

IV. Responses to Changes in the Global Environment Surrounding Audits

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A. Trends Surrounding Small and Medium-Sized Audit Firms

1. Changes in the Environment Surrounding Audits by Small and Medium-Sized Audit Firms

In recent years, there has been a continuing trend among listed domestic companies to change accounting auditors from large-sized audit firms to mid-tier/small and medium-sized audit firms. Particularly, the number of cases in which small and medium-sized audit firms serve as accounting auditors for newly listed domestic companies has been increasing, indicating a growing role expected of them in the capital markets.

Against this backdrop, the Quality Control Standards were revised in November 2021 to require the introduction of a risk-based system of quality management in response to the need to maintain and improve audit quality. For audit firms other than large-sized audit firms, this revision applies to audits of fiscal years beginning on or after July 2024. Additionally, in July 2022, the JICPA's Code of Ethics was amended to strengthen regulations related to independence. Further revisions were made in July 2024, targeting definitions of engagement teams and provisions related to group audit engagements.

These changes have had a significant impact on the operations of small and medium-sized audit firms. In addition to establishing systems to provide audit services to listed domestic companies, these firms are now required to implement and operate new system of quality management, and respond to strengthened independence regulations concerning audit fees, non-audit fees, fee dependency, and the concurrent provision of non-assurance services.

Furthermore, in light of changes in the economic and social environment surrounding accounting audits, including the expansion of the base of auditors for listed domestic companies, the CPA Act was revised in May 2022. This led to introduce a legal registration system for auditors of listed companies in place of the self-regulatory registration system for auditors of listed companies, which had been conducted by the JICPA. The registration of audit firms, etc. that conduct audits of listed domestic companies has been conducted by the Quality Control Committee of the JICPA, which has been responsible for the review system. Since April 1, 2023, it has been conducted by the "Registration Review Committee for Auditors of Listed Companies", which was newly established within the JICPA. The Committee consists of seven members, three of whom are members of the JICPA and four of whom are non-members. This has added further transparency and objectivity to the screening of registrations and decisions on cancellation of registrations. The revised Ordinance for Enforcement of the CPA Act ("Revised Ordinance for Enforcement") requires registered auditors of listed companies to establish a framework for information disclosure and business operations in accordance with the Audit Firm Governance Code amended in March 2023, to be applied from the beginning of the first accounting period of audited companies that starts on or after July 1, 2024 (July 1, 2023 for large-sized audit firms).

2. Response by the JICPA to Small and Medium-Sized Audit Firms

a. Operational status of the registration system for auditors of listed companies

The registration system for auditors of listed companies is designed to contribute to the reliability of financial audits by:

- (i) registering audit firms that conduct audits of listed companies in a legally mandated list of auditors of listed companies (“list of auditors of listed companies”),
- (ii) requiring a high level of discipline from registered auditors of listed companies (“registered auditors of listed companies”),
- (iii) having the JICPA conduct confirmation of eligibility to verify whether these registered auditors are fulfilling their responsibilities (“confirmation of eligibility”), and
- (iv) making decisions on cancellation of registrations when necessary.

The JICPA receives applications from entities who intend to be registered to the list of auditors of listed companies and conducts a review for application review to assess the status of their system of quality management. It also performs confirmation of eligibility to determine whether the applicant firms or registered auditors of listed companies have the necessary systems in place to fairly and appropriately conduct audit attestation services for the financial statements of listed companies. Based on the results of these confirmations of eligibility, the Registration Review Committee for Auditors of Listed Companies makes decisions whether to approve or cancel registration.

For confirmation of eligibility, the JICPA utilizes the Quality Control Review system, including the review for application review, and published the Guideline for confirmation of eligibility of audit firms engaged in the audit of listed companies (“Guideline”), which outline viewpoints and standards for review teams to consider when assessing eligibility. This Guideline also requires listed company auditors to perform self-assessments to determine whether they meet the conditions described in the Guideline, and if any deficiencies are identified, they must take voluntary improvement measures. This Guideline was revised in August 2024 to reflect the application status of the Revised Standards and discussions within the Registration Review Committee for Auditors of Listed Companies, including reorganization of items and addition of new viewpoints and criteria.

Audit firms that were conducting audits of listed companies at the time the revised law came into effect were designated as “Deemed Registered Auditors of Listed Companies” and allowed to continue audit attestation services until September 30, 2024, under transitional measures. From October 1, 2024, such firms are categorized as either “firms to be examined by the Registration Review Committee for Auditors of Listed Companies” or “firms whose registration has been denied but continue to audit listed companies.” For these deemed registered auditors of listed companies seeking formal registration, confirmation of eligibility is generally conducted based on written documentation (questionnaires), rather than through a review for application review.

The Registration Review Committee for Auditors of Listed Companies held a total of 33 meetings

between April 2023 and June 2025. During this period, 126 audit firms (including six firms other than deemed registered auditors of listed companies that newly applied for registration) were added to the list of auditors of listed companies. As of the end of June 2025, eight audit firms remained as deemed registered auditors of listed companies.

b. Enhancement of information disclosure by small and medium-sized audit firms

Under the Revised Ordinance for Enforcement, registered auditors of listed companies are required to establish a system for: (i) appropriately evaluating the status of operations management system and publishing the results of the evaluation and the reasons for the evaluation, etc. (Article 93); (ii) publishing the status of business management, etc. (Article 95); and (iii) conducting business in accordance with the Audit Firm Governance Code and publishing the status of application of the Code (Article 96).

The publication under Article 93 of the Revised Ordinance for Enforcement is made by making explanatory documents containing matters set forth in the Revised Ordinance of Enforcement available for public inspection. However, the publication under Article 95 and 96 of the Revised Ordinance for Enforcement does not specifically designate the subject and media in which the information should be described. This is because it is not appropriate to require registered listed company auditors to disclose a uniform set of items, and they are expected to proactively determine the disclosure items they consider important and to carry out substantial information disclosure through originality and ingenuity.

