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Case Report from  
Audit Firm Inspection Results  
summary  
(Program Year 2025)

# Main features of this Program Year

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"I. Operations Management System (Root Cause Analysis)" expands on case studies of root cause analysis and root cause from recent inspections in light of the importance of root cause analysis. In light of the importance of root cause analysis,

With regard to "II. Quality Control Environment," in order to contribute to responses to the revised quality control standards, the new standards are included as reference information in the provisions for the grounds for examples of deficiencies pointed out under the old standards.

Given that responses to circular transactions and security risks have become urgent issues, we have included a new column entitled "Responses to Circular Transactions and Cybersecurity Risks."

The charts have been enhanced to assist in understanding the content described in the "Required Actions" and "Points to Note."

The "Summary" has been revised by adding figures and tables so that they can be used as training materials within small and medium-sized audit firms.

# Operations Management System (Root Cause Analysis)

# Operations Management System (Root Cause Analysis)

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## Necessity of Root Cause Analysis

### Undetected deficiencies

It is necessary to remediate not only the deficiencies identified through inspections but also any undetected deficiencies that share the same root causes.

### Appropriate Improvement

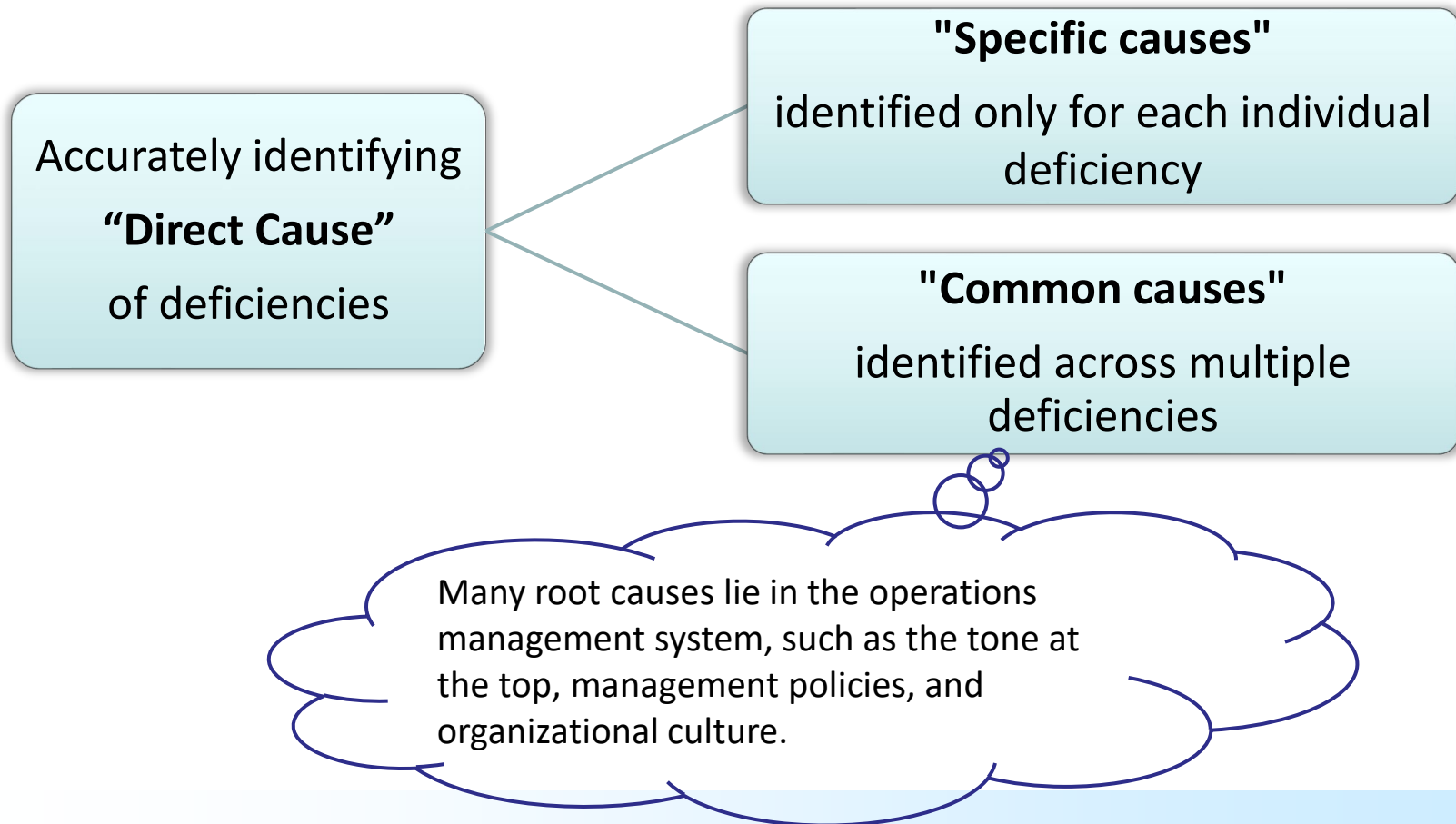
By implementing improvement measures that take into account the root causes of deficiencies, it is possible to achieve fundamental improvements without hindering effective and efficient audit services.

Each audit firm needs to recognize the importance of identifying the root causes of deficiencies and to strive for substantive improvements in audit quality.

# Operations Management System (Root Cause Analysis)

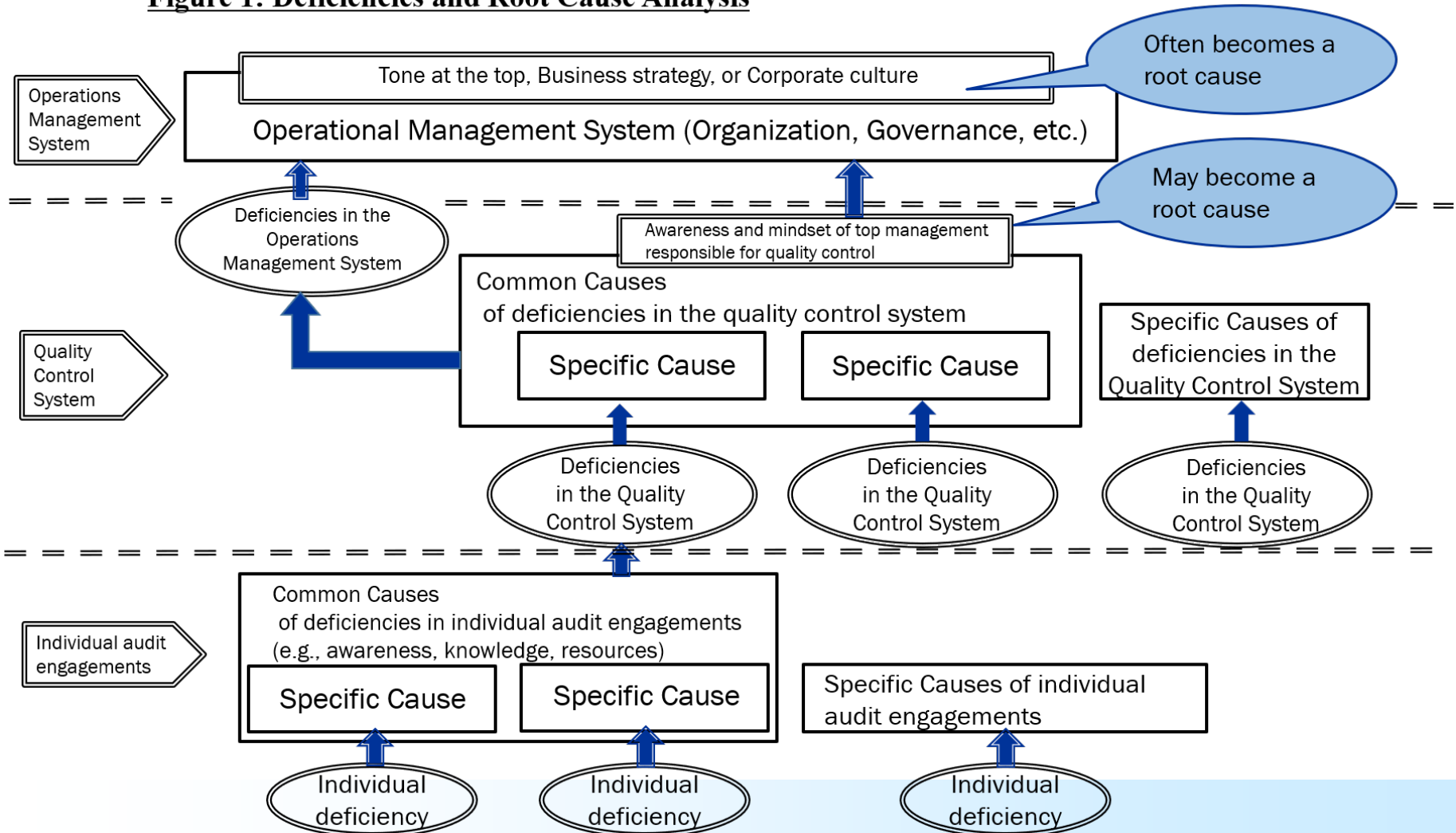
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## Root cause analysis requires ...



# Operations Management System (Root Cause Analysis)

**Figure 1: Deficiencies and Root Cause Analysis**



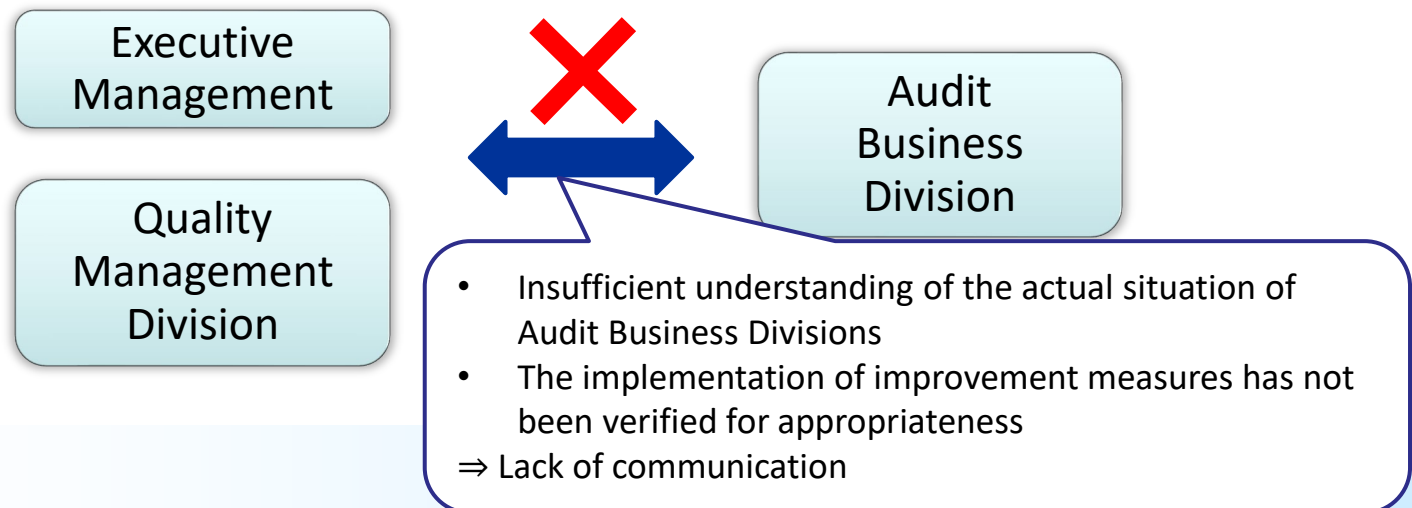
# Operations Management System (Root Cause Analysis)

## Specific examples of root causes (large-sized audit firms)

The executive management believed that, by introducing and implementing audit quality improvement measures, all engagement teams would obtain sufficient appropriate audit evidence.

