the quality of audits in recent years.

Monitoring before the expression of audit opinions is an operation assigned to a reviewer, designated by the quality control sector or audit services sector, to promptly find problems in quality management and prompt the audit team to take timely remedies.

Monitoring, furthermore, is often carried out in audit areas involving high risks, such as fraud or going concern, and those where deficiencies are continuously detected through external inspections and internal regular inspections, such as accounting estimates.

D. Education, Training and Evaluation of Audit Personnel

In order to maintain and improve audit quality, audit firms need to provide their audit personnel with opportunities to acquire necessary expertise and also need to evaluate them appropriately. It is particularly important to train and properly evaluate the audit personnel who can exercise the professional skepticism needed to detect accounting fraud. The CPAAOB monitors and inspects recruit, training, and assignment of, and evaluation/compensation, etc. for partners etc. of audit firms.

In this section we elaborate on the audit firms' human resource development and retention, education and training, and evaluation of its audit personnel (including engagement partners with primary responsibility).

1. Human Resource Development and Retention

To deal with changes to the auditing environment and the deepening complexity of audit methodologies, large-sized and mid-tier audit firms have been developing medium-to-long-term policies for developing human resources and offering education and training, in the context of which they have also provided personnel with a variety of career opportunities (Figure III-4-1).

Figure III-4-1: Examples of career opportunities at large-sized and mid-tier audit firms

- Carrying out work rotations and inter-organizational transfers (including regional offices)
- Involving in quality control activities and advisory and other non-audit services
- Placing personnel overseas at member firms
- Seconding personnel to locations outside the audit firm (e.g., group firms, JICPA and other relevant organizations, business companies, etc.)

(Source) Prepared by the CPAAOB based on information obtained through the CPAAOB inspections or the collection of reports

In addition, programs aimed at retaining human resources have been introduced, such as the adoption of flexible working arrangements including remote work and flextime, review of personnel evaluation programs, including compensation, and provision of various career plans through counseling and of work opportunities matching career plans. Some audit firms provide on-the-job training for young staff members on a one-to-one basis. There also are firms where counseling sessions are held on a group basis, such as those involving staff members of the same generation, to support them in maintaining their motivation. Among other cases, a mentor system that enables workers to seek advice on their personal problems helps reduce the rates of turnover and absence from work, while the turnover rate is monitored as an AQIs along with efforts to improve work environments for the enhancement of workers' interest in audit services.

2. Education and Training of Engagement Teams

Audit firms are required to establish quality objectives related to the development of specialist personnel and their capability and appropriateness to consistently perform high-quality audits (QCSCS para 28). To meet this requirement, audit firms have developed structures for educating and training their engagement teams in proportion to their size (Figure III-4-2).

Figure III-4-2: Examples of systems for education/training

Large-sized and mid-tier audit firms	• Establishing a training section within the human resources department to design and operate training programs for each job classification and level of experience • Audit firms implement a series of training programs to perform audit work such as updates of accounting and auditing standards, utilization of monitoring tools including data analysis tool, responses to fraud risks, key points and particular issues related to industrial sector and IPO audits, results of periodic internal inspections, CPAAOB's inspections and JICPA's Quality Control Reviews, professional ethics and independence, information security. • Conducting examinations to measure understanding of training • Audit firms provide support for acquiring language-related qualifications and implement language training programs at home and abroad (including online training) • In addition to the above, periodic training on issues specific to financial institutions is provided to personnel working on the audits of listed financial institutions. Briefings on the latest industry trends are also organized
Small and medium-sized audit firms, partnerships and solo practitioners	• Providing opportunities to attend training sessions held at the JICPA headquarters or regional chapters, or to study by watching JICPA training e-learning in most audit firms • Sharing results of periodic internal inspections, CPAAOB inspections and JICPA Quality Control Reviews within firms. Specifically, many firms share the details of improvement measures based on the results of periodic internal inspections, etc. during firm-wide training sessions.

(Source) Prepared by the CPAAOB based on information obtained through the CPAAOB inspections or the collection of reports

Large-sized and mid-tier audit firms have education and training sections, and mainly large-sized audit firms have developed training programs based on job classification and experience in conjunction with their global audit networks. Furthermore, by deploying e-learning systems, they enable individuals to access education and training at times and locations that are convenient for them. On the other hand, training programs for specialized personnel with limited experience in audit practices such as onboarding sessions for new employees tend to be conducted primarily in person.

Even among small and medium-sized audit firms, partnerships and solo practitioners, some of the comparatively larger ones have introduced level-based training systems and e-learning systems, while others are providing opportunities for education and training by covering the cost of tuition fees for external training programs. On the other hand, many small and medium-sized audit firms, partnerships and solo practitioners have difficulties in providing training programs that are suitable to auditors' experience and capability and situation in their audited companies. Thus, many firms are only confirming that their partners and staff are undergoing the Continuing Professional Development system provided by JICPA (i.e. whether they have obtained the required number of credits).

(Education and training needed for IFRS adoption)

As the number of companies adopting and having decided to adopt IFRS in Japan has now exceeded 290, large-sized audit firms in particular are working to develop partners and staff involved in audits of companies adopting IFRS. For that reason, the CPAAOB monitors the training structures relating to IFRS, with key examples shown below (Figure III-4-3). In some small and medium-sized audit firms,

partnerships and solo practitioners, all partners and staff are required to take training provided by the JICPA on IFRS. However, in many cases, those involved in audits of companies applying IFRS are expected to rely on self-study.