The JICPA has been requiring small and medium-sized audit firms conducting audits of listed companies to prepare and publish the "Annual Report on Audit Quality Management" ("annual report"), in response to Articles 95 and 96 of the Revised Ordinance of Enforcement. As a reference for preparing the annual report, the JICPA published "Guidance for the Preparation of Annual Reports on the Management of Audit Quality" in September 2023. This guidance encourages autonomous and proactive efforts by small and medium-sized audit firms to maintain and improve audit quality and provides a conceptual framework to help ensure the contents of the report are substantial and meaningful.

Furthermore, the JICPA requires small and medium-sized audit firms conducting audits of listed companies to conduct a dry run (simulation) of the annual report prior to the effective date of Articles 95 and 96 of the Revised Ordinance for Enforcement. As part of this dry run, firms are requested to submit a dry-run version of the annual report as a deliverable.

The effective date for the application of Articles 95 and 96 of the Revised Ordinance for Enforcement is defined as the start of the first accounting period of the audited entity beginning on or after July 1, 2024. For small and medium-sized audit firms, the reporting period is set as the first fiscal year ending after this effective date. The annual report must be published within six months from the end of this reporting period. (For example, if an audit firm whose fiscal year ends in June and the first audited company whose accounting period begins on or after July 1, 2024 has a fiscal year that ends in March,

the beginning of the audited company's accounting period is April 1, 2025, and the audit firm is required to report on the fiscal year ending June 30, 2025 and to publish its annual report by the end of December 2025. The audit firms are required to publish their annual reports by the end of December 2025 for the reporting period ending in June.)

The JICPA has shared key observations from the submitted dry-run versions of the Annual Report with its members. In April 2025, it held a training session on information disclosure through the Annual Report, during which it reported on various topics, including:

- questions and answers received through the consultations for information disclosure,
- analysis of key observations, and
- analysis of Audit Quality Indicators (AQIs) included in the formal versions of the Annual Report.

c. Support for strengthening the fundamentals of small and medium-sized audit firms

The JICPA accelerates efforts to strengthen the foundation of small and medium-sized audit firms and improve audit quality through enhancement of information disclosure and various support measures.

The JICPA not only supports small and medium-sized audit firms that conduct audits of listed companies in enhancing their information disclosure but also implements initiatives to strengthen their management foundations. Specifically, it has identified six key areas of management infrastructure (quality management, organizational and governance structure, human resources, IT systems, financial base, and international responsiveness) and, led by the JICPA's Small Medium Practices Policy Committee and the Small and Medium-Sized Audit Firms Liaison Council, has carried out various initiatives.

Furthermore, as part of its medium-term support measures for small and medium-sized audit firms, the JICPA has implemented or planned to implement the following key initiatives.

- Publication of guidance for the revised Quality Control Standards
 - Publication of Practical Guidance No.3 to the QCSCS No.1: *Q&A on Quality Control and Engagement Quality Reviews for Audit Firms and Audit Engagements*
 - Revision of the Practical Guidance No.4 of the QCSCS No.1: *Tools for Quality Control at Audit Firms*
 - Publication of Research Report No. 8 by the Small and Medium Practices Policy Committee: *Guidance on Preparing Quality Management Regulations for Audits*
- Training session for Compliance with the revised Code of Ethics
- Opinion Exchange with Capital Market Participants
- Support for recruitment and training at small and medium-sized audit firms
 - Launched a "CPA Job Information" website on JICPA's members-only portal
 - Published the "Employment Guidebook for Small and Medium-Sized Audit Firms", targeting successful candidates for the CPA Examination.
- Maintenance of overseas office directory

- Enhancement of support functions for small and medium-sized audit firms
 - Interactive training sessions to improve audit quality

To support the development and assistance of small and medium-sized audit firms, and to strengthen individual consultation functions, the JICPA organizes interactive sessions led by former reviewers of the Quality Control Review. These sessions involve a small number of participating firms and are conducted in a format that includes Q&A and discussions, facilitating the exchange of opinions and sharing of information.
 - Seminar on the case report from audit firm inspection results published by the CPAAOB
- Support for digitalization of small and medium-sized audit firms

Driven by the activities of the Small and Medium-Sized Audit Firm IT Community (a forum of IT personnel from small and medium-sized audit firms), the JICPA is implementing the following initiatives

 - Identifying the status of IT infrastructure development and the use of IT-based audit methods at small and medium-sized audit firms
 - Providing support for the development of IT infrastructure, including cybersecurity measures, and the development of IT-based audit tools
 - Specific digitalization support measures include the development of a shared IT infrastructure environment (support for the creation of a platform of an electronic audit documentation system)
 - Holding training sessions on effective use of IT
 - Organizing regular meetings of the Small and Medium-Sized Audit Firm IT Community
- Holding regular meetings to exchange opinions with small and medium-sized audit firms, etc.
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d. Support within the audit industry involving the JICPA

The Audit Confirmation Center GK, established through joint investment by large-sized audit firms, provides a platform for balance confirmation procedures that focuses on standardization and efficiency in audit operations, acceleration of confirmation processing, and ensuring high-level security. Traditionally, the process required sending, responding to, and collecting confirmation letters in paper form. However, by utilizing this platform, it has become possible to send electronic confirmation letters and receive responses via the web.

The electronic confirmation letters cover balances such as accounts receivable and payable, bank transaction balances, and securities transaction balances. As of November 1, 2024, in addition to large-sized audit firms and mid-tier audit firms, 94 small and medium-sized audit firms and offices are using the platform. However, among small and medium-sized audit firms, only about 50 firms are currently utilizing it.

In October 2024, the JICPA participated in the Council of Audit Firm for Expanding Electronic Balance Confirmation, established by the Audit Confirmation Center. Through this participation, the Council is

advancing discussions and examining issues to promote the digitization of balance confirmation procedures across the entire audit industry. As mentioned above, since the use of the platform by small and medium-sized audit firms remains limited, the Council is discussing system development and other measures to promote the expansion of its use among these firms.

The Audit Digital & Innovation Consortium LLC (“ADIC”), established through joint investment by one mid-tier audit firm, two small and medium-sized audit firms, and one business corporation, aims to provide platform services that contribute to the digitalization and digital transformation of small and medium-sized audit firms, including the introduction of electronic audit working paper systems. Specifically, it supports the development of a cloud-based IT platform that enables small and medium-sized audit firms to use electronic audit working papers in a secure environment.