The executive management did not sufficiently recognize the need to confirm whether the Quality Management Division and the audit business division were closely coordinating with each other with respect to audit quality improvement measures.

The management executives were not sufficiently aware of the need to confirm with the audit division the status of implementation of audit quality improvement measures.



# Operations Management System (Root Cause Analysis)

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## Specific examples of root causes (mid-tier audit firms)

The CEO lacks sufficient awareness toward establishing an effective and organized operations management system.

The CEO lacks sufficient awareness of the need to verify the adequacy and effectiveness of the quality control system.

The partners have not grasped the situation in which there is a lack of a sufficiently critical attitude toward assessing management's assertions in audits of accounting estimates.

The CEO lacks sufficient awareness of the need to promptly advance improvement measures.

The CEO lacks sufficient awareness of the need to proactively provide support to regional offices.

The CEO has not exercised leadership toward ensuring an appropriate level of audit quality.

# Operations Management System (Root Cause Analysis)

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## Specific examples of root causes (mid-tier audit firms)

Although efforts to design the quality control system are observed, there are situations where the strengthening of head office functions remains insufficient.

Top management's awareness of quality control has not kept up with the pace of business expansion.

A substantial portion of audit services relies on part-time staffs and assistants to engagement.

There are issues in quality management at a specific regional office.

The operations management system differs depending on each firm's history and size, and accordingly, the root causes vary from firm to firm.

# Operations Management System (Root Cause Analysis)

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## **Specific examples of root causes (small and medium audit firms)**

The CEO has not exercised leadership toward improving audit quality.

The CEO placed excessive reliance on staffs and assumed that an appropriate level of audit quality was being ensured.

The CEO has not recognized that engagement teams lack sufficient understanding of the intent of the auditing standards and of the level required by those standards.

The CEO has not recognized the need to establish an organizational audit engagement framework.

The CEO and the PICOQC lack professional ethics and, within the firm, have prioritized avoiding findings in external inspections above all else, thereby fostering and allowing to spread a culture that places little importance on professional integrity and the maintenance of credibility.

# Operations Management System (Root Cause Analysis)

## Specific examples of root causes (small and medium audit firms)

- Because the organization is relatively small, it is difficult to address quality management and other matters in an organizational manner.
- The level of quality management is often significantly influenced by individual capabilities.

There is a lack of leadership by the CEO toward improving audit quality.

The overall level of audit quality across the firm is not being accurately grasped.

In particular, when significant changes arise in the business environment of the audit firm as a result of a merger, it is necessary to respond appropriately in line with such changes.

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## II. System of Quality Management

# Implementation of quality management activities

## Establishment of System of Quality Management

It is necessary to maintain and improve an effective System of Quality Management in accordance with the nature and status, etc. of audit services.



In the main Case Report, examples of deficiencies are presented separately for large-sized audit firms and mid-tier audit firms as well as small and medium-sized audit firms.

Please also refer to other categories!

## Relationship between System of Quality Management and individual audit engagements

The design and operation of a System of Quality Management has a significant impact on the quality of individual audit engagements.



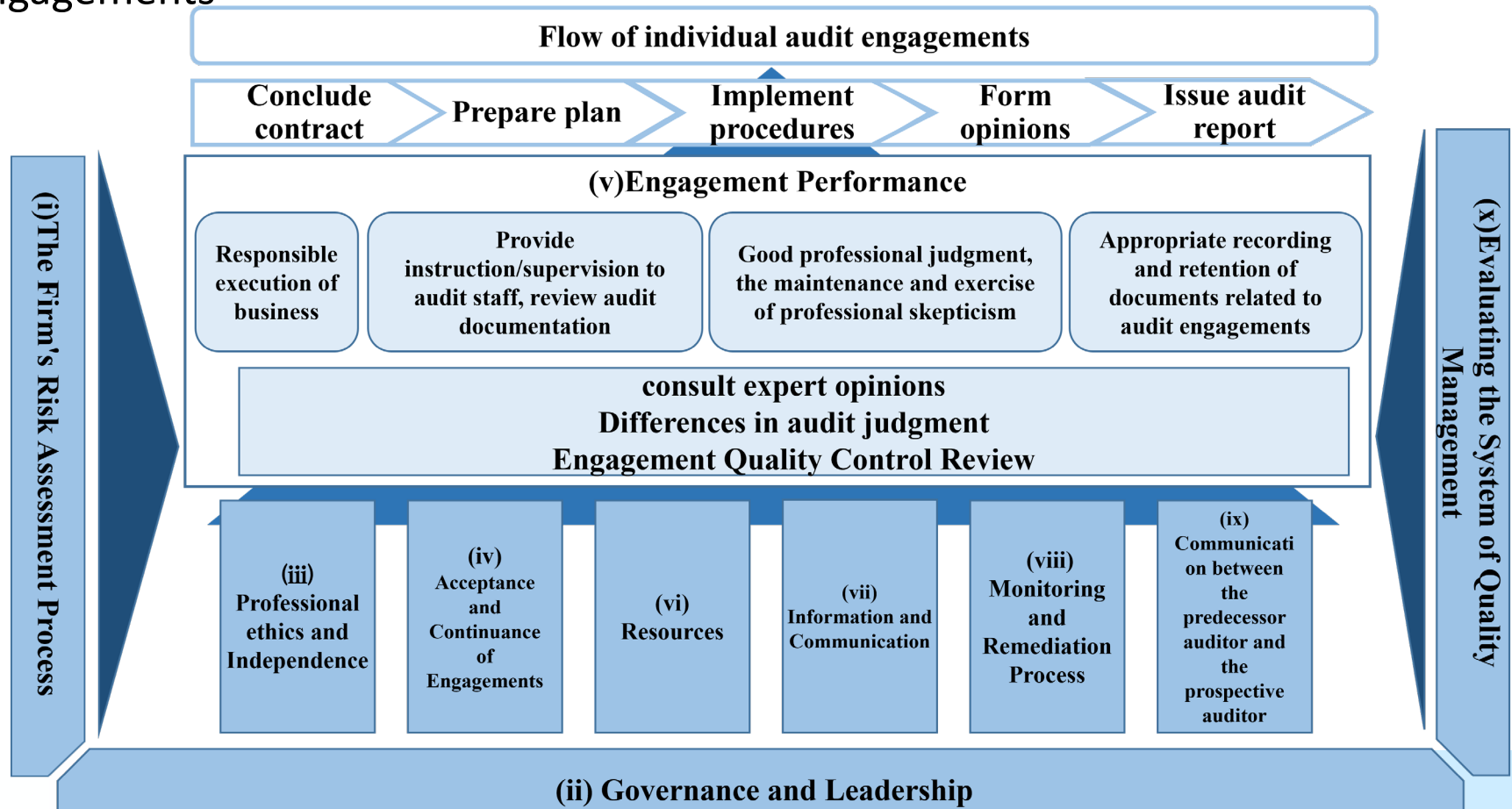
Required quality control environment

Quality Control Standards for Audits ", " Quality Control Standards Report ", etc.

See next page!

# Implementation of quality control activities

Relationship between System of Quality Management and individual audit engagements



# Implementation of quality control activities

## Analysis of deficiencies (large-sized audit firms)

General  
comments

Although deficiencies related to the establishment of a System of Quality Management have seldom been detected in recent years, deficiencies in individual audit engagements continue to be detected. Therefore, it is considered that there are deficiencies in the operation of the System of Quality Management

Others

The same or similar deficiencies are repeatedly pointed out as a result of the failure to sufficiently verify the penetration and effectiveness of measures taken to improve the deficiencies.



There are cases where efforts to improve quality control are deemed insufficient.

# Implementation of quality control activities

## Analysis of deficiencies (mid-tier audit firms and small and medium-sized audit firms)

General comments	Deficiencies continue to be identified in a wide range of areas, both in the design and operation of the System of Quality Management.
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### Major causes

- ✓ Lack of awareness and knowledge of quality control operations by the CEO, etc.
- ✓ Insufficient understanding of the depth and method of analyzing the cause of the deficiency.
- ✓ Insufficient management resources have been invested in the design and operation of the System of Quality Management.
- ✓ Lack of awareness of the need to verify the effectiveness of measures, believing that employees will respond appropriately if they are made aware of them through training, etc.

Pay particular attention to cases where the business scale has expanded due to merger or acceptance of new contracts!

# 1. Initiatives to improve operations [Large-sized audit firms]

## Characteristics of operational improvements at large-sized audit firms

Improvement measures for identified deficiencies are often drafted under the initiative of the quality control division at the head office and communicated to each engagement team through training and notifications, with each engagement team reviewing actual audit procedures

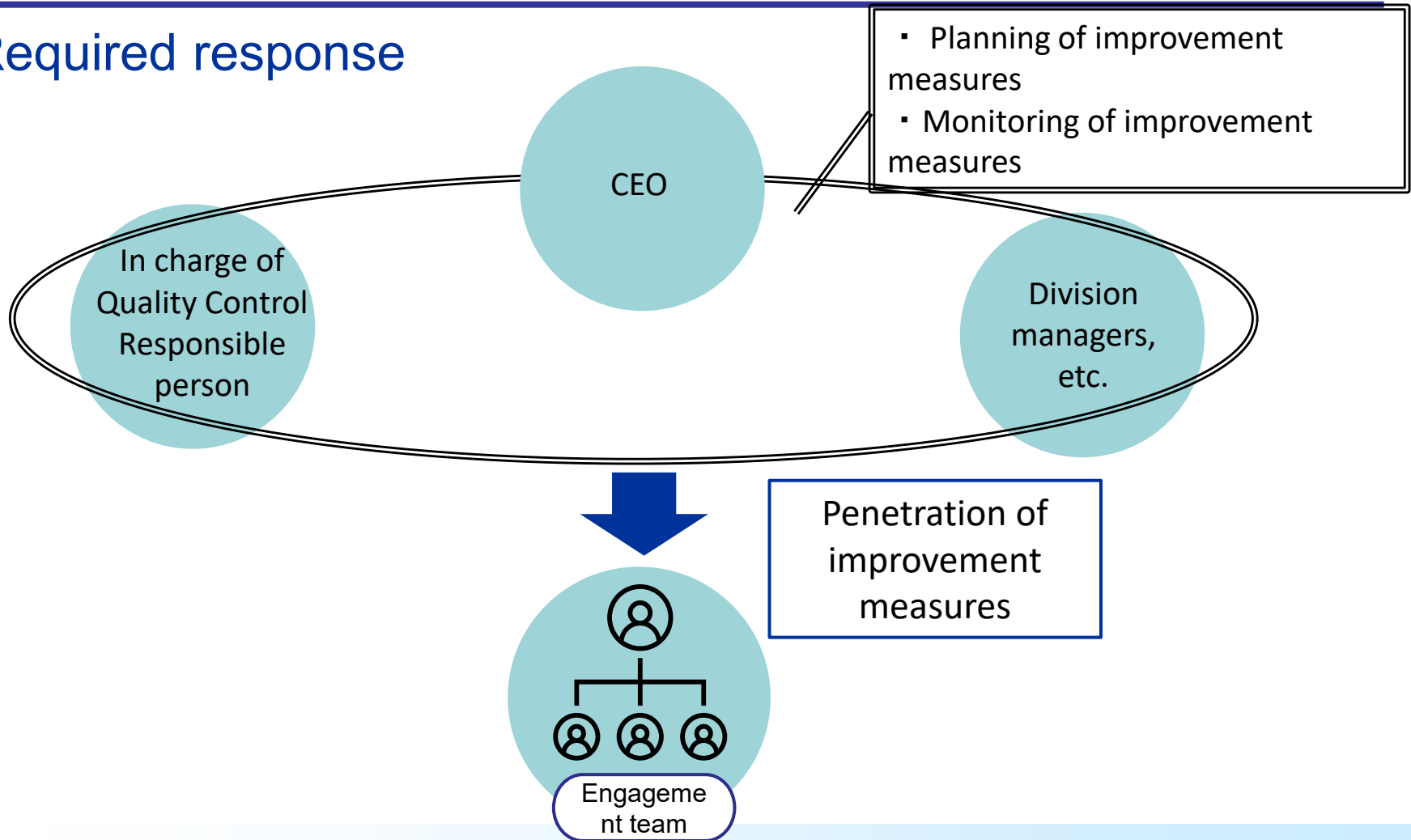
There is also a tendency to build System of Quality Management not only at headquarters but also at divisions that are closer to engagement teams in order to further disseminate improvement efforts.