Figure III-4-3: Examples of education/training related to IFRS

Large-sized and mid-tier audit firms	• Introducing in-house IFRS certification, and providing periodic training on updates of the standards for certified personnel • Setting up specialized sections for interpretation and specific application of IFRS, and distributing necessary guidelines within the firm, in addition to providing advice and consultations on specific issues to audit teams • Dispatching personnel to network organizations responsible for examining the interpretation and application policies of IFRS, or holding periodic exchange of opinions with such organizations.
--------------------------------------	--

(Source) Prepared by the CPAAOB based on information obtained through the CPAAOB inspections or the collection of reports

3. Evaluation of Engagement Team Members

The appropriate performance evaluation of engagement team members demonstrates that the audit firm is committed to audit quality, and ongoing effort is particularly important for fostering the organizational culture that forms the foundation of audit quality. Audit firms must establish quality objectives that ensure professionals demonstrate a commitment to quality through their conduct and attitude, develop and maintain the appropriate competencies to fulfill their roles, and are held accountable and evaluated through timely assessments, compensation, promotions, and other incentives. (QCSCS para 32 (2)).

a. Evaluation of partners

Large-sized and mid-tier audit firms evaluate partners based on their contribution to audit quality and the management of the firms and the exploitation of new business. In particular, they have adopted evaluation methods placing emphasis on audit quality. For example, large-sized audit firms make assessments as mentioned in Figure III-4-4.

Figure III-4-4: Examples of evaluations of partners at large-sized audit firms

• Partners are usually evaluated in various areas, including team management and a business development based on "Performance Evaluation Rules." In the case of partners who provide audit services, there is an emphasis on quality control. • Partners are evaluated with an emphasis on audit quality, including global capabilities • Skills and performance evaluations are conducted and quality control as well as ethics/compliance are given considerable weight in skills evaluations. • Assessments made during periodic inspections in relation to firm's system of quality control (for details, see "C. Monitoring of System of Quality Management, 1. Periodic Inspections") as well as the results of Quality Control Reviews etc. are reflected in the performance evaluations of engagement partners.
--

(Source) Prepared by the CPAAOB based on information obtained through the CPAAOB inspections or the collection of reports

The results of performance evaluation are provided to partners, and the partners are usually expected to take the action deemed necessary, such as setting goals for addressing areas

required improvement. Some audit firms adjust partner compensation and assignment of audited companies based on evaluation results. The firms occasionally restrict partners' involvement in audit engagements when evaluation results are extremely poor.

Some small and medium-sized audit firms, partnerships and solo practitioners, however, do not conduct periodic evaluations of partners, and even when they do, they have not often articulated policies and procedures for the evaluations. When conducting audits of listed companies, the Governance Code for audit firms stipulates that firms should establish and implement policies related to personnel management, evaluation, and compensation (Principle 4, Guideline 4-2), and further development of such frameworks is expected going forward.

b. Evaluation of staff

Audit firms evaluate personnel in accordance with their evaluation standards and determine promotions based on the results of the evaluations.

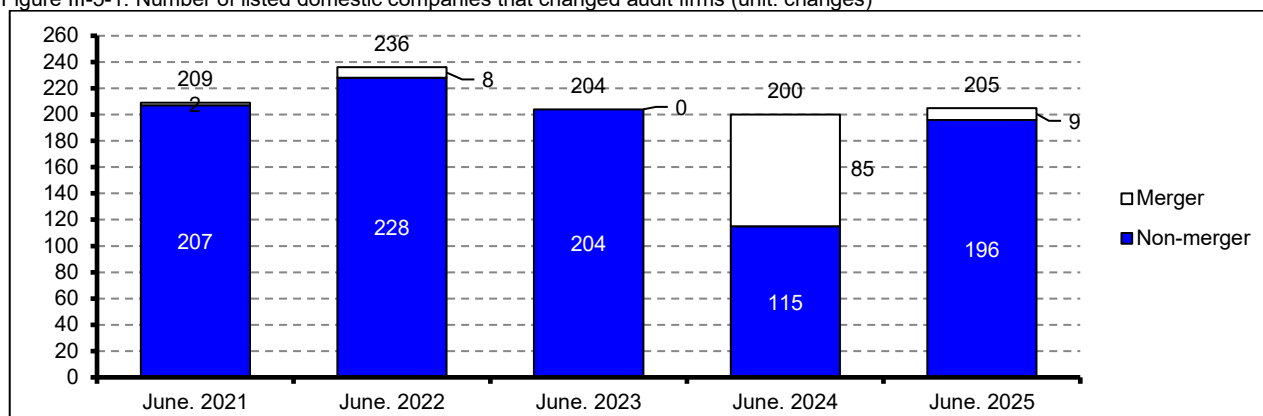
Large-sized and mid-tier audit firms establish rough standard of promotion by employees' seniorities. They generally promote managers after approximately a seven to 10 year and to partners, following a selection process. As small and medium-sized audit firms rarely hire newly qualified CPAs, they often hire mid-career CPAs on the assumption that they are going to be promoted to partners. Many large-sized and mid-tier audit firms evaluate personnel based on their understanding of auditing standards related to audit quality, communications skills within an engagement team, management skills (including capacities for an international issue) and so forth. Although small and medium-sized audit firms evaluate personnel in a similar manner to large-sized and mid-tier audit firms, some of them have not established policies regarding promotion and selection system based on evaluation results. When conducting audits of listed companies, the Governance Code for audit firms stipulates that firms should establish and implement policies related to personnel management, evaluation, and compensation (Principle 4, Guideline 4-2), and further development of such frameworks is expected to go forward.

E. Acceptance of New Audit Engagements and Changes of Accounting Auditors

Since the acceptance of new audit engagements can have a significant impact not only on the quality standards of individual audit engagements but also on overall operations of the audit firm, the CPAAOB conducts review through monitoring activities and also seek to understand the reasons for changes in accounting auditors and the impact of the acceptance of the new audit engagements on the firm's overall quality control. The section below analyzes the acceptance of new audit engagements and changes in accounting auditors, and the connection between details ascertained through monitoring activities and publicly available information.