ADIC was established with the advice and cooperation of the JICPA, and even after its establishment, the JICPA continues to support the development of a shared IT infrastructure environment for small and medium-sized audit firms through the provision of information and exchange of opinions.

In addition to the above, although the JICPA is not involved, the Audit Firms Support Association (“AFSA”), a general incorporated association established in April 2024 by three mid-tier audit firms and two small and medium-sized audit firms as members, aims to enhance the audit quality of small and medium-sized audit firms. The AFSA supports these firms in meeting the requirements set forth in the Governance Code for Audit Firms and other standards. Specifically, the AFSA provides services such as offering advice as an independent third party to member small and medium-sized audit firms engaging listed company audits, responding to inquiries from members on professional opinions by accounting and auditing experts, and supporting improvements in response to significant findings from external inspections. In the future, the AFSA also plans to offer support for training related to accounting, auditing, and ethics.

3. Response by the CPAAOB

The Revised Standards, as "Points to Note Regarding Implementation of the Revised Quality Control Standards," state that it is particularly important for small and medium-sized audit firms to be provided with necessary support from a medium - to long-term perspective, and that the administrative authority should strive to ensure proactive quality management by audit firms through inspections by the CPAAOB, while supporting the efforts of the JICPA.

As part of its efforts to support small and medium-sized audit firms, the CPAAOB delivered a lecture targeting the management of small and medium-sized audit firms during a course titled “*Strengthening Organizational and On-site Capabilities of Audit Firms*” held by the Accounting Education and Training Organization, a general incorporated foundation. In this lecture, the CPAAOB explained its expectations regarding appropriate organizational management.

In addition, the CPAAOB has published the Case Report from Audit Firm Inspection Results and has given presentations on these case studies at training sessions held by regional offices of the JICPA.

Furthermore, based on the Basic Policy for Monitoring in the 8th Term, the CPAAOB continues to place emphasis on inspections of small and medium-sized audit firms, while also supporting them by delivering lectures at seminars and training sessions organized by relevant institutions

B. Recent Trends with Auditing

1. Trends in International Auditing and Assurance Standards and Ethical Standards

The International Auditing and Assurance Standards Board (IAASB) and the International Ethics Standards Board for Accountants (IESBA), both established within the International Ethics and Auditing Federation (IFEA)²⁸, are engaged in the development of international auditing standards, assurance standards and ethics standards.

Recent major revisions to the International Standards on Auditing (ISA) issued by the IAASB include the revision of ISA 240: The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements. In March 2025, the IAASB Board approved the finalization of the revised standard, which is scheduled to be applied to audits of financial statements for fiscal years beginning on or after December 15, 2026. The revised ISA 240 clarifies the auditor's role and responsibilities in relation to fraud in financial statement audits. It requires auditors to communicate with management and those charged with governance regarding fraud, and to identify matters that they consider to be of particular importance in the audit of the current year's financial statements as Key Audit Matters. The revision of ISA 570 (Going Concern), which sets a 12-month period for management's assessment on going concern from the date of financial statement approval, was finalized at the IAASB Board meeting held in December 2024. The finalized standard was published in April 2025, and is scheduled to be applied to audits of financial statements for fiscal years beginning on or after December 15, 2026. In addition, the IAASB is currently advancing a project to revise ISA 330 (The Auditor's Responses to Assessed Risks) and ISA 520 (Analytical Procedures) alongside the revision of ISA 500 (Audit Evidence), based on public comments received on the exposure draft published in November 2023. The aim of this project is to address key areas such as professional judgment and the maintenance of professional skepticism, consistency between practice and auditor behavior, and the use of technology in obtaining and evaluating the sufficiency and appropriateness of audit evidence. The IAASB plans to publish the exposure draft for these revisions in December 2025.

One of the major recent developments in international assurance standards established by the IAASB is the International Standard on Sustainability Assurance (ISSA) 5000, titled "*General Requirements for Sustainability Assurance Engagements*." A draft of ISSA 5000 was released for public comment in August 2023. Subsequently, in September 2024, the IAASB board approved the finalization of the standard, and it was officially published in November of the same year. ISSA 5000 applies to all assurance engagements related to various types of sustainability information, and to all assurance practitioners, including certified public accountants and others. It covers both limited assurance and reasonable assurance. The standard is applicable to assurance concerning sustainability information for periods beginning on or after December 15, 2026, or sustainability information as of a specific date on or after December 15, 2026.

²⁸ An organization created to replace the International Federation of Accountants (IFAC) and bring under its umbrella the IAASB and IESBA in 2022, in the interest that standard-setters should be independent of professional accountants. Transferring of IAASB and IESBA to IFEA was implemented in January 2023.

A major recent development in the IESBA Code of Ethics established by the IESBA is that, following the approval of revisions at the IESBA board meeting in December 2024, the IESBA published in January 2025 the *International Ethics Standards for Sustainability Assurance Engagements (including International Independence Standards) and Other Revisions to the IESBA Code Relating to Sustainability Assurance and Reporting*, as well as the *Revisions to the IESBA Code Relating to the Use of Work of External Experts*. The former establishes a new part (Part 5) that regulates the independence and ethics of the practitioners, including those who are not professional accountants, who perform sustainability assurance engagements that meet certain criteria. The latter provides guidelines for evaluating the competence, capability, and objectivity of individuals who possess expertise other than that of professional accountants or sustainability assurance practitioners, when their work is used in sustainability assurance. The revisions to the IESBA Code of Ethics relating to assurance engagements will apply to sustainability assurance engagements for fiscal years beginning on or after December 15, 2026, or for sustainability information as of a specific date on or after that same day. The above-mentioned Part 5 will apply to sustainability assurance engagements for fiscal years beginning on or after July 1, 2028, or for sustainability information as of a specific date on or after that date.

2. Revision of the Code of Ethics by JICPA

Referring to revisions made to the IESBA Code of Ethics, the JICPA amended its Code of Ethics in July 2022. Major additions and modifications to individual rules include matters related to compensation and non-assurance activities.