### Major deficiencies

- ✓ Insufficient cooperation between the headquarters and divisions
- ✓ There is a lack of organizational support at headquarters and divisions.
- ✓ Efforts to improve operations have not permeated divisions and regional offices where human resources are fixed

# 1. Initiatives to improve operations [Large-sized audit firms]

## Required response



# 1. Efforts to Remediation [Mid-tier Audit Firms and Small and Medium-sized Audit Firms]

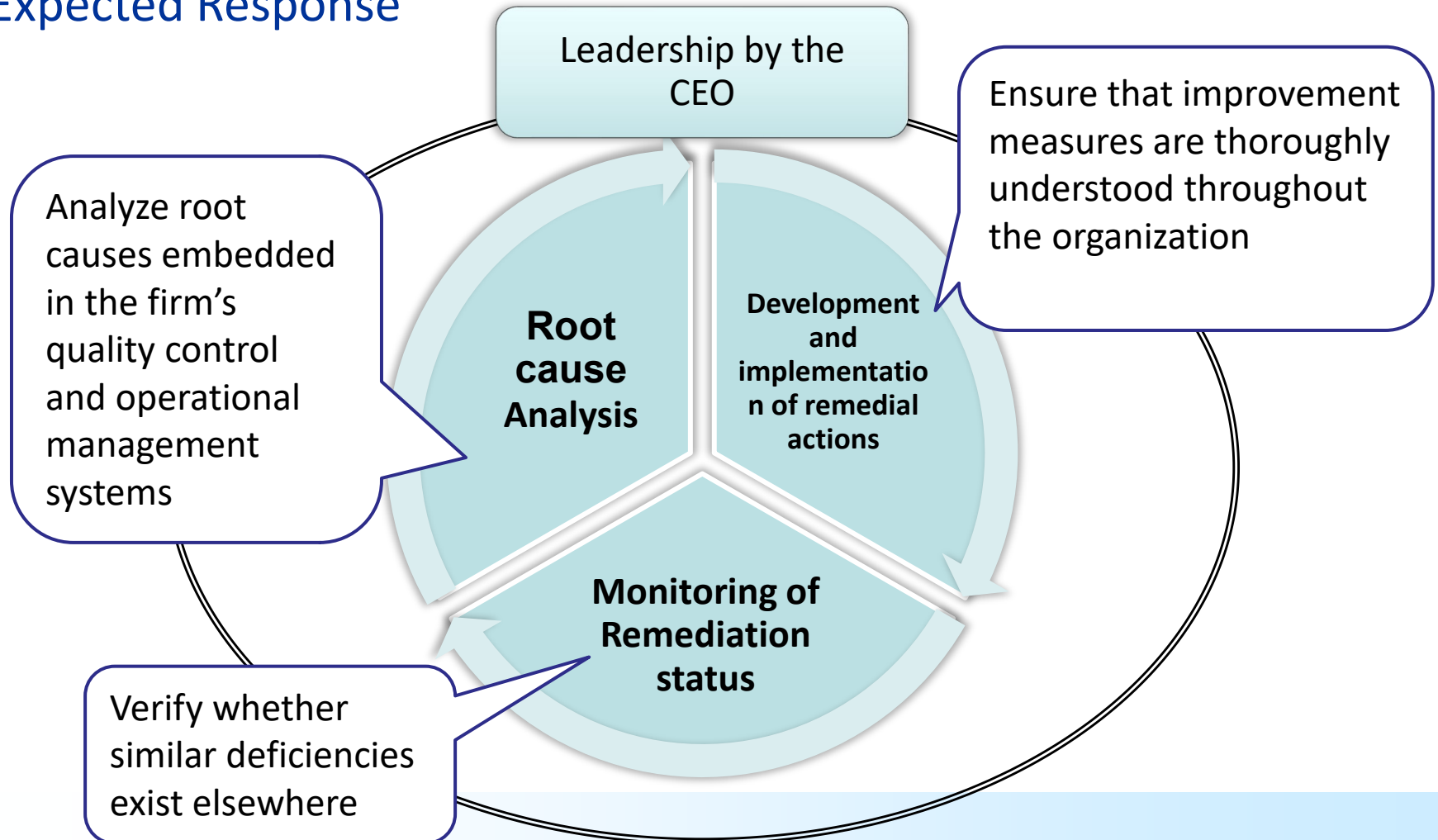
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## Major deficiencies Identified

- ✓ Root cause analysis of identified deficiencies has not been performed
- ✓ Remedial actions have been insufficient due to inadequate staffing in quality control functions
- ✓ Excessive reliance has been placed on audit documentation templates, and awareness of audit quality has not been sufficiently improved
- ✓ Information on identified deficiencies and remediation measures has not been adequately communicated to personnel, including part-time staff
- ✓ The status of remediation of deficiencies identified in CPAAOB inspections at merged audit firms has not been evaluated
- ✓ Verification of responses to identified deficiencies has been carried out in a formalistic manner

# 1. Efforts to Remediation [Mid-tier Audit Firms and Small and Medium-sized Audit Firms]

## Expected Response



## 2. Design, Implementation and Operation of Internal Rules and Compliance with Laws, Regulations, and Professional Standards

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### Design, Implementation and Operation of Internal Rules

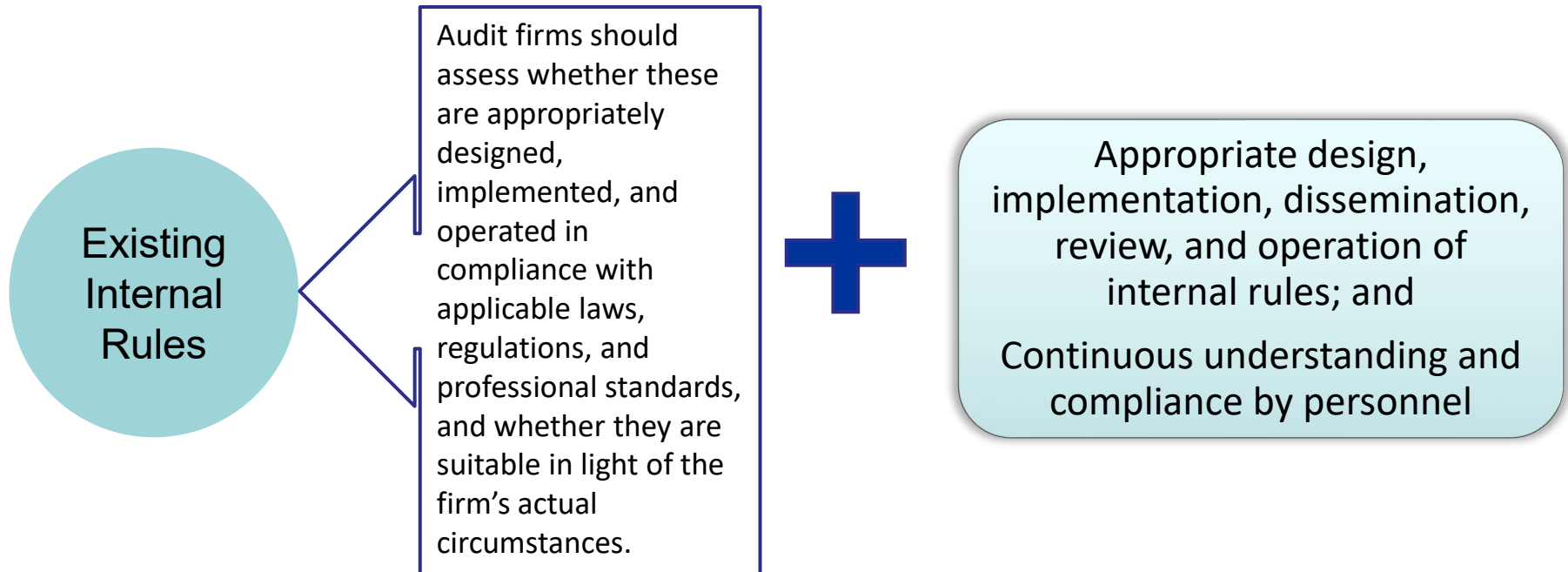
Major Deficiencies Identified	Major Causes
Internal rules have not been reviewed and updated in response to changes in the firm's size, structure, or operations	<ul style="list-style-type: none"> <li>✓ Insufficient understanding of applicable laws, regulations, and professional standards</li> <li>✓ Unmodified adoption of template rules provided by the JICPA without reflecting the firm's actual circumstances</li> </ul>
The governance structure for partners' meetings has not been appropriately established or operated	
Internal rules have not been sufficiently communicated to personnel	
Audit engagements are not performed in accordance with internal rules	

## 2. Design, Implementation and Operation of Internal Rules and Compliance with Laws, Regulations, and Professional Standards

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### Design, Implementation and Operation of Internal Rules

#### Expected response



## 2. Design, Implementation and Operation of Internal Rules and Compliance with Laws, Regulations, and Professional Standards

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### Compliance with Laws, Regulations and Professional Standards

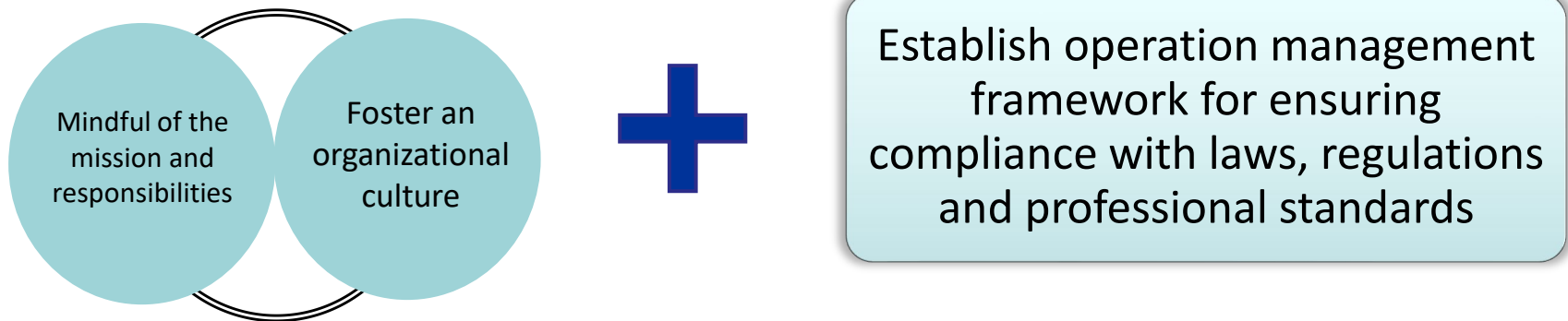
Major Deficiencies Identified	Major Causes
Failure to ensure compliance with restrictions on competition among partners	<ul style="list-style-type: none"> <li>✓ Insufficient understanding of applicable laws, regulations, and professional standards</li> <li>✓ Failure to clearly define responsible personnel and workflows for verifying compliance with such requirements</li> </ul>
Failure to ensure compliance with rotation requirements for key engagement personnel	
Inappropriate responses to inspections, such as falsification of audit documents	
False statements concerning CPA qualifications	
Failure to obtain necessary approvals for conflict-of-interest transactions	

## 2. Design, Implementation and Operation of Internal Rules and Compliance with Laws, Regulations, and Professional Standards

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### Compliance with Laws, Regulations, and Professional Standards

#### Expected Response



## 2. Design, Implementation and Operation of Internal Rules and Compliance with Laws, Regulations, and Professional Standards

### Information Security

Major Deficiencies Identified	Main Causes
Failure to appoint individuals responsible for information security	<ul style="list-style-type: none"> <li>✓ Insufficient understanding by those responsible for information security of the importance of information security</li> <li>✓ Excessive reliance on personnel's compliance with internal rules, without implementing measures to monitor actual operation</li> </ul>
Security policies are established and reviewed only on a formal basis	
Audit data is retained on personal devices in violation of internal rules	

### Expected Response

Information leakage may have serious adverse effects on the operation of the firm.

audit firms are required to establish and operate appropriate information security systems.