There were 205 cases of changing auditors of domestic listed companies in the year to June 2025. The total number of changes has remained at roughly the same level over the past three years. Compared to the fiscal year ending in June 2024, when many changes were due to mergers, the number of changes for reasons other than mergers²⁴ has increased significantly (Figure III-5-1). For information on mergers, see "[I. Overview of the Audit Sector, B. Audit Firms, 4. Mergers of Audit Firms](#)".

Figure III-5-1: Number of listed domestic companies that changed audit firms (unit: changes)



(Note) The number of companies that had decided on an incoming auditor by the end of June of each period based on timely disclosure of listed domestic companies.

(Source) Prepared by the CPAAOB

As can be seen from changing in audit firms by size for reasons other than mergers, there had been a declining trend in changes from large-sized audit firms to mid-tier audit firms or small and medium-sized audit firms since peaking in the year to June 2022. However, in the year to June 2025, this trend reversed, showing an increase (Figures III-5-2 and III-5-3). This trend is considered to reflect the fact that large-sized audit firms continue to place importance on operational management when continuing audit contracts, taking into account audit fees, audit risk, and the personnel required to perform the audit engagement. At the same time, audited companies selecting auditors are placing greater emphasis on selecting auditors by considering factors such as the duration of continuous audit periods and the reasonableness of audit fees.

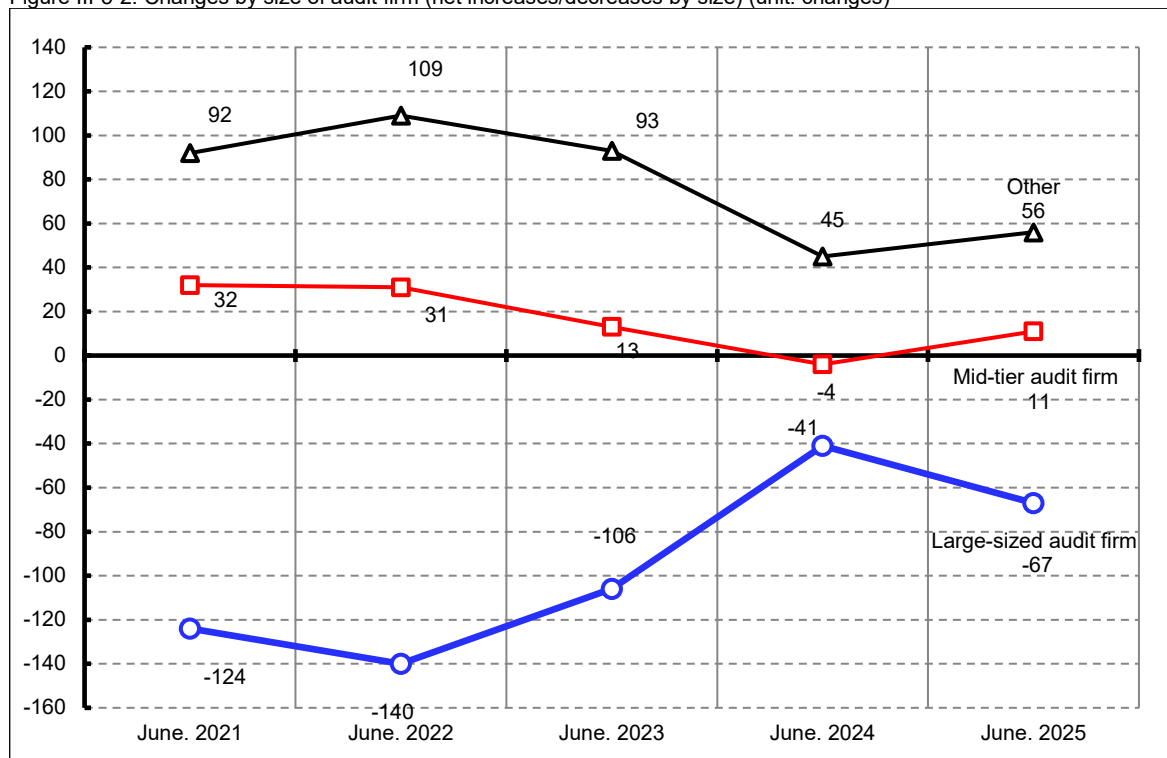
For information about business operations concerning continuance of audit contracts at large-sized audit

²⁴ In the fiscal year ending June 2025, there were no mergers between audit firms. However, changes involving the transfer due to the integration of regional offices of an audit firm, as well as transfers to newly established audit firms founded by CPAs currently performing audits, are categorized as "mergers."

firms, see "[3. Reasons for Changes in Accounting Auditors as Identified Through Monitoring Activities](#)".

In addition, while there has been an increase in changes from one small and medium-sized audit firm to another, large-sized audit firms and mid-tier audit firms have continued to take a cautious stance toward entering into new audit engagements with listed domestic companies that were previously audited by small and medium-sized audit firms, particularly from the perspective of audit fees and related considerations. Likewise, these listed domestic companies are increasingly selecting other small and medium-sized audit firms, as a result of considering factors such as audit fees and the appropriateness of audit services in relation to their business scale. The above-mentioned shift from large-sized audit firms to mid-tier as well as small and medium-sized audit firms indicates an increase in the role of small and medium-sized audit firms in auditing listed companies. However, the CPAAOB's recent inspection of small and medium-sized audit firms identified inadequate systems to properly conduct audit services, making it imperative for them to maintain and improve their audit quality. As a result, the CPAAOB will place greater emphasis on inspections of small and medium-sized audit firms.