Regarding compensation, audit firms are required to disclose information related to audit fees (audit fees and non-audit fees) when the client of an audit engagement is a business entity with a high degree of social impact ("PIE"). Also, as a safeguard for cases where the firm's fee dependence on PIEs exceeds or is likely to exceed 15% for two consecutive years, pre-audit opinion review is now required, and disclosure of fee dependency becomes mandatory. In addition, in cases where the firm's fee dependence on PIEs continues to exceed or is likely to exceed 15% for five consecutive years, the firm is required to resign after the fifth annual opinion.

For non-assurance engagements, if the client of the audit engagement is a PIE, the audit firm or network firm must not provide non-assurance engagements that could be subject to self-review as a disincentive.

The Cabinet Office Ordinance on Audit Certification of Financial Statements, etc. was also revised to require audit firms to add matters concerning the fees that CPAs or audit firms (including those who belong to the same network as these firms) receive from audited companies (including consolidated subsidiaries and non-consolidated subsidiaries) as descriptions in audit reports.

In July 2024, the JICPA also revised its Code of Ethics. The main revisions include provisions related to the definition of listed entities and public interest entities (PIEs), the definition of engagement teams and regulations concerning group audit engagements, and provisions related to technology (including

a change in terminology related to “confidentiality”). The revised Code of Ethics has been effective since April 1, 2025.

3. Other Trends in Financial Reporting Systems

a Discontinuation of the quarterly disclosure system and its impact on audit firm's operation

The quarterly disclosure system was legislated in June 2006. However, in recent years, economic and social conditions have changed significantly, and the demand for reviewing framework of company's information disclosure is observed. Under these circumstances, the importance of non-financial information related to medium- to long-term corporate value has increased in corporate disclosure. On the other hand, it is pointed out that there are overlaps between quarterly reports based on the FIEA (Quarterly Securities Report) and those based on exchange rules (Quarterly Earnings Report (Tanshin)), and such reports should be reviewed from the viewpoint of cost reduction and efficiency. In light of this, on November 20, 2023, the "Act for Partial Amendment of the Financial Instruments and Exchange Act, etc." was enacted to abolish the quarterly report system and uniformly require companies submitting securities reports to submit semiannual reports.

In November 2023, based on the council of experts, the Tokyo Stock Exchange (TSE) formulated the “Practical Policy Concerning the Revision of the Quarterly Disclosure System” and revised the Securities Listing Regulations in March 2024, making reviews of the first and third quarters by an auditor mandatory only in the following cases.

- 1) A listed company receives a result other than an unqualified opinion in an audit report of their latest Annual Securities Report, Semiannual Securities Report or Quarterly Earnings Report (only if a review has been conducted)
- 2) A listed company receives a result other than an unqualified opinion in an Internal Control Audit Report of the latest Annual Securities Report
- 3) A listed company has significant deficiencies in internal controls that should be disclosed in their latest Internal Control Report
- 4) A listed company does not submit the latest Annual Securities Report or Semiannual Securities Report by the initial deadline
- 5) The Semiannual Securities Report for the current term is amended, and a review report is attached to the amended financial statements

* 1) and 3) are also applicable to cases where the most recent Annual Securities Report, Semiannual Securities Report, Quarterly Earnings Report (only in receiving a review) or Internal Control Report is amended, and the amendment report meets the conditions.

** Except where it is clear that the reliability of financial statements is not in question regarding 4) and 5).

Furthermore, the Business Accounting Council has released "Written Opinion of the proposals to revise the quarterly review standards to the interim review standards". This revision changes

the name of the quarterly review standards to the interim review standards, as it is common to all interim reviews conducted by auditors who audit annual financial statements, including reviews on quarterly earnings reports (kessan tanshin), in addition to reviews on interim financial statements under the revised FIEA. And it also introduces a form of conclusion regarding compliance in addition to the form of conclusion regarding fair disclosure stipulated in the current quarterly review standards.

The differences between the conclusion regarding fair disclosure and the conclusion regarding compliance are described in the Secretariat's materials of the Corporate Accounting Committee of the Business Accounting Council at its 55th meeting held on December 14, 2023.

Both the "Conclusion regarding fair disclosure" and the "Conclusion regarding compliance" require an assessment of whether the accounting policies used by management are in accordance with accounting principles generally accepted in Japan and applied on a consistent basis, whether the choice and application of policies fairly reflects the reality of accounting events and transactions, and whether the interim financial statements are in accordance with accounting principles.

In addition, "conclusions regarding fair disclosure" involves an assessment from a step-away point of view whether the financial statements as a whole are appropriately presented for the users of interim financial statements to understand the financial position and results of operations.

JICPA has published the following practical guidelines for the review of interim financial statements and related matters that require understanding.

- Interim Review Standards Statement No. 1, "Review of Interim Financial Statements Conducted by an Independent Auditor": An amendment to the existing Quarterly Review Standards Report No. 1, "Quarterly Review", responding to the reviews of interim financial statements under the FIEA.
- Interim Review Standards Statement No. 2, "Review of Interim Financial Statements Conducted by the Independent Auditor": Responding to interim reviews other than interim reviews under the FIEA conducted by annual auditors.
- Revision of the Practical Guidelines for Assurance Engagements 2400, "Review of Financial Statements": Responding to interim reviews other than FIEA reviews conducted by auditors other than annual auditors.
- Practical Guidance No. 1 for Interim Review Standards Statement No. 2 "Q&A Regarding Interim reviews of Quarterly Financial Statements, etc. Prescribed by the Securities Listing Regulations of the Tokyo Stock Exchange (Practical Guidance)"
- Revision of the Interim Review Standards Statement No. 1 and No. 2 (Implemented in March 2025): Clarification that specific independence requirements apply to audits of financial statements of certain entities.

- Revision of Practical Guidance No. 1 for Interim Review Standards Statement No. 2 (Implemented in March 2025): Addition of Q&A regarding marginal notes in interim review reports.

According to collection of reports from large-sized audit firms, among the 1,481 audited companies that published their quarterly financial results for the first quarter ended June 30, 2024, 324 companies (21.8%) underwent voluntary reviews. Even in cases where a voluntary review was not conducted, procedures were often performed as part of the annual audit, and it was reported that there were no significant differences in workload or fees compared to cases where a voluntary review was conducted.