Strengthen them in response to advances in information technology!

## 2. Design, Implementation and Operation of Internal Rules and Compliance with Laws, Regulations, and Professional Standards

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### Prevention of Insider Trading

Major Deficiencies Identified	Main Causes
Failure to continuously implement insider trading prevention measures	<ul style="list-style-type: none"> <li>✓ The individual responsible for insider trading prevention does not comprehensively understand the prevention measures required under the internal rules</li> <li>✓ Excessive reliance on the assumption that personnel properly comply with internal rules, without verifying actual compliance</li> </ul>

### Expected Response

Establish internal rules that provide effective procedures to prevent insider trading and continuously implement insider trading prevention measures in accordance with such rules

### 3. Professional Ethics and Independence

Major Deficiencies Identified	Major Causes
Failure to confirm the independence of EQC reviewers subject to independence requirements	<ul style="list-style-type: none"> <li>✓ Procedures for independence confirmation, including timing, scope, and responsible personnel, are not clearly defined</li> <li>✓ Independence confirmation procedures are performed only as a formality, and conclusions are reached without sufficient evaluation</li> <li>✓ Failure to update internal rules in response to amendments to laws, regulations, and professional standards relating to independence</li> </ul>
Failure to perform independence confirmation procedures in a timely manner (e.g., prior to engagement commencement)	
Lists of entities subject to independence requirements are not complete or up to date	
Failure to assess long-term involvement of audit personnel as a potential threat to independence	
Misjudgment regarding the existence of a network	
Failure to assess independence in relation to non-audit services provided by related entities	
Inadequate evaluation of fee dependency	

### 3. Professional Ethics and Independence

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#### Expected Response

Establish an appropriate framework to comply with the fundamental principles of the Code of Ethics

Identify threats

Evaluate the  
significance of  
identified threats

Eliminate threats or  
reduce them to an  
acceptable level

## 4. Acceptance and Continuance of Engagements

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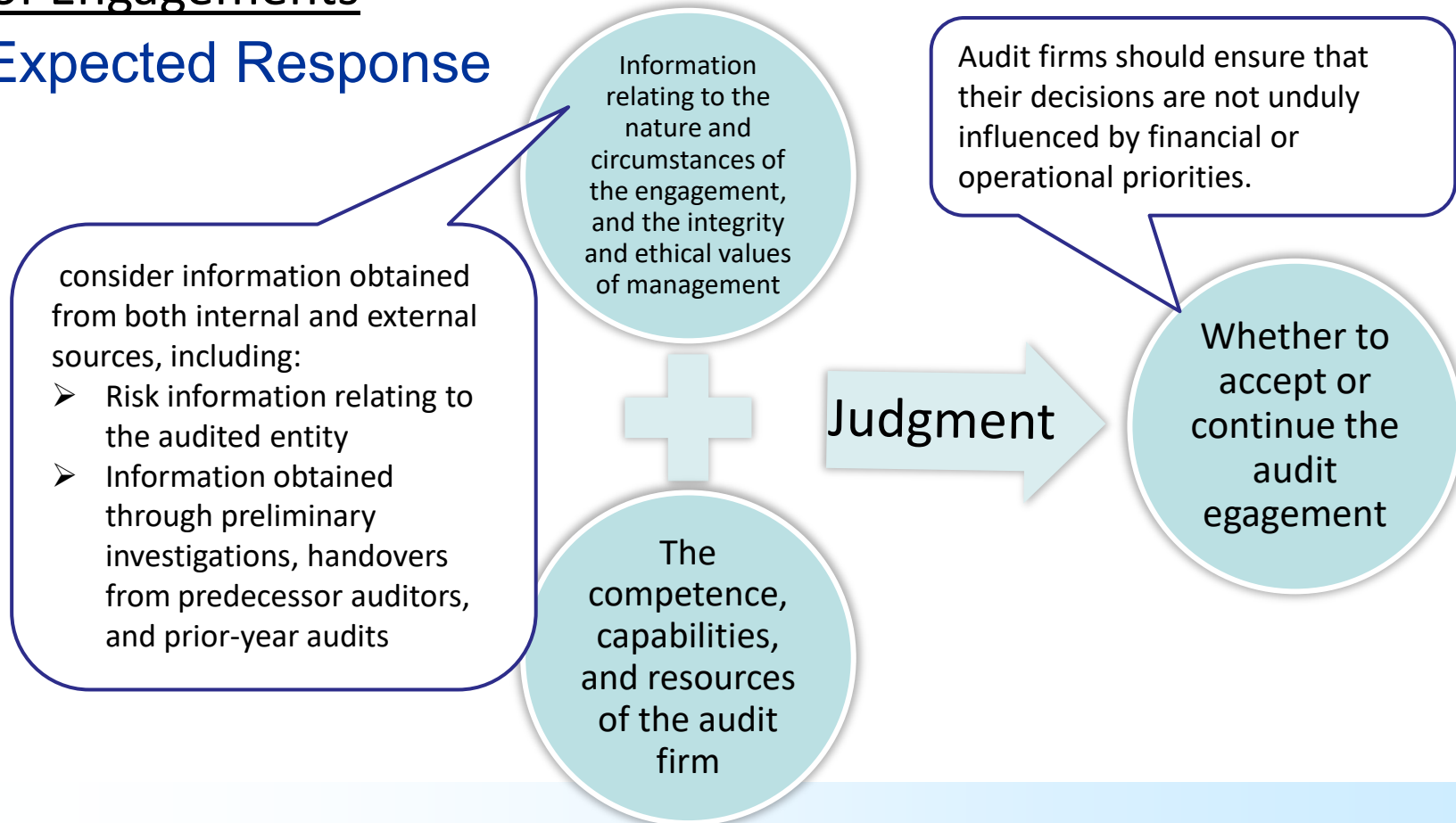
### Assessment of Risks Associated with Acceptance and Continuance of Engagements

Major Deficiencies Identified	Major Causes
Insufficient assessment of the integrity of management of the audited entity	<ul style="list-style-type: none"> <li>✓ Engagement partners prioritize the acceptance of engagements over appropriate risk assessment</li> <li>✓ Lack of sufficient experience of engagement partners to assess engagement risks based on identified facts</li> <li>✓ Insufficient understanding of the importance of firm-wide risk assessment based on information obtained from predecessor auditors</li> </ul>
Engagement risks are assessed only in a formalistic manner	
Insufficient consideration of the audit resources necessary to perform the engagement	
Failure to appropriately reflect identified inappropriate transactions in the assessment of engagement risks	

# 4. Acceptance and Continuance of Engagements

## Assessment of Risks Associated with Acceptance and Continuance of Engagements

### Expected Response



## 4. Acceptance and Continuance of Engagements

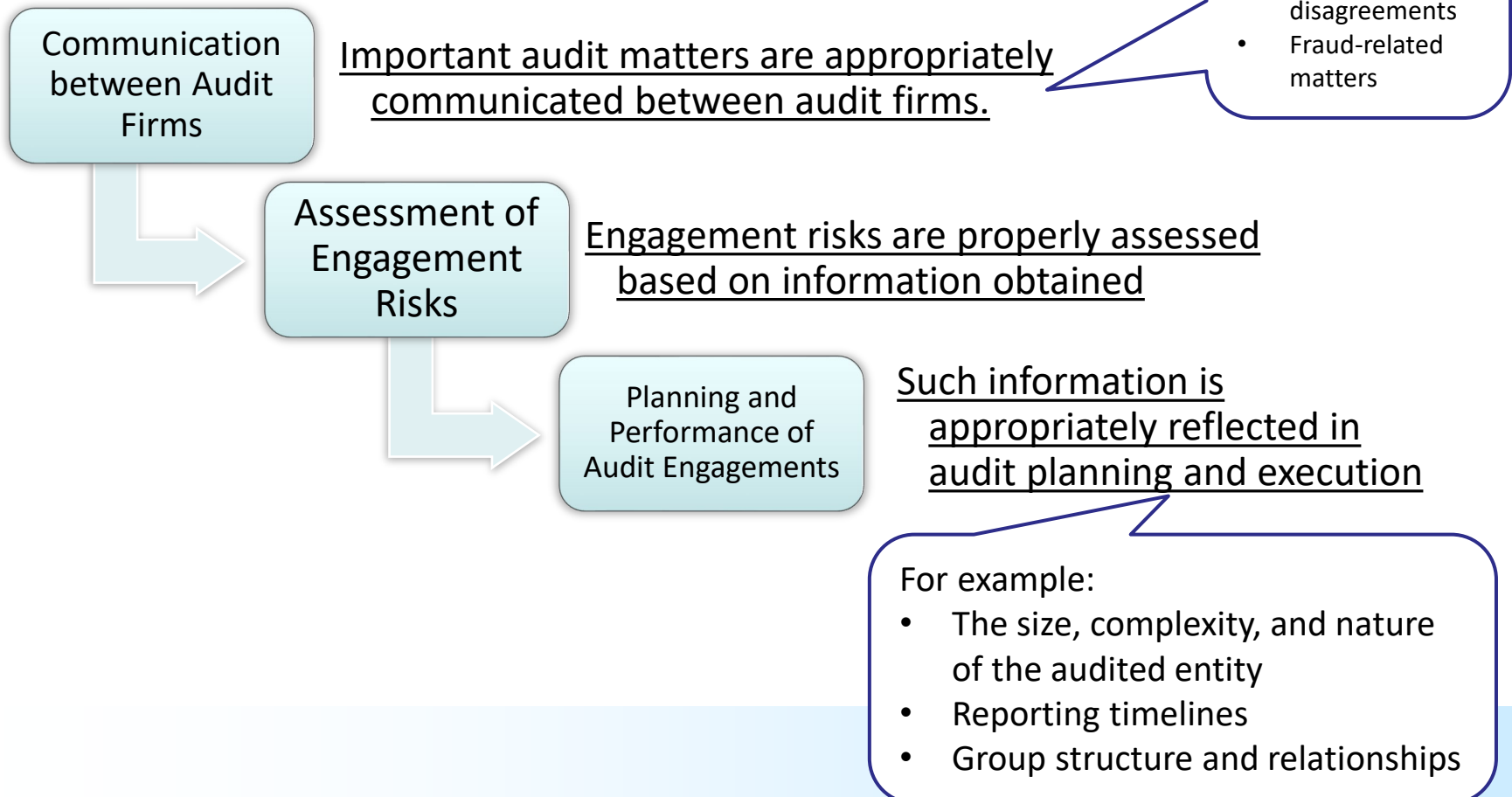
### Communication with the Predecessor Auditor

Major Deficiencies Identified	Major Causes
Failure to make inquiries to the predecessor auditor	✓ Engagement partners prioritize the early acceptance of audit engagements
Failure of the predecessor auditor to properly communicate its assessment of management integrity to the prospective auditor	✓ Overreliance on the assumption that engagement teams will comply with internal rules and appropriately perform communication procedures with the predecessor auditor