Figure III-5-2: Changes by size of audit firm (net increases/decreases by size) (unit: changes)



(Note1) Net increases/decreases in the number of changes

(Note2) Aggregates of number of companies that had decided on an incoming auditor by the end of June of each period, based on timely disclosures by listed domestic companies

(Note3) Figures in the above table do not include changes due to mergers of audit firms.

(Source) Prepared by the CPAAOB

Figure III-5-3: Total changes by size (unit: changes)

From/To		June 2023	June 2024	Increase/Decrease
Large-sized	→ Large-sized	12	14	2
	→ Mid-tier	10	25	15
	→ Other	40	49	9
Mid-tier	→ Large-sized	5	3	▲2
	→ Mid-tier	0	2	2
	→ Other	11	14	3
Other	→ Large-sized	4	4	0
	→ Mid-tier	2	3	1
	→ Other	31	82	51
Total		115	196	81

(Note1) Aggregates of number of companies that had decided on an successor auditor by the end of June of each period, based on timely disclosures by listed domestic companies

(Note2) "Other" in the figure refers to small and medium-sized audit firms, partnerships and solo practitioners.

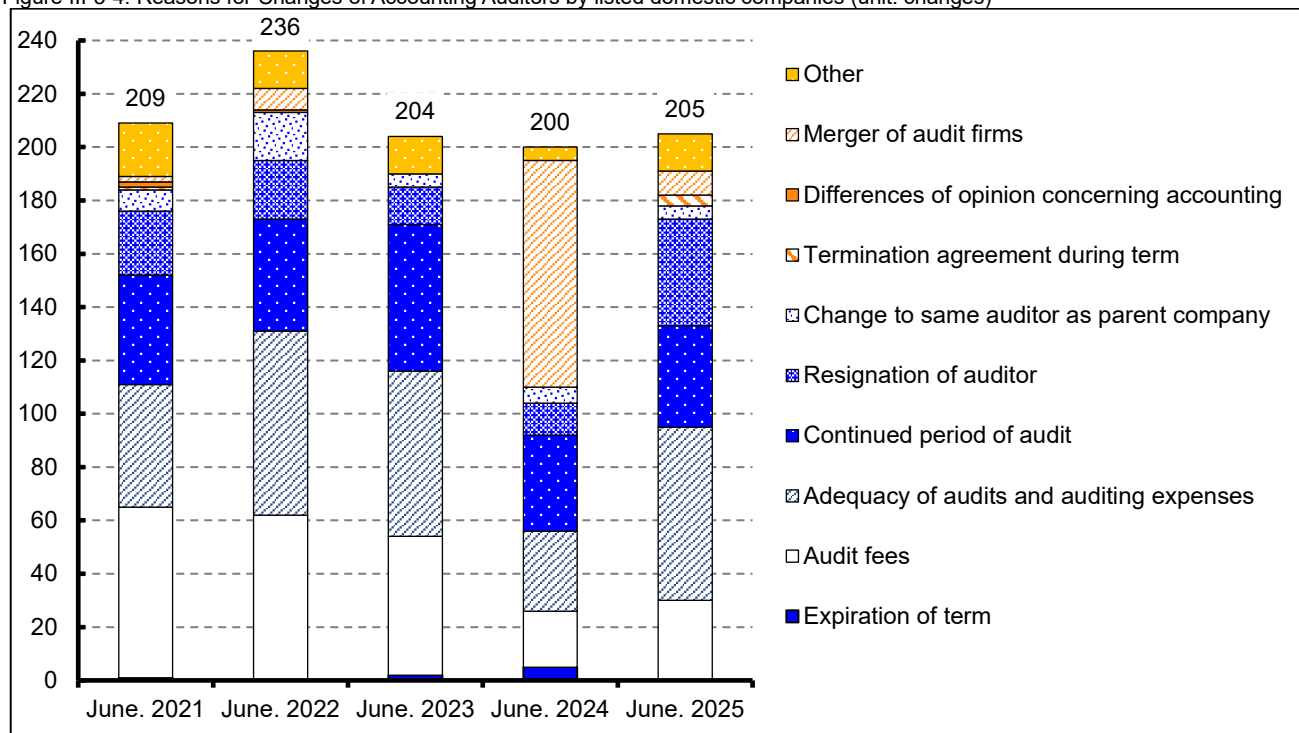
(Note3) Figures in the above table do not include changes due to mergers of audit firms.

(Source) Prepared by the CPAAOB

1. Reasons for Change of Accounting Auditors Given in Timely Disclosures by Audited Companies

When a listed domestic company changes its accounting auditors, the company shall disclose the change immediately (Article 402 of the Securities Listing Regulations, Tokyo Stock Exchange). In this case, the substantial reason for the change and the background thereof must be specifically disclosed. Under this regulation, many firms stated the proposal of increase in audit fees as well as the adequacy of audit work in light of the size of the company's business and the reasonableness of audit fees as reasons for changes. In addition, in many cases, the reason for changes in accounting auditors is stated as a result of comparison with other audit firms in consideration of the prolonged continuous audit period of the current auditor. (Figure III-5-4). In the year to June 2025, many cases continued to state that the change of accounting auditors was due to these reasons. In addition, the number of cases in which the current accounting auditor declined to renew the audit engagement has also increased. Among these, there are cases where the reason cited is the anticipated increase in audit workload without sufficient personnel to handle it, or the fact that registration as an auditor of listed companies was not granted.

Figure III-5-4: Reasons for Changes of Accounting Auditors by listed domestic companies (unit: changes)



(Note1) Compiled based on timely disclosures by listed domestic companies choosing new auditors by the end of June each year.