According to collection of reports from mid-tier audit firms, among the 618 audited companies that published their quarterly financial results for either the first or third quarter ended June 30, 2024, 176 companies (28.4%) had either already undergone or were scheduled to undergo voluntary reviews. Similar to large-sized audit firms, procedures were often performed as part of the annual audit even when a voluntary review was not conducted. However, some firms noted a slight reduction in workload and fees in such cases.

According to collection of reports from small and medium-sized audit firms (52 firms), among the 374 audited companies that published their quarterly financial results for either the first or third quarter ended June 30, 2024, 96 companies (25.6%) had either already undergone or were scheduled to undergo voluntary reviews. Even when a voluntary review was not conducted, procedures were often performed as part of the annual audit, similar to large-sized and mid-tier audit firms. However, 115 companies (30.7%) were reported as having no such procedures performed, and some firms noted a reduction of more than 10% in workload and fees in these cases.

According to the collection of reports, the abolition of the quarterly reporting system has had the following practical impacts:

- Even when a voluntary review is not conducted, audited companies may request a check of figures disclosed in the quarterly financial results. In response, some firms accept such requests as simplified review, others enter into new voluntary review agreements, while some decline the requests altogether.
- When auditor involvement shifts from quarterly to semi-annual, some firms express concerns about reduced timeliness and depth of communication with audited companies. Additionally, delays in understanding the business environment and the concentration of audit work during the half-year and year-end periods are also cited as concerns.
- Some firms report that by deprioritizing companies without voluntary review agreements, they have gained more flexibility in assigning audit personnel and scheduling audit work internally.
- There are concerns that the likelihood of corrections to quarterly financial results may

increase, and that signs of fraud may be detected later, potentially requiring additional procedures during the annual audit.

CPAFOB will continue to monitor the impact of the abolition of the quarterly disclosure system on audit practices.

b Submission of the Annual Securities Report Prior to the Shareholders' Meeting

In March 2025, the Minister for Financial Services issued a request titled "Appropriate Information Disclosure Prior to the Shareholders' Meeting" to all listed companies. The request indicated that the most desirable timing for submitting the annual securities report would be at least three weeks prior to the shareholders' meeting. However, taking into account the practical burden on companies, the request encouraged companies to begin by considering submission a day or several days before the meeting starting this year. FSA stated that, while aiming to reduce the burden on companies, it would monitor the submission status of annual securities reports for fiscal years ending March 2025 and beyond and consider conducting reviews of the reports.

The annual securities report review is a framework for examining the appropriateness of disclosures in securities reports and promoting enhanced disclosure quality. It has traditionally been conducted jointly by the Financial Services Agency and Local Finance Bureaus. The review consists of three main components: (1) reviews related to legal amendments, (2) thematic reviews, and (3) reviews utilizing various information sources.

In this context, the recent request titled "Appropriate Information Disclosure Prior to the Shareholders' Meeting" will be addressed through an in-depth thematic review, taking into account responses to the questionnaire related to legal amendments. The review related to legal amendments covers changes in laws and regulations and applies to all companies submitting securities reports. The thematic review focuses on specific topics, selecting target companies for more detailed examinations. Companies, subject to this review receive individual questionnaires from their respective Local Finance Bureaus.

For this review, companies submitting annual securities reports are expected to respond to the legal amendment-related questionnaire by selecting one of five options. Among these, companies that choose one of the following responses (i) that they plan to submit the annual securities report prior to the shareholders' meeting starting from the fiscal year ending March 31, 2027 or later; (ii) that they do not plan to submit the report prior to the shareholders' meeting for the time being; or (iii) "Other" will be asked to provide additional explanations or reasons in the questionnaire.

In June 2025, the FSA presented materials at the third meeting of the Liaison Council for Preparing the Environment for Disclosure of Annual Securities Reports Prior to Shareholders' Meetings. According to the materials, out of 2,262 listed domestic companies with fiscal years

ending March 2025, 1,241 companies indicated that they plan to disclose their annual securities reports prior to the shareholders' meeting, representing 54.9% of the total.

Large-sized audit firms have expressed the following views regarding the impact of submitting annual securities reports prior to the shareholders' meeting on audit operations:

- There may be a need to shorten the audit period for the annual securities report, requiring earlier identification of audit procedures that can be brought forward, and more proactive pre-discussions and resolutions regarding new disclosures and topics.
- Audited companies need to consider the overall schedule for the shareholders' meeting and the preparation of the securities report and establish a cooperative framework with auditors based on mutual agreement.
- Many firms have received requests to advance the timing of audit report submission, presenting challenges in securing audit resources, revising audit schedules, and confirming earlier preparation efforts by audited companies.
- If the report is submitted a day or a few days before the shareholders' meeting, it is expected that there will be no significant impact on the firm's operations.
- In cases where the audit schedule must be significantly advanced, beyond just a few days before the shareholders' meeting, firms indicate that it will be necessary to conduct prior meetings focused on matters amended by laws and regulations, and to perform early checks of disclosure skeleton drafts (drafts containing only qualitative information, with quantitative data left blank). They also highlight the need to address differences in disclosure content compared to cases where the report is submitted after the shareholders' meeting, particularly with regard to reviewing sections other than "Financial Statements."

CPA AOB will continue to monitor the impact of submitting annual securities reports prior to the shareholders' meeting on audit practices.

■ Introduction of new lease accounting standards ■

A lease transaction refers to an arrangement in which a company rents and uses a specific asset such as a building, machinery, or vehicle for a fixed period. In this arrangement, the leasing company owns the asset, and the company ("lessee") obtains the right to use the asset by paying lease fees.

In Japan, the accounting standards for lease transactions were established in 2007 with the issuance of the Accounting Standard for Lease Transactions (ASBJ Statement No. 13) and the Guidance on Accounting Standard for Lease Transactions (ASBJ Guidance No. 16). These standards, collectively referred to as the "former lease accounting standards," were consistent with international accounting standards at the time.