# 4. Acceptance and Continuance of Engagements

## Communication with the Predecessor Auditor

### Expected Response



## 5. Recruitment, education and training, evaluation and election

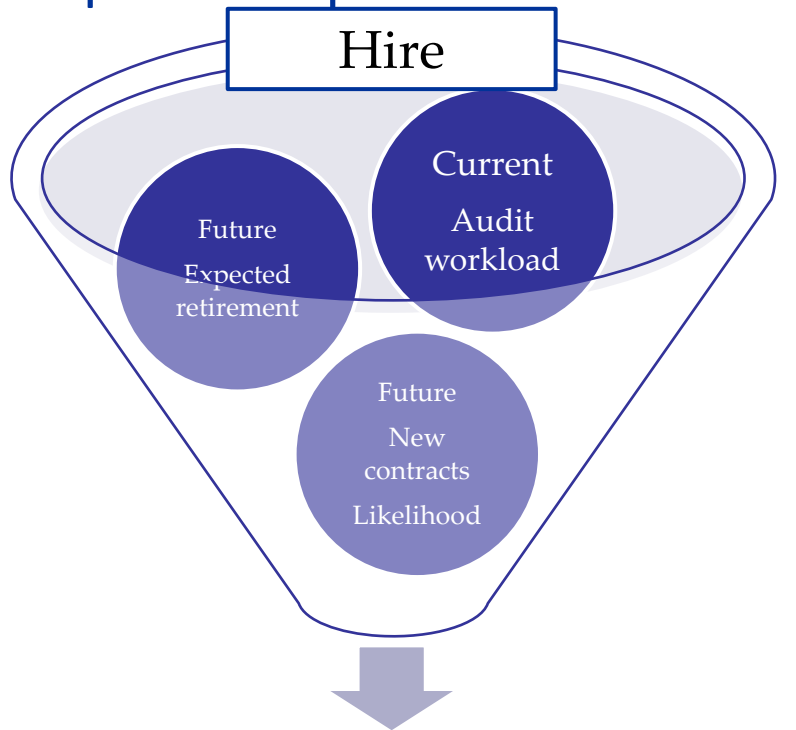
### Recruitment, education and training

Major deficiencies	Main causes of occurrence
Not engaging in optimal recruitment with emphasis on quality	<ul style="list-style-type: none"> <li>✓ The acquisition of knowledge, etc. concerning audit engagements is entirely left to the audit frontline</li> <li>✓ Not aware of the need to verify that required training has been taken</li> <li>✓ The engagement team was not aware of the need to establish an appropriate education and training system as an engagement team.</li> </ul>
Opportunities for education and training on fraud are not provided.	
Training programs based on issues pointed out by external inspections were not planned or planned.	
No training is provided to part-time personnel who have graduated from large-sized audit firms	
No measures are taken for employees who have not taken the required training.	

# 5. Recruitment, education and training, evaluation and election

## Recruitment, education and training

### Required response



**It is necessary to estimate the appropriate number of required recruits.**

### Education and training

Identifying audit areas where understanding is insufficient

Part-time or unqualified Engagement team

Due consideration should be given to the knowledge, capabilities and experience of each professional staff.

Formulation of training content

Implementation of training

Implement measures to encourage employees to attend classes, such as by checking the status of attendance.

Dissemination through review of audit documentation, etc.!

Utilize on the audit frontline

## 5. Recruitment, education and training, evaluation and election

### Evaluation, remuneration and promotion

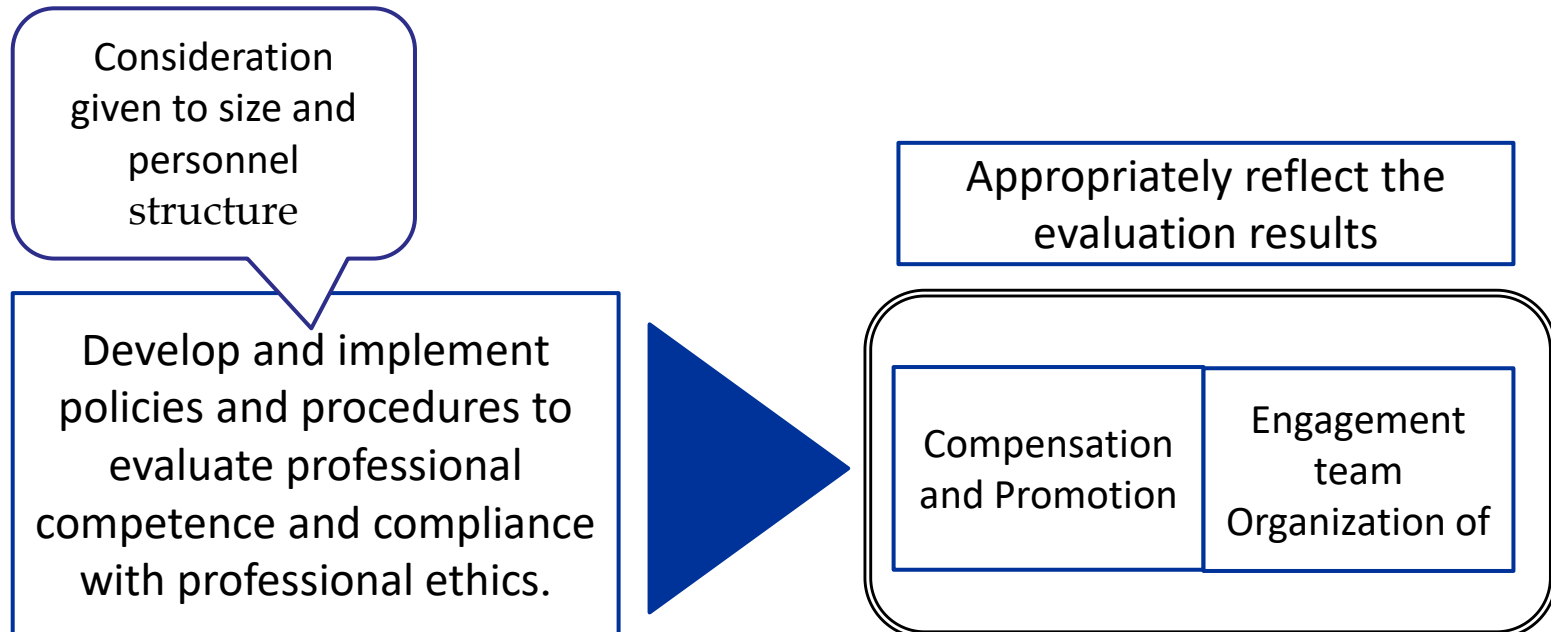
Major deficiencies	Main causes of occurrence
Evaluations of assistants to engagement partners were not discussed or approved by the partners' meeting;	<ul style="list-style-type: none"> <li>✓ In evaluating professional staff and determining their remuneration, determining the remuneration of partners, etc. based on the CEO's subjective assessment</li> <li>✓ We believe that there are no major differences in the quality of audit engagements between partners, etc.</li> <li>✓ Because the organization has a small number of employees, we believe it is important not to make any difference in evaluations among employees.</li> </ul>
There is no mechanism to fairly evaluate the enhancement and maintenance of capabilities by assistants to engagement partners	
There are no specific evaluation criteria for employees.	
There are no evaluation items related to audit quality in partner evaluations.	
Evaluation of audit quality, etc. is not reflected in the determination of partners' remuneration;	
No evaluation of part-time staff	

# 5. Recruitment, education and training, evaluation and election

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## Evaluation, remuneration and promotion

### Required response



## 5. Recruitment, education and training, evaluation and election

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### Appointment

Major deficiencies	Main causes of occurrence
The engagement team did not appropriately monitor whether engagement partners had secured sufficient time;	✓ The engagement team did not conduct an appropriate external evaluation in line with the actual situation of the audited company.
Engagement partners are not reviewed in accordance with audit results	✓ Assigning engagement partners with priority given to the audit division to which they belong
Insufficient monitoring by the head office concerning the organization of administrative teams	✓ Prioritizing the acquisition of new audit engagements
Inadequate selection of IT experts	✓ The engagement team did not understand the customs kill and capacity of engagement partners, etc.
The CPAAOB has not properly set up contact points for expert opinions.	

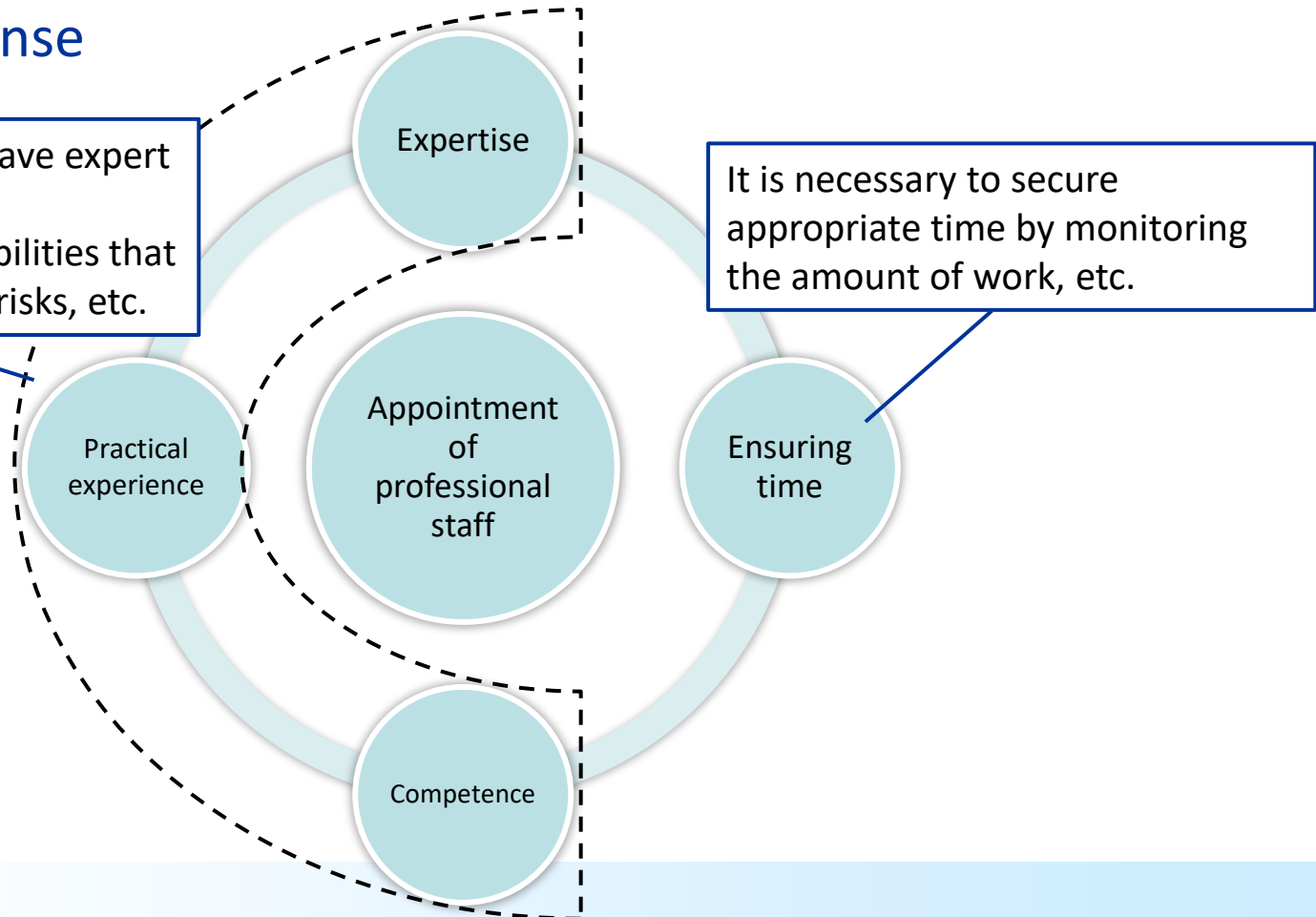
# 5. Recruitment, education and training, evaluation and election

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## Appointment

### Required response

The audit firm must have expert knowledge, practical experience, and capabilities that are suitable for audit risks, etc.