(Note2) In the case of two or more reasons disclosed, the classification was made based on principal reasons.

(Source) Prepared by the CPAAOB

2. Reasons for Change of Accounting Auditors during Fiscal Term

In the year to June 2025, there were four cases of changes of accounting auditors in the middle of the fiscal year out of a total of 205. The changes were primarily due to terminations or resignations initiated by the audit firms, following the discovery of inappropriate accounting practices at the audited companies.

3. Reasons for Changes of Accounting Auditors as Identified Through Monitoring Activities

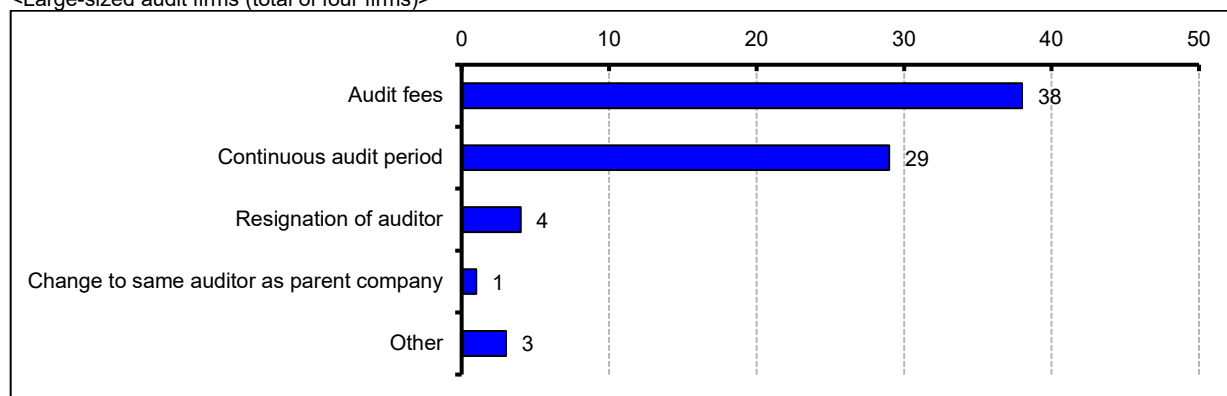
This section lays out reasons for changing accounting auditors ascertained through monitoring activities in PY2024 rather than through timely disclosure by audited companies. The number of changes obtained through the CPAAOB monitoring does not match the number obtained through company disclosure for the following reasons: inspections were not conducted, and reports were not collected from all audit firms in PY2024 and the number includes the previous year's figures due to the timing of inspections and collection of reports.

a. Large-sized audit firms

Among the 57 cases of changes in accounting auditors reported by large-sized audit firms as predecessor accounting auditors through inspections and information collection, the most frequently cited reason, similar to the previous year, was "audit fees", followed by "continuous audit period" (Figure III-5-5). Many cases cited both "audit fees" and "continuous audit period" as the reason for the changes. This suggests that audited companies are considering factors

such as continuous audit period and audit fees when deciding to change their accounting auditor. At the same time, when considering whether to renew audit contracts, large-sized audit firms continue to manage their audit engagements by analyzing each audit engagement individually or across the firm as a whole, taking into account whether audit fees are commensurate with audit risk, whether the audit risk is within a manageable range for continuing the engagement, and whether sufficient personnel can be secured to carry out the audit.

Figure III-5-5: Reasons for changes in accounting auditors according to the predecessor auditors (unit: changes)
<Large-sized audit firms (total of four firms)>



(Note1) Based on data from 57 changes identified through inspections and report collection during PY2024.

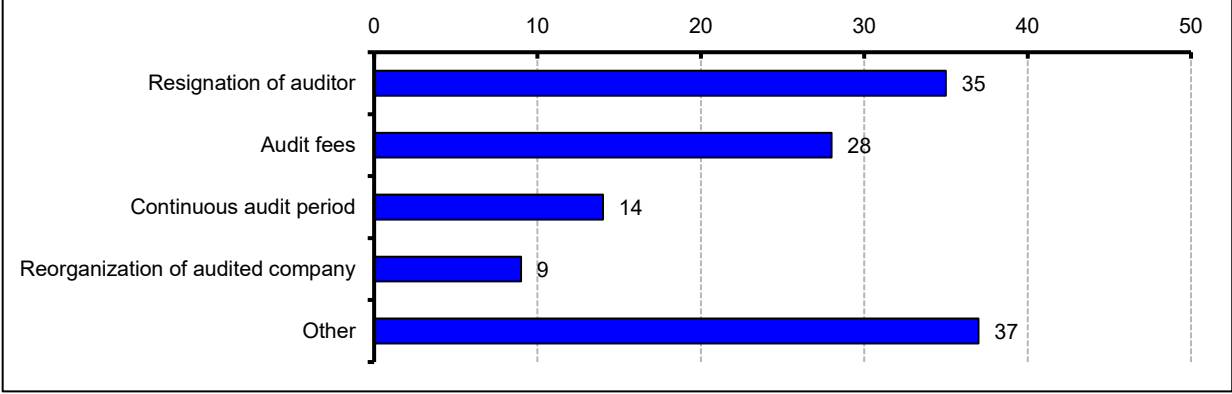
(Note2) If there was more than one reason, that change is included in the figure for each reason (a cumulative total of 75)

(Source) Prepared by the CPAAOB

- b. Mid-tier audit firms and small and medium-sized audit firms, partnerships and solo practitioners
Among the 83 cases of changes in accounting auditors reported by mid-tier audit firms and small and medium-sized audit firms as predecessor accounting auditors through inspections and information collection, the most frequently cited reason was “resignation proposed by auditors”. The underlying reasons for these resignations often included increased audit risk due to deteriorating business performance or weakness in the audited company’s accounting systems, as well as personnel shortages within the audit firm.