Under the former lease accounting standards, lease transactions were classified into finance leases and operating leases. A finance lease is a transaction in which the leasing company purchases the asset on behalf of the lessee and leases it to the lessee. These leases are non-cancellable during the lease term, and the lease payments cover almost the entire cost of the asset and related expenses. In contrast, an operating lease transaction is more similar in nature to a typical rental agreement. Only finance lease transactions were required to be recorded as assets and liabilities on the balance sheet.

However, in January 2016, the International Accounting Standards Board (IASB) issued IFRS 16 "Leases," which requires lessees to recognize all lease transactions as assets and liabilities on the balance sheet. As a result, differences arose between Japanese accounting standards and international standards, particularly in the recognition of liabilities. This discrepancy raised concerns about potential issues in international comparability.

In response, the Accounting Standards Board of Japan (ASBJ) began developing a new accounting standard that would require lessees to recognize all lease transactions as assets and liabilities on the balance sheet. Since March 2019, ASBJ has been conducting thorough deliberations on this matter.

In September 2024, the ASBJ issued the Accounting Standard for Leases (ASBJ Statement No. 34) and the Guidance on Accounting Standard for Leases (ASBJ Guidance No. 33), collectively referred to as the "new lease accounting standards." Under these new standards, the term "lease transactions" was revised to simply "leases," and, in principle, all assets and liabilities arising from leases must be recorded on the balance sheet.

The new lease accounting standards apply to companies subject to disclosure under the FIEA, including listed companies, their subsidiaries and affiliates, as well as large companies under the Companies Act. The standards will be effective from the beginning of the consolidated fiscal year or business year starting on or after April 2027, with early adoption permitted from the beginning of the fiscal year or business year starting on or after April 2025.

Under the new lease accounting standards, the definition and identification criteria for leases have been revised. A transaction is identified as a lease based on three key considerations: (1) whether the asset can be specifically identified, (2) whether the party has the right to obtain economic benefits from the asset, and (3) whether the party has the right to direct the use of the asset.

As a result, companies subject to the new standards must begin by collecting relevant contracts and reviewing each one to determine whether they qualify as a lease. Furthermore, to support audit procedures, they are required to prepare documentation that records the basis for their lease determinations. Therefore, in order to accurately identify transactions subject to the new lease accounting standards and to ensure appropriate accounting treatment, companies are required to implement accounting systems and revise their business processes, accordingly. In particular, identifying applicable transactions imposes a significant workload on companies. However, some audit firms are working to reduce this burden by developing generative AI tools that assist in determining whether a transaction falls within the scope of the new standards.

In preparation for the implementation of the new lease accounting standards, companies subject to the standards are expected to make prompt and thorough preparations. At the same time, audit firms must also respond to the increased scope of contracts subject to audit, the greater complexity of accounting treatments, and the resulting increase in audit workload, while also enhancing their professional expertise as auditors.

C. Trends in Sustainability Disclosure and Assurance

1. Trends in Disclosure of Sustainability Information

In recent years, there has been a continued emphasis on sustainability information in corporate management and investors' decisions, and non-financial information related to medium - to long-term corporate value has become increasingly important. Non-financial information is expected to contribute not only to corporate management and investment decisions, but also to direct capital toward companies that are actively engaged in addressing social issues related to climate, nature, human rights and the exclusion of marginalized groups, thus embedding such efforts in society in terms of the financial system.

Until recently, the mainstream of disclosure of sustainability information has been conducted voluntarily such as integrated reports; however, both in Japan and internationally, discussions are progressing toward the establishment of disclosure standards that stipulate specific reporting requirements.

Internationally, the International Sustainability Standards Board (ISSB) finalized Standard S1 (IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information) and Standard S2 (IFRS S2 Climate-related Disclosures) in June 2023. These standards have been applied from financial years beginning on or after January 2024. While many countries are in the process of developing their own standards equivalent to those issued by the ISSB, some have already begun, or are planning to begin, direct application of the ISSB standards.

In Japan, the disclosure of sustainability information began with annual securities reports for fiscal years ending on or after March 31, 2023. To enable disclosures based on specific standards, the Sustainability Standards Board of Japan (SSBJ) finalized and published its sustainability disclosure standards on March 5, 2025. These standards consist of three documents: the Universal Sustainability Disclosure Standard “Application of the Sustainability Disclosure Standards” (“Application Standard”), the Theme-based Sustainability Disclosure Standard No. 1 “General Disclosures” (“General Standard”), and the Theme-based Sustainability Disclosure Standard No. 2 “Climate-related Disclosures” (“Climate Standard”). Much of the content is aligned with the standards issued by the International Sustainability Standards Board (ISSB). For example, the Application Standard includes fundamental elements such as the reporting period and timing, which correspond to parts of the ISSB’s S1 standard. The General Standard and the Climate Standard outline the core content regarding sustainability-related risks and opportunities. The Climate Standard focuses on climate-related risks and opportunities, while the General Standard covers other types of risks and opportunities.

In preparation for the introduction of sustainability disclosure standards and assurance systems in Japan, discussions have been underway since March 2024 within the Financial System Council’s Working Group on Disclosure and Assurance of Sustainability-related Financial Information (“Sustainability WG”). These discussions are centered around companies (particularly those listed on the Prime Market of the Tokyo Stock Exchange) that are engaged in constructive dialogue with global investors. Specific topics under consideration include the scope of application, the timing of

implementation and transitional measures, and the handling of responsibilities and safe harbor provisions in cases of false statements.

Although sustainability disclosure is being newly introduced or expanded in countries outside Japan, there are also signs of regulatory easing in some regions due to concerns over regulatory burdens and changes in political leadership. For example, in the United States, the Securities and Exchange Commission (SEC) finalized its climate-related disclosure rule in March 2024, requiring all SEC-registered domestic and foreign companies to disclose climate-related information. The rule was designed to be phased in from 2026, depending on company size. However, following a series of lawsuits challenging the rule, the SEC decided in April 2024 to suspend its enforcement until judicial decisions are finalized.²⁹ Meanwhile, at the state level, there are movements to require climate-related disclosures from companies that meet certain criteria.