## 6. Audit Documentation

### Preparation of audit documentation and supervision / review by superiors

Major deficiencies	Main causes of occurrence
Engagement partners did not appropriately direct or supervise assistants to engagement partners;	✓ Placing excessive reliance on engagement partners conducting reviews;
Lack of critical attitude toward audit documentation by assistants to engagement partners who graduated from large-sized audit firms and by Snow's partners	✓ The audit firm was not sufficiently aware of the importance of the role of the audit documentation; ✓ Performing audit procedures is left to assistants to engagement partners
The engagement team did not conduct in-depth reviews of external high-level areas;	✓ The engagement team thought that an oral explanation, etc. would be sufficient, so it did not review the audit documentation;

## 6. Audit Documentation

### Preparation of audit documentation and supervision / review by superiors

#### Required response

Understands the instructions and performs the work in accordance with the audit plan;

Direction and supervision



Engagement partner

Whether the conclusions reached by the engagement team are supported by the audit evidence obtained;

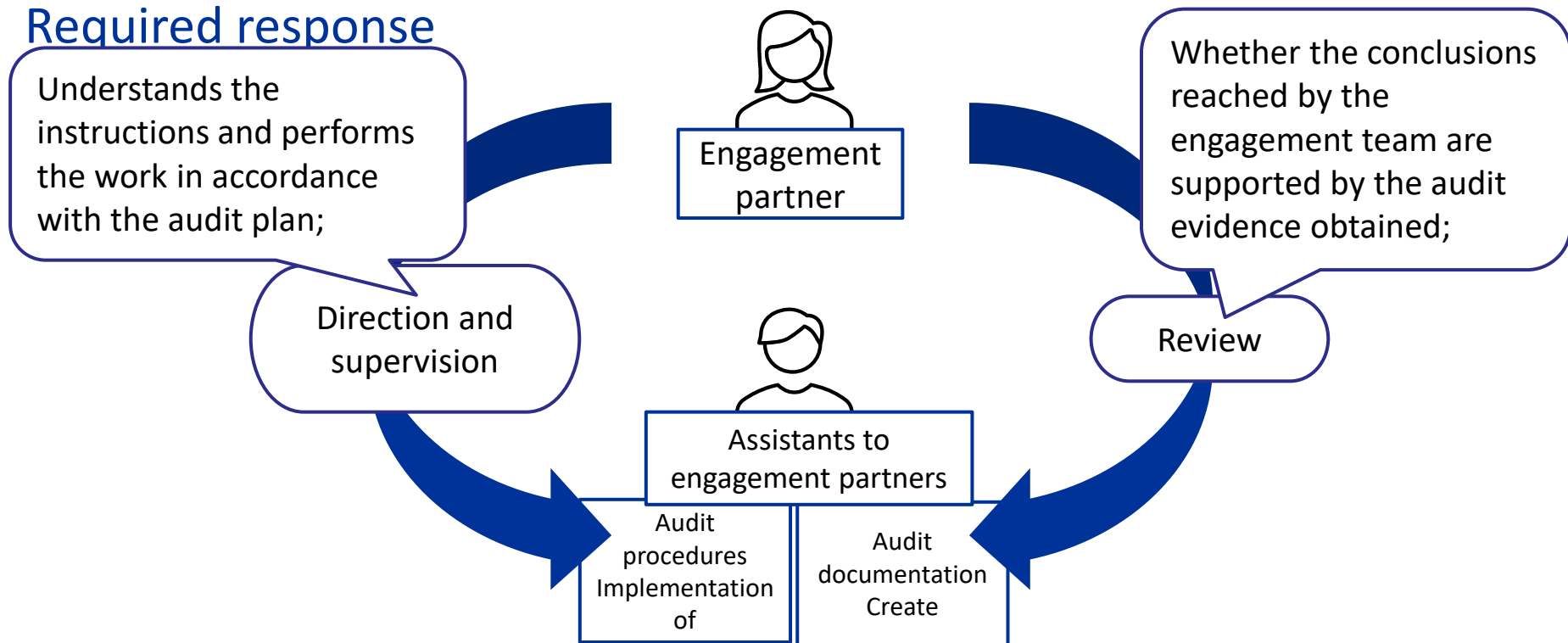
Review



Assistants to engagement partners

Audit procedures  
Implementation of

Audit documentation  
Create



## 6. Audit Documentation

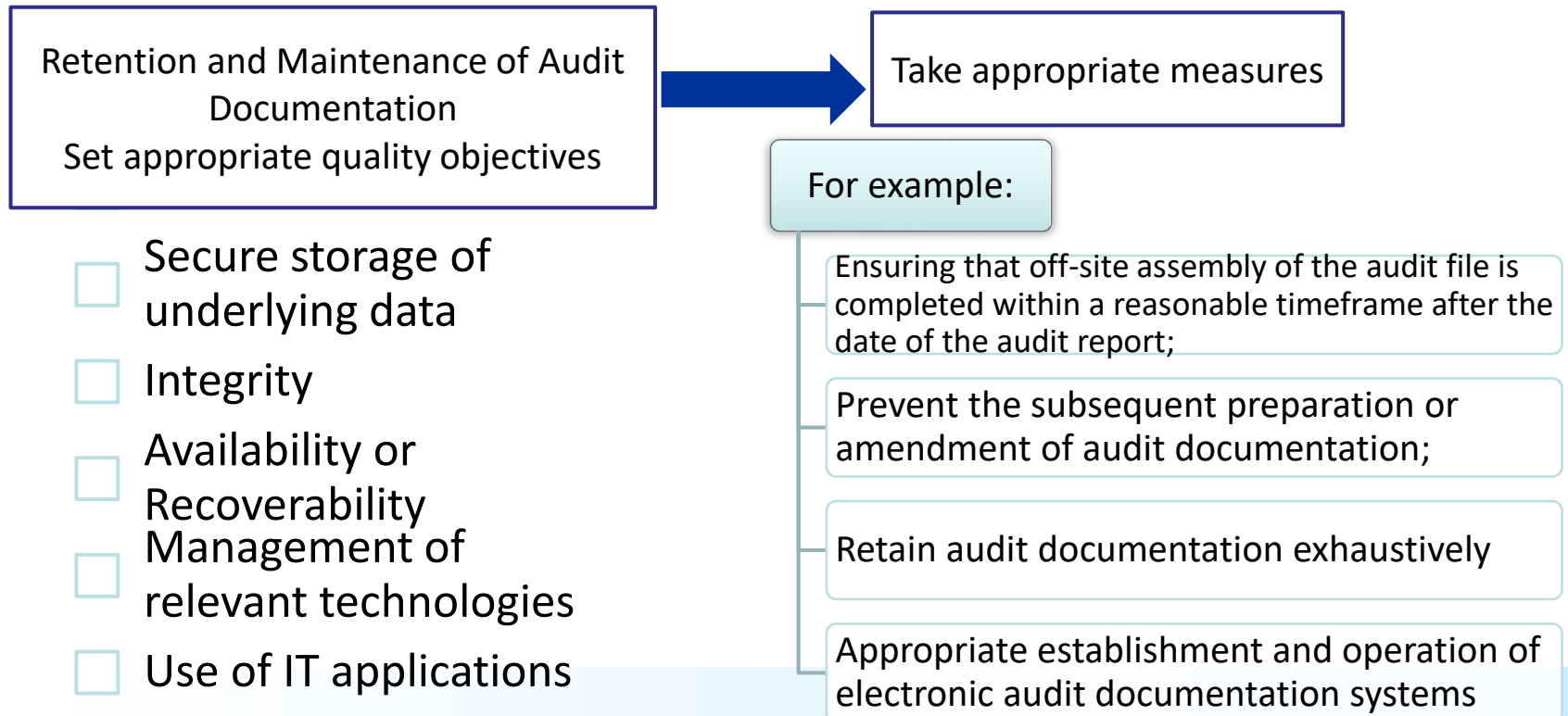
### Alternative arrangements of audit files and control and retention of audit documentation

Major deficiencies	Main causes of occurrence
Some of the audit documentation was not retained in the audit file;	✓ No sense of guilt about preparing or amending audit documentation after the date of the audit report;
Amendments to audit documentation made after the deadline for preparing audit documentation: Specific reasons for amendments, etc. were not documented.	✓ Insufficient awareness of the control of audit documentation
The preparation date and review date included in the electronic audit documentation are post-hoc.	
Audit documentation was systematically falsified in order to avoid deficiencies being identified in external inspections, etc.	
Audit documentation is newly prepared or revised after the date of the audit report;	

## 6. Audit Documentation

### Alternative arrangements of audit files and control and retention of audit documentation

#### Required response



## 7. Review of Audit Engagements

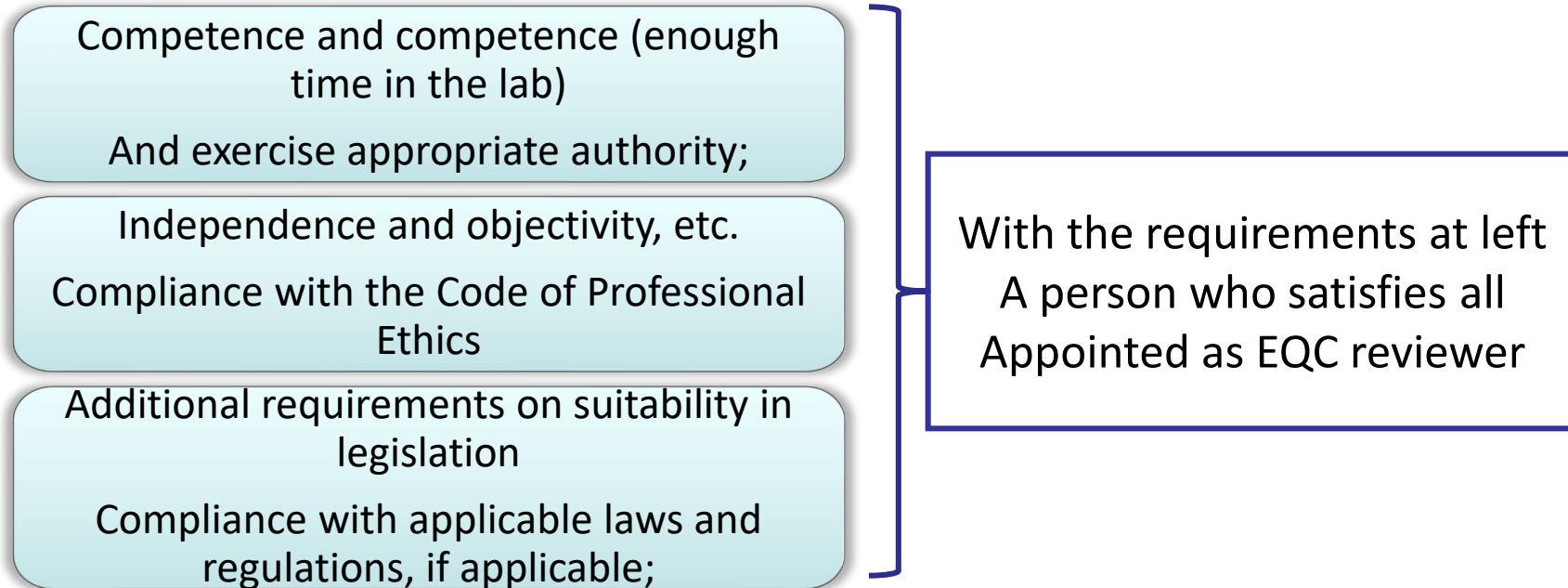
Major deficiencies	Main causes of occurrence
The suitability of the EQC reviewer was not considered.	<ul style="list-style-type: none"> <li>✓ Insufficient recruitment and training of EQC reviewers</li> <li>✓ The EQC reviewer does not spend enough time on the review</li> <li>✓ No attention was paid to matters pointed out in external inspections, etc.</li> <li>✓ Lack of a critical attitude toward audit teams</li> <li>✓ The branch awareness, etc. was not shared between the engagement team and the EQC reviewer.</li> </ul>
The engagement team did not request a review by the partners' meeting prescribed in the internal rules when a significant problem occurred.	
Engagement partners were not sufficiently discussed and audit documentation was not sufficiently reviewed;	
The fact that an audit had not been completed and an audit opinion could not be expressed was not communicated to the audited company;	