Following this, many cases cited both “audit fees” and “continuous audit period” as the reason for the changes. In addition, under “other” reasons, there were cases the included the unification of accounting auditors with parent companies, the discovery of inappropriate accounting practices at the audited company, and administrative disciplinary actions taken by the Financial Services Agency against the audit firm (Figure III-5-6).

Figure III-5-6: Reasons for changes in accounting auditors according to the predecessor auditor (unit: changes)
<Audit firms other than large-sized audit firms>



(Note1) Based on data from 83 changes for which the reason was identified through the inspection by the CPAAOB in PY2024 and reports collected from four mid-tier audit firms, 55 small and medium-sized audit firms.

(Note2) If there was more than one reason, that change is included in the figure for each reason (a cumulative total of 123)

(Source) Prepared by the CPAAOB

F. Audit Fees

1. Rules on Audit Fees

Audit fees are determined through negotiations between auditors and audited companies. The JICPA has set guidelines for the calculation of audit fees to serve as a reference.

On the other hand, the JICPA's Code of Ethics, most recently amended in June 2024, states that an audit firm may quote whatever fee deemed appropriate based on the content and value of services, while the quotation of a low fee without due foundation may make it difficult to offer professional services according to applicable technical and professional standards. Therefore, the quotation of a low fee causes auditor's self-interest that disturbs auditor from observing the principles concerning proper capacity and attention required to professional specialists.

2. Methods for Calculating Audit Fees

The JICPA's "Guidelines for the Calculation of Audit Fees" give "hourly rates" and "fixed fees and hourly rates" as possible approaches. These methods are used when calculating estimated amount. The actual audit fee is determined through negotiations with audited companies (Figure III-6-1).

Figure III-6-1: Methods for calculating estimated audit fees

Methods	Methods for calculating estimated audit fees
Hourly rates	Audit fees are calculated by multiplying the number of hours an audit team spend by a certain unit price (hereinafter referred to as the "charged rate").
Fixed fees and hourly rates	Audit fees comprise two components: the fixed fee (a fixed amount) and the hourly rates (a variable amount). The fixed fee is determined based on the factors such as the type of audit (FIEA audits, Companies Act audits, etc.) and the size of audited companies (capital, assets, sales, etc.), while the hourly rates are calculated by multiplying the time planned to spend on the audit by the charged rate.

(Source) Prepared by the CPAAOB based on "Guidelines for the Calculation of Audit Fees" (October 2003), JICPA

According to the reports collected in PY2024, audit fee estimates are calculated as follows.

a. Large-sized audit firm

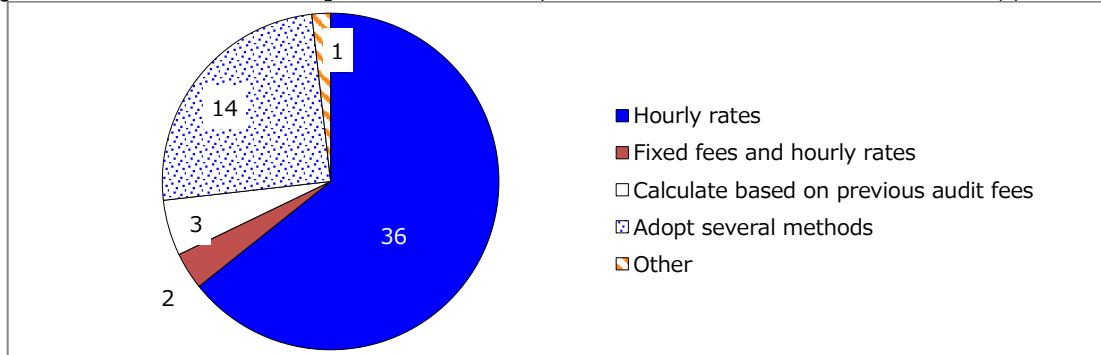
All large-sized audit firms state that they adopt the hourly rates approach for audit fee estimates. Hourly rates are set for each hierarchy level of employee, and the rate is determined while considering indirect costs associated with firm management and quality control such as the payrolls of administrative departments and IT system-related expenses.

Some large-sized audit firms set elaborate charge rates, taking into account not only job classification but also the complexity of the audit engagement and each service provided.

b. Mid-tier audit firms and small and medium-sized audit firms, partnerships and solo practitioners

Many firms charge fees based on the hourly rates approach. There are also firms that combine basic and service execution fees, calculate fees on the basis of fees in the past, or use multiple calculation methods (Figure III-6-2).

Figure III-6-2: Methods for calculating estimated audit fees (mid-tier and small and medium-sized audit firms) (unit: audit firms)



(Note) Aggregated from reports collected from mid-tier and small and medium sized audit firms in PY2024

(Source) Prepared by the CPAAOB

Regarding the hourly rates approach, 60% of mid-tier audit firms and small and medium-sized audit firms, partnerships and solo practitioners do not set charged rates by job classification (Figure III-6-3).