In the European Union, the Corporate Sustainability Reporting Directive (CSRD), which came into effect in January 2023, requires companies to disclose and assure sustainability reports. The timing of its application is set in phases depending on whether a company is listed or unlisted, and on its size. Starting with the fiscal year 2024, the directive has been applied to “large companies”³⁰ located in the EU such as listed companies with more than 500 employees. Subsequently, in February 2025, the European Commission published two legislative proposals known as the “Omnibus Package,” aimed at simplifying sustainability-related regulations. These proposals were designed to reduce the regulatory burden on EU companies and enhance their global competitiveness. The proposed legislation includes measures to reduce the burden on companies, such as a two-year postponement of the application timeline for companies that have not yet become subject to reporting obligations³¹, a narrowing of the scope of applicable companies through changes to the threshold criteria, and a decision not to proceed with a future transition to reasonable assurance for sustainability reporting.³²

2. Trends in Assurance on Sustainability Disclosures

a Expansion of non-financial information disclosure

It is also useful for investors and other stakeholders to ensure standards for the disclosure of sustainability information so that disclosure of each company has a certain degree of consistency and increase the reliability of information through assurance by a third party. In recent years, amid growing interest in a sustainable society, there has been an increase in sustainability-themed finance such as ESG investment. At the same time, society is also paying attention to information dissemination that may cause misleads among stakeholders, such as

²⁹ In March 2025, the SEC announced that it had withdrawn its defense of the climate-related disclosure rule in the ongoing litigation.

³⁰ A company is considered a “large company” and subject to the applicable regulations if it meets at least two of the following three criteria: (1) Net assets exceeding 25 million euros, (2) Net sales exceeding 50 million euros, (3) Number of employees exceeding 250.

³¹ For large companies other than those classified as “Wave 1” (i.e., listed companies with more than 500 employees to which the CSRD began applying from the fiscal year 2024), referred to as “Wave 2,” the application of the directive is scheduled to be postponed to the fiscal year 2027. For listed small and medium-sized enterprises (excluding micro-enterprises), referred to as “Wave 3,” the application is expected to begin in the fiscal year 2028.

³² Among the proposals in the Omnibus Package, the postponement of the application timeline was approved by the European Parliament and the Council of the European Union in April 2025 and has already entered into force.

greenwashing.

To ensure the quality of third-party assurance on sustainability information, the ISSA 5000 standard published by the IAASB in November 2024 allows for application to all assurance providers, including non-professional accountants. The standard assumes that members of the engagement team and EQC reviewers will apply IESBA standards or at least equivalent or higher requirements for assurance engagements, and that the engagement practitioner is a member of a firm that is subject to ISQM1 or at least equivalent or higher requirements. Furthermore, ISSA 5000 sets out requirements and application guidance for each component of the assurance process, from the acceptance and continuance of engagement contracts to the preparation of assurance reports.

Also, in December 2024, IESBA finalized the “International Ethics Standards for Sustainability Assurance (Including International Independence Standards) and Other Revisions to the Code Relating to Sustainability Assurance and Reporting” and “Using the Work of an External Expert”. For more information, see ["B. Recent Trends with Auditing. 1. Trends in International Auditing and Assurance Standards and Ethical Standards"](#).

In Japan, discussions are underway regarding the introduction of an assurance system for sustainability information disclosed in annual securities reports. These discussions are taking place within the Sustainability WG and its subcommittee, the “Expert Group on Assurance of Sustainability Information” (“Expert Group”). The Sustainability WG is examining broad policy directions, such as the scope and level of sustainability assurance and the types of entities that should be responsible for conducting assurance engagements. Meanwhile, the Expert Group is engaged in more detailed deliberations on the specific rules that should apply to assurance practitioners, including registration requirements, responsibilities and liabilities, and assurance standards related to sustainability information. The outcomes of the Expert Group’s discussions are reported to the Sustainability WG. At the sixth meeting of the Sustainability WG, held in June 2025, an interim report on the progress of these discussions was presented.

Regarding international developments, in Europe, large companies that began reporting under the CSRD from the fiscal year 2024 are required to obtain limited assurance at the same time as the disclosure obligations take effect. In addition, as mentioned earlier in section 1., the Omnibus Package includes a proposal to postpone the application timeline by two years for companies other than those classified as “large companies” under the CSRD.³³ It also proposes to continue with limited assurance and not to transition to reasonable assurance in the future. On the other hand, in the United States, the SEC’s climate-related disclosure rule includes provisions for transitioning from limited assurance to reasonable assurance for sustainability

³³ For foreign companies such as parent companies located outside the EU that have subsidiaries or branches within the EU, the start date for limited assurance has not been postponed, and its introduction is scheduled to begin from the fiscal year 2028.

information. However, enforcement of this rule was suspended in April 2024.³⁴

b Response by Audit Firms

Regarding assurance of sustainability information, investors have expressed a desire for enhanced reliability of sustainability information. In response, audit firms that have accumulated experience in providing assurance through financial audits are taking the following actions.

Large-sized audit firms, either directly or through their group entities, are providing advisory services related to sustainability information. In addition, they conduct voluntary assurance engagements on sustainability information as an accredited assurance body of the Japanese Association of Assurance Organizations for Sustainability Information.³⁵ In addition, a department has been established to promote the sustainability information assurance engagements, which promotes collaboration between audit-related departments and non-financial information specialists, and also allows audit staff to accumulate practical experience by engaging in the assurance of sustainability information.

Furthermore, those firms have developed a system of assurance procedures in collaboration with global network, formulated rules for quality control, and put in place the system of quality management including EQ reviews. Within global networks, audit procedures are being revised in line with ISSA 5000, which was finalized in November 2024. Some firms have begun receiving information from their global networks, and others have started using tools developed within those networks to improve the efficiency and standardization of assurance engagements. Human resources development for sustainability assurance engagements at large-sized audit firms is relatively well-developed among audit firms in Japan. Some firms have implemented structured training programs that combine learning and practical experience and require audit practitioners to complete these programs as mandatory training. In certain cases, firms have also introduced certification system for sustainability disclosure and assurance professionals.

Many mid-tier audit firms have formed project teams to gather information and provide training within the firm. In some cases, dedicated departments have been established to promote assurance engagements for sustainability information. To strengthen human resources, many firms support the registration of their staff as certified reviewers with the Japanese Association of Assurance Organizations for Sustainability Information. Collaboration with global networks is also active, including collecting information on international developments and providing training content. However, some firms report that they do not receive support from their global networks. Additionally in certain cases, advisory firms within the same group are engaged in supporting sustainability disclosures and conducting voluntary assurance engagements. Through these

³⁴ Subsequent developments are the same as those described in Footnote 32.