# 7. Review of Audit Engagements

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## Required response

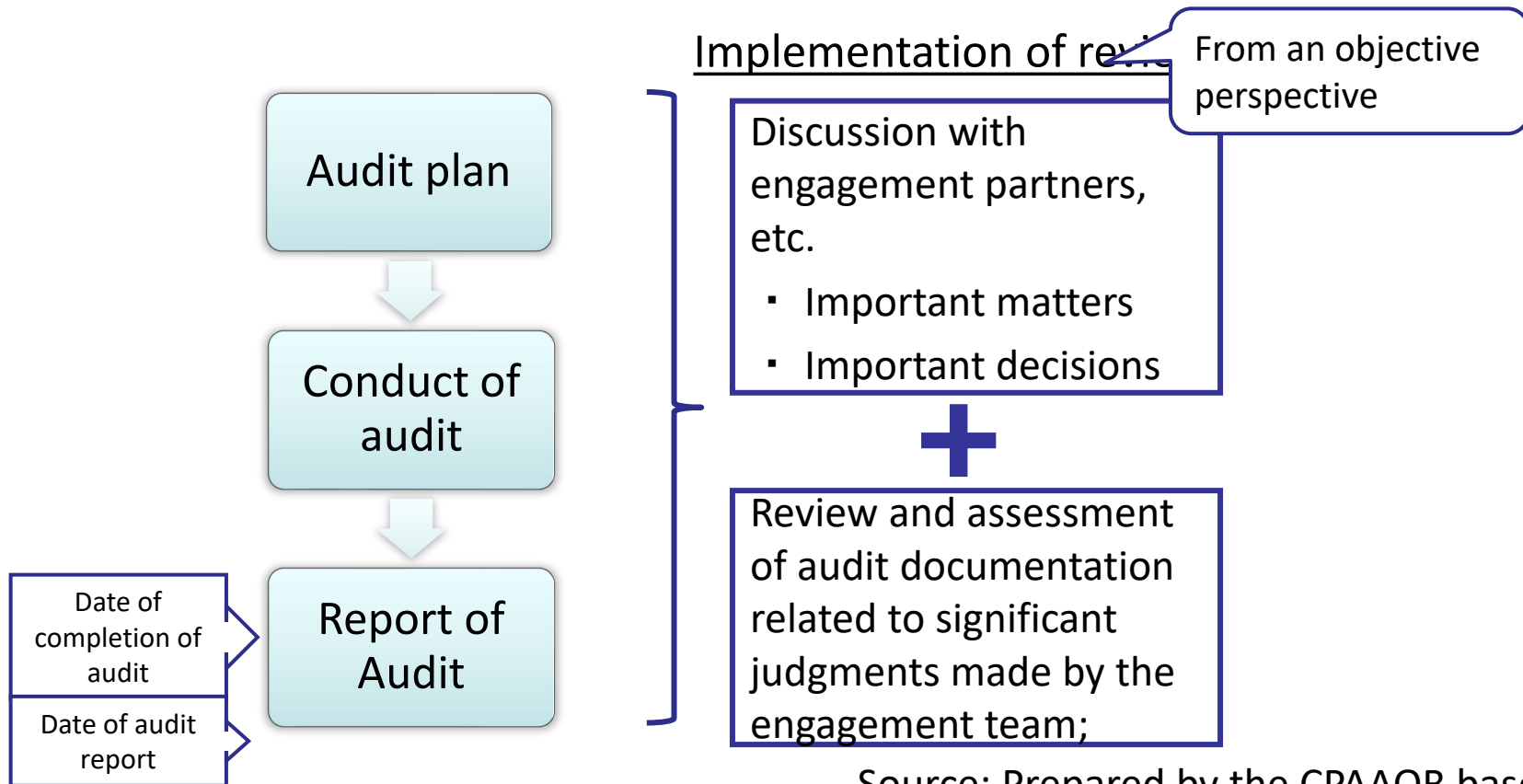
### Eligibility of EQC reviewer



Source: Prepared by the CPAAOB based on data published by the JICPA

# 7. Review of Audit Engagements

## Required response



Source: Prepared by the CPAAOB based on data published by the JICPA

## 8. Monitoring the quality control system

Major deficiencies	Main causes of occurrence
Certain engagement partners are not subject to regular reviews;	✓ The engagement team did not sufficiently understand the importance of monitoring the quality control system, and did not allocate sufficient time or personnel for verification.
Monitoring activities are conducted in a formal manner	
The PICOQC did not direct or supervise the monitoring activities.	
A system is in place to monitor the quality control system while the CEO is off.	
Audit documentation was not reviewed during periodic inspections;	
Deficiencies in individual audit engagements were not appropriately identified through periodic inspections;	
Information on the hotline was not appropriately communicated to the PICOQC, etc.	

## 8. Monitoring the quality control system

### Required response

#### Other

Self-discovery and understanding of quality control system issues  
Taking corrective action on a voluntary basis;

Identification of items to be selected and inspected for individual audit engagements

- Size, industry type, etc. of audited company
  - Tenure and experience of engagement partners
  - Results of past periodic reviews
  - Results of the CPAAOB
  - Quality Management View Results
- Take into account

Appointment of Qualified Implementers

- It is necessary to have sufficient time for effective monitoring activities and other aptitude, appropriate ability, and objectivity
- Even if an external person is appointed, confirm that the monitoring function is exercised.

Establishment of a monitoring framework that ensures effectiveness

- Establish a system to confirm the appropriateness of corrective measures.
- Properly manage the execution history of periodic inspections.
- Establish internal and external reporting systems

## 9. Cooperation with Audit & Supervisory Board Members, etc.

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Major deficiencies	Main causes of occurrence
The matters required by the ASS were not communicated to company auditors, etc.	✓ Lack of understanding of items that should be communicated with company auditors, etc.
The CPAAOB did not communicate the details of the quality control left view results notification received to the company auditors, etc.	

# 9. Cooperation with Audit & Supervisory Board Members, etc.

## Required response

- Accounting auditors need to improve the effectiveness of audits by sharing information with company auditors on the implementation status of audits at each stage, from the formulation of audit plans to the implementation of audit procedures and the formation of audit opinions, as well as the significant situations identified in the process.
- The engagement team shall support the audit team to ensure effective communication between the audit team and the Audit & Supervisory Board members, etc.



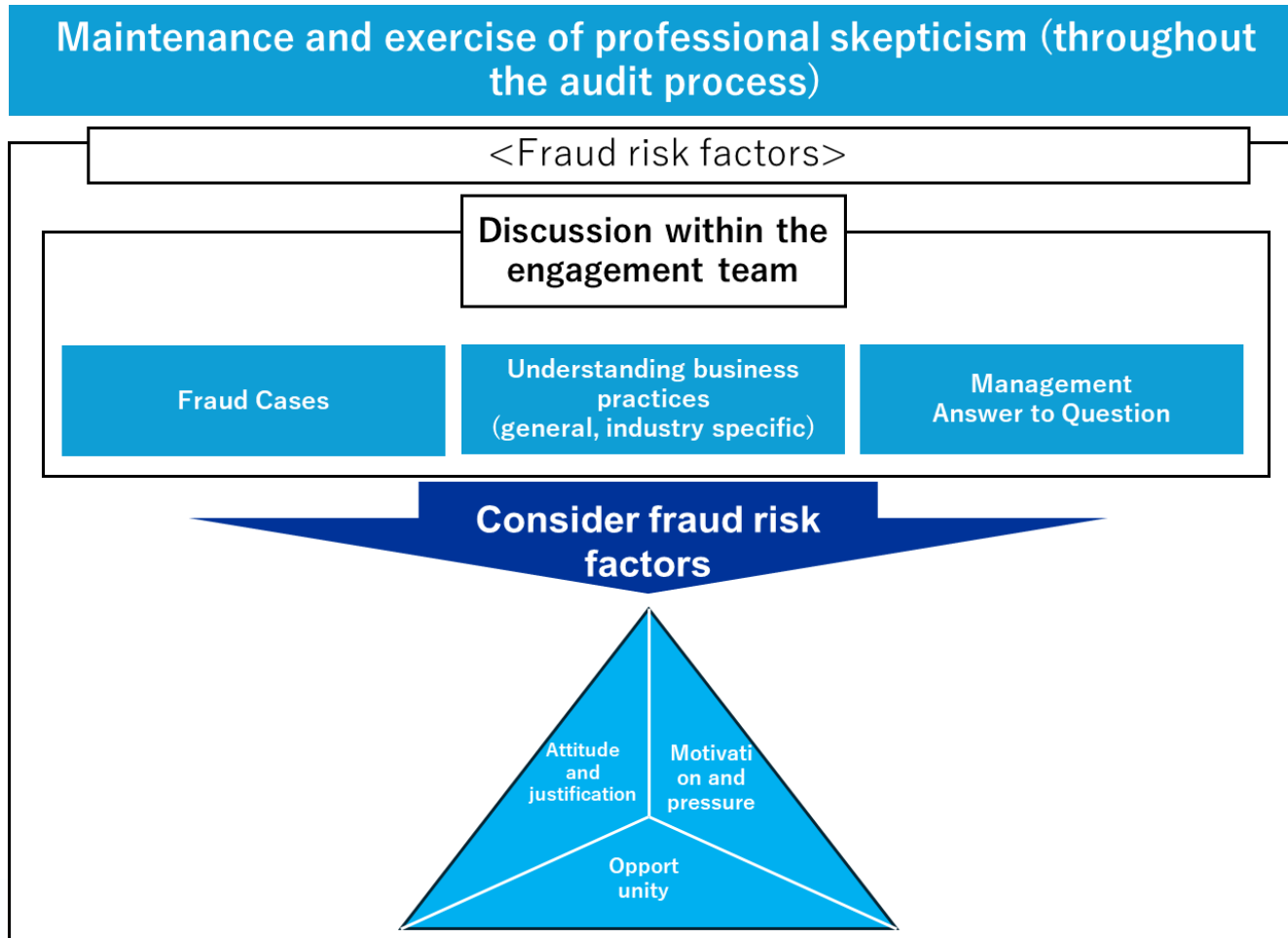
## III. Individual audit engagements

# 1. Fraud in the audit of financial statements

item	Major deficiencies
Fraud identification and assessment	<ul style="list-style-type: none"> <li>✓ Insufficient consideration of fraud methods</li> <li>✓ Insufficient rebuttal of revenue recognition failure to identify fraudulent medicines</li> <li>✓ Insufficient examination of the causes of the fraudulent branch (motives, promoters, etc.)</li> <li>✓ Insufficient consideration of whether the information obtained indicates fraud or others.</li> </ul>
Responses to fraud assessed	<ul style="list-style-type: none"> <li>✓ Failure to obtain audit evidence that is more relevant or reliable</li> <li>✓ Mismatch between fraud risk scenarios and substantive procedures</li> <li>✓ Inadequate consideration of the possibility of fraud in unusual transactions, etc.</li> </ul>
Response to management override internal controls	<ul style="list-style-type: none"> <li>✓ Consideration of fraud scenarios based on the understanding of the project team regarding journal entry has not been conducted.</li> </ul>
Consideration of doubts	<ul style="list-style-type: none"> <li>✓ Failure to examine whether there are suspected material misstatements due to fraud when circumstances that indicate possible material misstatements due to fraud have been identified</li> </ul>