Figure III-6-3: Setting of rates corresponding to job classification (mid-tier and small and medium-sized audit firms)

Settings	Number of audit firms	Percentage
Rates set	23	41%
Rates not set	33	59%
Total	56	100%

(Note) Aggregated from reports collected from mid-tier and small and medium sized audit firms in PY2024

(Source) Prepared by the CPAAOB

3. Audit Fees Before and After Changes in Accounting Auditors

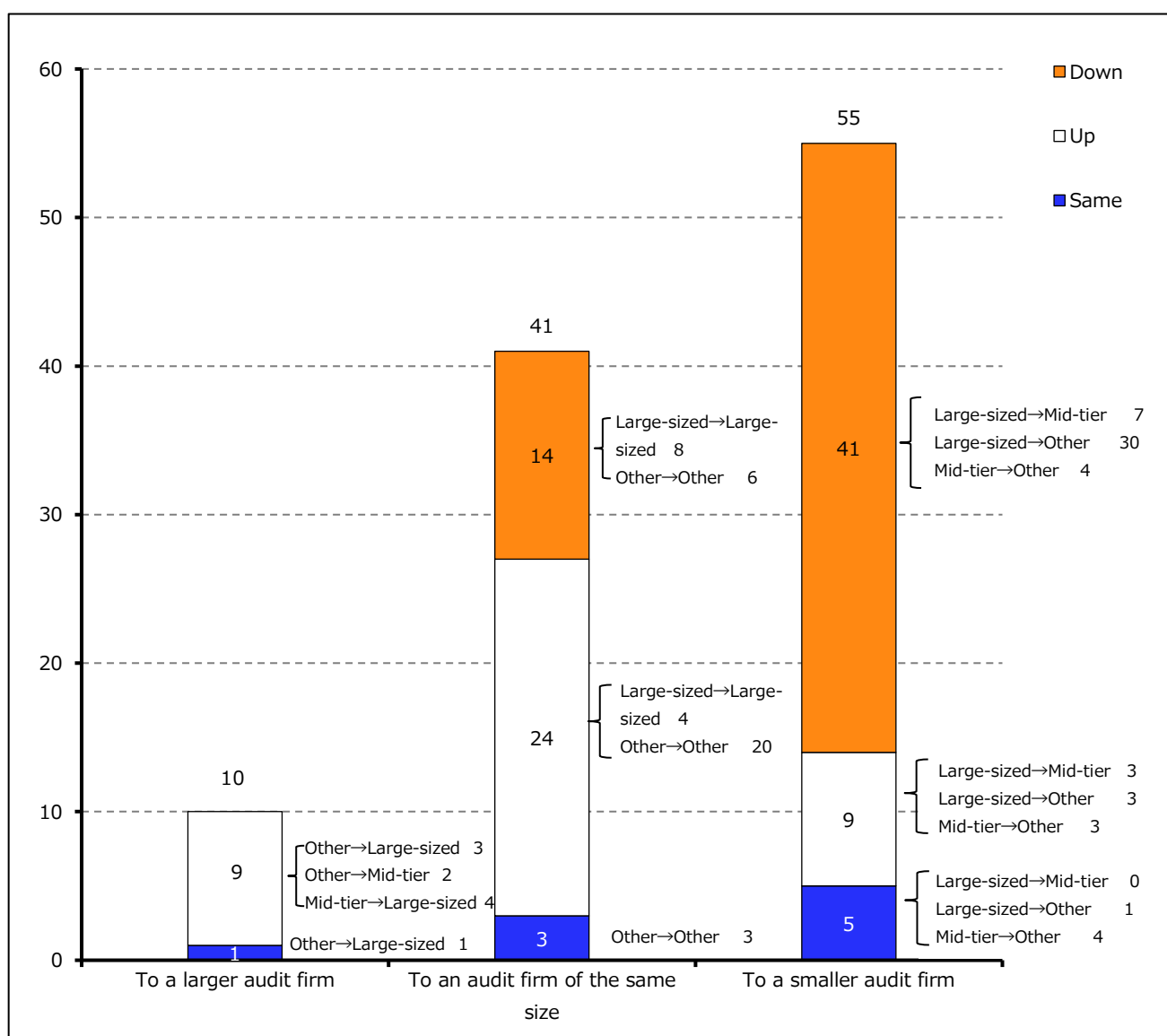
As audit fees are often reviewed after changing auditors, the CPAAOB analyzed pre- and post-transfer fees for 106 cases of changes in auditors at listed domestic companies that submitted timely disclosure from July 2023 to June 2024, excluding those involving mergers of audit firms. The analysis found that the changes in audit fees varied depending on the scale of the successor accounting auditor.

In cases where companies changed from larger audit firms (10 cases), there were no instances of audit fee reductions. Meanwhile, in changes to audit firms of the same scale (41 cases), audit fees increased in approximately 60% of cases (24 cases), while they decreased in about 30% of cases (14 cases). Furthermore, in changes to smaller firms (55 cases), audit fees decreased in around 70% of cases (41 cases). Specifically, among these, in cases where companies changed from a large-sized audit firms to small or medium-sized firms (34 cases), audit fees decreased in approximately 90% of cases (30 cases) (Figure III-6-4).

As noted earlier in [1. Reasons for Change of Accounting Auditors Given in Timely Disclosures by Audited Companies](#), many listed domestic companies cited the appropriateness of audit services and audit fees in relation to their business scale as reasons for changing auditors. Based on the results of the above analysis, it appears that some listed domestic companies determined that the audit fees charged by their incumbent auditors were excessive relative to their business scale, and therefore

primarily small and medium-sized audit firms selected as successor auditors with the aim of reducing audit fees.

Figure III-6-4: Audit fees following Changes of Accounting Auditors (unit: changes)



(Note1) Tabulated timely disclosures of changes in accounting auditors by listed domestic companies (from July 2023 to June 2024) are included, provided that the audit fees before and after the changes were publicly disclosed

(Note2) Breakdowns of these changes are shown in the graph

(Note3) "Other" in the figure refers to small and medium-sized audit firms, partnerships and solo practitioners.