³⁵ The Japanese Association of Assurance Organizations for Sustainability Information is a general incorporated association. Its predecessor was the Japan Environmental Information Review Association, which was established in 2005 for the purpose of ensuring the reliability of reviews of environmental reports, etc. and contributing to the improvement of reliability of environmental reports, etc. by realizing efficient and effective reviews. The association has six accredited review organizations.

practical activities, know-how is being accumulated within domestic group entities. At the same time, some firms are still in the process of developing the necessary systems, manuals, and guidance for conducting assurance engagements.

Regarding small and medium-sized audit firms, we gathered information on the status of engagement with assurance services for non-financial information through collection of information from 52 small and medium-sized audit firms.

Among the firms that responded, most indicated that they were "interested in assurance engagements related to non-financial information and making specific consideration within the firm such as gathering information". These firms reported gathering information through training sessions hosted by professional associations or global networks. Some have established internal structures to consider assurance services for sustainability information, participated in training provided by associations or global networks, or engaged in activities such as those organized by the Sustainability Information Support Committee for Small and Medium-Sized Firms.

In addition, 85% of firms responded that they were either "interested in assurance engagements on non-financial information but have not yet considered specifically," or "not interested in assurance engagements on non-financial information, and do not intend to respond even if consulted." Among these, 27% noted a lack of management resources as a reason, while 15% stated that they had not begun specific discussions because none of their audit clients are currently subject to mandatory third-party assurance requirements.

■ The impact of political developments in various countries on corporate accounting and audit industry ■

In recent years, elections have been held in many countries around the world, resulting in the formation of governments that advocate conservative and protectionist policies. These political developments have had a certain impact on corporate accounting and the audit industry.

For example, in June 2024, elections for the European Parliament, the legislative body of the European Union (EU), were concluded. In countries such as France and Germany, parties promoting nationalist policies increased their number of seats, and far-right groups also gained more seats within the European Parliament. This outcome was largely driven by the economic stagnation in EU member states, particularly France and Germany, and is closely linked to the growing support for protectionist policies aimed at enhancing the growth and competitiveness of the EU, including their domestic companies. In response to this situation, the European Commission, under the supervision of the European Parliament, published “Omnibus Package” in February 2025 aimed at simplifying sustainability-related regulations and reduce the burden on companies. As a result, Japanese companies operating within the EU are now required to reconsider their approach to sustainability-related disclosures. Likewise, audit firms have also had to revise their engagement plans concerning the assurance of sustainability information.

In November 2024, the United States held both presidential and congressional elections. The Republican Party won the presidency and secured a majority in both houses of Congress. The party, which advocated anti-liberal and conservative policies, including protectionist policies such as “America First.” These policies gained a certain level of support from the public who were dissatisfied with issues such as undocumented immigrants allegedly taking away job opportunities, and the continued rise in prices. Immediately after the inauguration of the new president in January 2025, an executive order titled “Ending Illegal Discrimination and Restoring Merit-Based Opportunity” was issued in the aim of eliminating DEI (Diversity, Equity, Inclusion) programs in U.S. government agencies. Some U.S. member firms of the Big Four global networks, which had provided extensive consulting services to U.S. government agencies, responded to this executive order by abolishing their internal DEI programs. The Big Four global networks had previously promoted DEI programs partly to address the shortage of certified public accountants. For example, by opening doors to all minorities, ensuring equal opportunities for promotion and advancement, and publicly communicating that they accept individuals without discrimination as members of their organizations, they aimed to attract more CPA candidates. The recent developments represent a reversal of that approach.

Furthermore, in the United States, protectionist policy management under the new administration have become more prominent. In February 2025, additional tariffs on imports from China came into effect, and in April 2025, the introduction of reciprocal tariffs was announced. Under this policy, an additional 10% tariff would be applied to all imported goods from every country, with further tariff increases planned for countries and regions with large trade deficits. As a result, although the situation had stabilized by the end of June of the same year, the policy led to significant fluctuations in exchange rates and U.S. interest rates, thereby increasing uncertainty and opacity in the economic environment and having a major impact on the business operations of Japanese companies. In response to this situation, large-sized audit firms, in coordination with their global networks, have been disseminating internal materials and information regarding accounting and audit considerations. Specifically, they have indicated necessary audit responses such as reviewing risk assessments considering the impact on the business plans of audited companies, and examining accounting estimates, including impairment of goodwill and fixed assets.

In May 2025, the U.S. House of Representatives passed a budget reconciliation bill commonly referred to as the “One Big Beautiful Bill Act”, which includes provisions aimed at making income tax cuts permanent, introducing tax exemptions for tips and overtime income, and increasing funding for border security and immigration measures. One notable provision in the bill calls for the transfer of the PCAOB’s responsibilities and authority to the SEC within one year of the bill’s enactment, effectively proposing the dissolution of the PCAOB. As of the end of June 2025, the bill remains under deliberation in the U.S. Senate. If enacted, a key concern will be whether the SEC can effectively replicate the PCAOB’s functions such as oversight and inspection of audit firms and the development of auditing standards without compromising quality. Some audit oversight authorities in Europe have expressed reservations regarding this point. Large-sized audit firms that conduct audit engagements subject to PCAOB inspection have been preparing to comply with the PCAOB’s newly issued quality control standard- QC1000 and are closely monitoring developments in the Senate’s deliberations.³⁶

³⁶ As of the end of June 2025, the provision calling for the dissolution of the PCAOB does not meet the requirements of Senate rules for

CPAAOB has stated that it will continue to monitor how political developments in various countries may affect corporate accounting and the auditing profession through its oversight of audit firms.

inclusion in budget-related legislation. This is because the PCAOB is funded by public companies and does not contribute to federal budget reductions, and the SEC does not have the budgetary capacity to absorb the PCAOB. Accordingly, there are indications that this provision may be separated from the budget reconciliation bill and reconsidered independently.