(Source) Prepared by the CPAAOB based on timely disclosures of changes in accounting auditors and securities reports submitted by June 2025

4. Dependence of Fees (Safeguards)

When the proportion of audit fees received from a specific audited company becomes high relative to the total revenue²⁵ of the audit firm²⁶, the resulting fee dependency and concerns over losing that source of income may increase the level of self-interest threats and create undue pressure on the audit

²⁵ Total of audit and attestation revenue and non-audit and attestation revenue (various advisory services, tax processing and so forth)

²⁶ Audit firms and business enterprises that control business enterprises and audit firms through their contracts, human relations and so forth.

firm, potentially impairing its independence.

The “Guidelines on Independence” was abolished as of March 31, 2023, following the revision of the Code of Ethics by the JICPA and the publication of “Practical Guidance on Code of Ethics No.1, Q&A on the Code of Ethics” (Practical Guidance). The “Guidelines on Independence” had previously stipulated that where the audit fees from a particular listed domestic company exceeded 15% of the audit firm’s revenues for two consecutive years, the audit firm must examine which of the safeguards below would be appropriate:

- a. Prior to the issuance of the audit opinion on or after the second year’s financial statements, the audit firm requests a professional accountant, who is not a member of the audit firm, to perform an engagement quality review of that engagement
- b. After the audit opinion on or after the second year’s financial statements has been issued and before the issuance of the audit opinion on the third year’s financial statements, the audit firm requests a professional accountant, who is not a member of the firm to perform a periodic inspection of that engagement, or the JICPA to perform a Quality Control Review of that engagement

Rules on remuneration dependency are newly established in the revised Code of Ethics. Under these rules, if the reliance on remuneration for a particular audited company exceeds or is likely to exceed 15% for two consecutive years, the audit firm is required to implement a safeguard by undergoing a review equivalent to an engagement quality review conducted by a member who is not part of the audit firm, prior to expressing its audit opinion (“pre-issuance review”) .

The revised Code of Ethics applies to audit engagements for fiscal years beginning on or after April 1, 2023. However, in the initial year of application, audit firms are expected to apply the safeguards prescribed under the former “Guidelines on Independence.”

With regard to the status of implementing safeguards related to fee dependency, no applicable cases were identified among large-sized audit firms or mid-tier audit firms. However, among small and medium-sized audit firms, safeguards were implemented in 8 engagements across 8 firms, out of 57 firms identified through inspections and the collection of reports conducted in PY2024.

Among the eight engagements, six that applied safeguards based on the former “Guidelines on Independence” were addressed through periodic inspections after the audit opinions were expressed. For the remaining two engagements, which applied safeguards under the revised Code of Ethics, the audit firms are required to undergo a pre-issuance review prior to expressing their audit opinions.

■ Enhancing audit quality and improving profitability and operational efficiency ■

Audit firms have been implementing various initiatives (“quality control measures”) to address deficiencies identified through external inspections and to maintain and improve audit quality. However, the depth of inspections conducted by the CPAAOB and the Quality Control Reviews by the JICPA has been increasing year by year. Although the nature of the deficiencies identified has evolved, the number of findings has not significantly declined. Moreover, securing the necessary resources—both personnel and time—for audit teams responsible for actual audit execution and for quality control divisions that plan and implement quality control measures remains a challenge. In particular, for large-sized audit firms, due to the scale of their organizations, it is not easy to ensure that quality control measures are thoroughly implemented across all departments and locations.

In recent years, especially among large-sized audit firms, efforts have been made to standardize and centralize audit procedures by assigning less complex tasks to audit assistants or processing them collectively at delivery centers. These efforts aim to allocate more time from CPAs and other professionals to higher-risk audit areas. Additionally, the development and application of audit tools utilizing technologies such as AI have been advancing, contributing to both the efficiency and sophistication of audit work. Furthermore, in order to ensure sufficient and appropriate audit quality, firms are making more precise estimates of the time required for audit engagements and are requesting revisions to audit fees from audited companies, thereby reviewing the level of audit compensation.

According to business reports submitted to the Local Finance Bureaus, personnel expenses and IT-related costs continue to rise across audit firms, while the total amount of audit fees has not increased proportionately. Analysis of timely disclosure information related to changes in auditors at listed domestic companies also reveals that many companies cite proposed increases in audit fees or the appropriateness of audit services and fees in relation to their business scale as reasons for the change.

Although the number of registered CPAs has been gradually increasing in recent years, the number of those affiliated with audit firms has not grown at the same pace. This is partly due to the growing number of attractive career opportunities in other fields, such as consulting firms or as CFOs of operating companies, where compensation levels may be higher. As a result, concerns have emerged regarding a shortage of professionals engaged in audit work.

In this context, while audit firms are actively investing in human resources and IT to secure the necessary resources for ensuring the effectiveness of quality control measures, revisions to audit fees have not always reached a level sufficient to ensure sustainable profitability. In some cases, this has led to the risk of audit contracts being terminated. Faced with the challenge of fulfilling their mission to contribute to the market through the delivery of high-quality audits, the management of audit firms must navigate the difficult balance between improving audit quality and maintaining profitability.

Ensuring the reliability of capital markets requires strengthening market governance²⁷, and further enhancement of the audit function is essential. However, the importance of audits in capital markets and the public-interest role of audit firms are sometimes overlooked. Therefore, in addition to discussions on improving audit quality, it is expected that active dialogue will take place from the broader perspective of the capital market, including audited companies and market participants, regarding the importance of financial audits, the fair evaluation of audit work, and the future role that audit firms should play.

Although the term “market governance” is used in various contexts, in this report it refers broadly to not only market discipline exercised by market participants, but also to the functions of audit firms and others that help ensure an environment in which such discipline can operate autonomously.

²⁷ Although the term “market governance” is used in various contexts, in this case, it broadly refers not only to market discipline exercised by market participants, but also to the functions of audit firms and other entities that ensure an environment in which such discipline can operate autonomously.