# 1. Fraud in the audit of financial statements

(Required action 1/2)



# 1. Fraud in the audit of financial statements

## Required action 2/2

- Give due consideration to where and how material misstatements due to fraud could occur in the financial statements with respect to revenue recognition;
- Obtain more relevant, persuasive or corroborated by multiple sources audit evidence for the fraud than for an assertion that does not identify the fraud;

Audit evidence required for risks of material misstatement due to fraud

Than when no fraud risk is identified

Quality

Quantity

More relevant

Stronger evidence

or

More

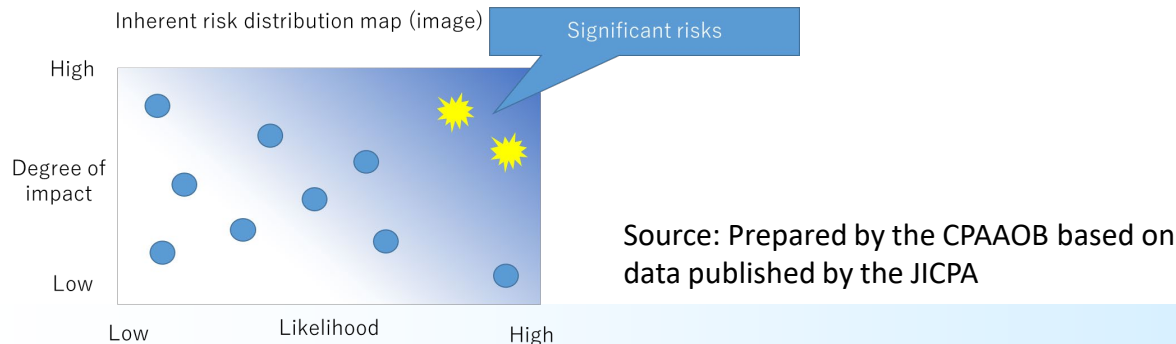
## 2. Risk Assessment and Response to Assessed Risks

item	Major deficiencies
Audit plan	<ul style="list-style-type: none"> <li>✓ Failure to consider whether revision of the audit plan was necessary in light of changes in the entity and its environment</li> </ul>
Understanding of the entity and its environment	<ul style="list-style-type: none"> <li>✓ Failure to obtain an understanding of information processing activities related to significant account balances</li> <li>✓ Failure to obtain an understanding of the audited company's accounting policies</li> <li>✓ Failure to obtain an understanding of internal controls designed to address significant risks.</li> </ul>
The auditor's procedures in response to assessed risks	<ul style="list-style-type: none"> <li>✓ Failure to perform substantive procedures in response to risks of material misstatement</li> <li>✓ Insufficient evaluation of the appropriateness of the presentation and disclosures in the financial statements</li> </ul>
Evaluation of misstatements identified during the audit	<ul style="list-style-type: none"> <li>✓ Failure to evaluate the effect of identified misstatements on the audit of internal control over financial reporting, to include them in the management representation letter, and to communicate them to those charged with governance</li> </ul>

## 2. Risk Assessment and Response to Assessed Risks

### Required response

- Auditors should obtain a sufficient understanding of the entity and its environment and perform risk assessment based on that understanding. They should also carefully identify and assess risks by referring to this casebook and audit guidance issued by the JICPA.
- The auditor should determine the nature, timing, and extent of further audit procedures from the perspective of whether sufficient appropriate audit evidence can be obtained in response to the assessed risks.
- In response to the revisions to ASS No.315, the auditor should appropriately evaluate inherent risk by considering inherent risk factors such as complexity, subjectivity, change, and uncertainty.



## 3. Audit evidence

### (1/2) units

item	Major deficiencies
Common matters	<ul style="list-style-type: none"> <li>✓ Failure to obtain sufficient appropriate audit evidence in response to significant risks</li> <li>✓ Inappropriate design and execution of audit procedures, including improper use of dual-purpose testing</li> <li>✓ Insufficient evaluation of the reliability and relevance of information used as audit evidence</li> <li>✓ Inadequate evaluation of the competence, capabilities, and objectivity of management's experts</li> <li>✓ Failure to perform audit procedures covering the entire relevant audit period (including intervening periods)</li> </ul>
Confirmation procedures	<ul style="list-style-type: none"> <li>✓ Failure to appropriately evaluate the reliability and validity of responses</li> <li>✓ Inadequate performance and follow-up of confirmation procedures, including alternative procedures and investigation of differences</li> </ul>
Substantive analytical procedures	<ul style="list-style-type: none"> <li>✓ Failure to ensure the reliability of data</li> <li>✓ Failure to obtain appropriate audit evidence to support management's explanations</li> </ul>

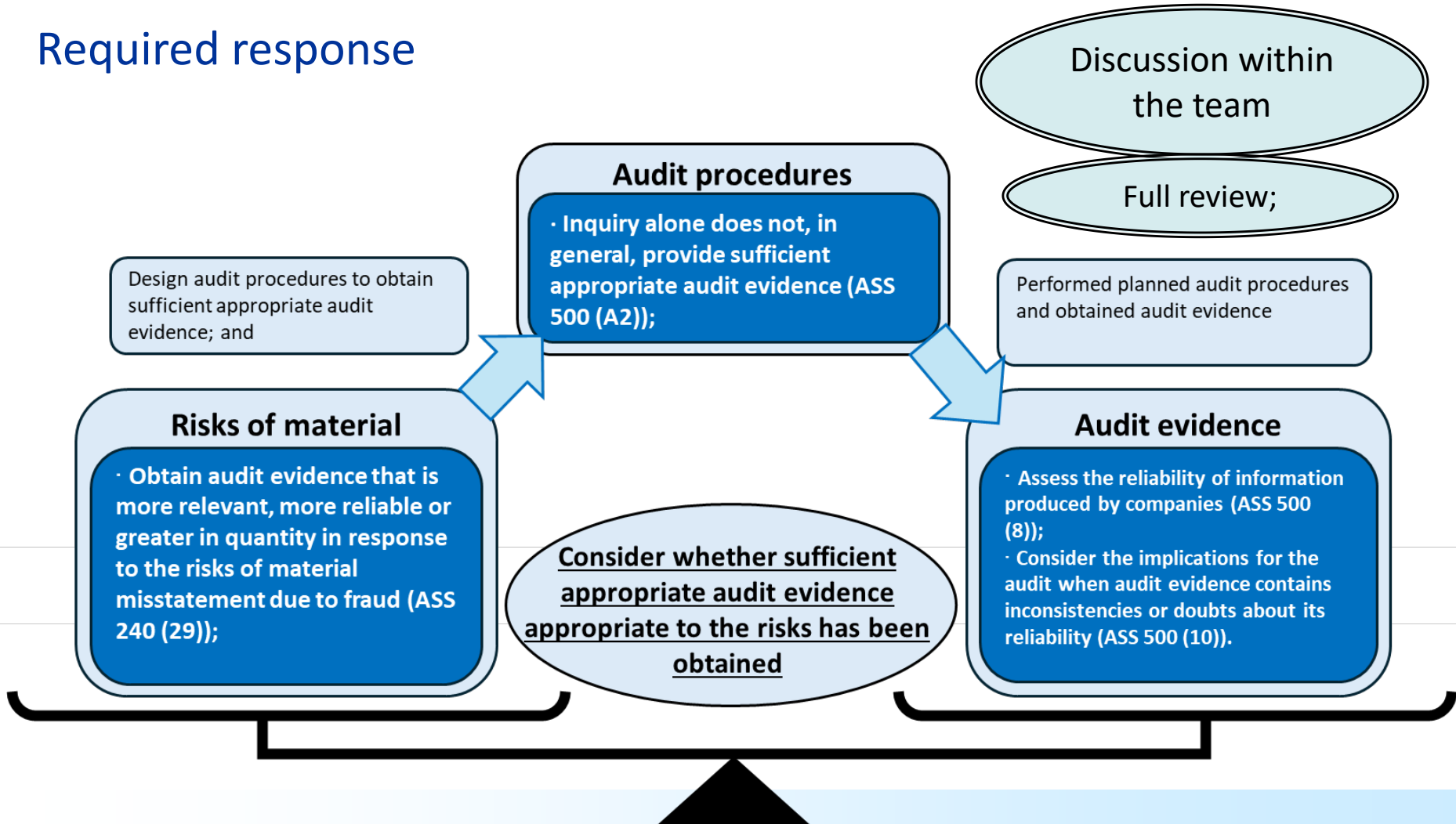
## 3. Audit evidence

(2/2 doses)

item	Major deficiencies
Audit sampling	<ul style="list-style-type: none"> <li>✓ Inappropriate design and execution of audit sampling, including improper population definition, biased sample selection, and failure to evaluate alternative procedures</li> </ul>
Testing by selecting specific items	<ul style="list-style-type: none"> <li>✓ Inappropriate use of selective testing without evaluating the need for testing the remaining population</li> </ul>
Related parties	<ul style="list-style-type: none"> <li>✓ Failure to identify and investigate related party relationships and transactions</li> <li>✓ Insufficient professional skepticism and evaluation of unusual or non-routine transactions involving potential related parties</li> </ul>
Going concern assumption	<ul style="list-style-type: none"> <li>✓ Failure to obtain sufficient appropriate audit evidence to support management's assessment of going concern, particularly regarding financing arrangements and cost reduction measures</li> </ul>
Subsequent events	<ul style="list-style-type: none"> <li>✓ Failure to evaluate whether a subsequent event requires disclosure</li> </ul>

# 3. Audit evidence

## Required response



## 4. Auditing Accounting Estimates

(1/3)

Item	Major deficiencies
Impairment of fixed assets	
[Risk assessment]	<ul style="list-style-type: none"> <li>✓ The degree of estimation uncertainty was not assessed.</li> <li>✓ The engagement team did not consider which assumptions were material.</li> <li>✓ No consideration was given to the finalized amounts of prior periods accounting estimates.</li> </ul>
[Estimation method]	<ul style="list-style-type: none"> <li>✓ Asset grouping, allocation standards for head office expenses were not understood.</li> <li>✓ Examination of the reasonableness of the budget for the next fiscal year pertaining to business that incurred consecutive losses was not conducted.</li> <li>✓ Whether or not operating losses are significantly below the business plan was not examined.</li> </ul>
[Key assumptions]	<ul style="list-style-type: none"> <li>✓ No examination was given to the assumption that future cash flows after the plan will remain at the same level.</li> <li>✓ Consideration of sales volume, sales unit price, etc., which are important assumptions, was not conducted.</li> <li>✓ Impact of management policies for the next fiscal year and beyond on future cash flows was not examined.</li> <li>✓ The necessity of using the services of experts in real estate appraisal was not examined.</li> </ul>
[Data]	<ul style="list-style-type: none"> <li>✓ Reliability of profit / loss information for each asset group was not examined.</li> </ul>

## 4. Auditing Accounting Estimates

(2/3)

Item	Major deficiencies
Goodwill	<ul style="list-style-type: none"> <li>✓ Consideration of the appropriateness of the amortization period for goodwill was not examined.</li> <li>✓ Comparison between business plan and actual results at the time of stock acquisition were not examined.</li> <li>✓ Management's assumptions, including the key assumptions in the business plan were not sufficiently examined</li> </ul>
Recoverability of deferred tax assets	<ul style="list-style-type: none"> <li>✓ The figure related to significant assumptions and significant data in the business plan were not examined.</li> <li>✓ Consistency with estimated future cash flows for impairment of fixed assets was not confirmed.</li> <li>✓ Insufficient examination on the appropriateness of loan scheduling for borrowers with deteriorating business performance.</li> </ul>
Inventories	<ul style="list-style-type: none"> <li>✓ Appropriateness of the valuation method was not examined.</li> <li>✓ Impact of actual the current period sales volume falling short of estimated sales volume on net selling price assumption was not examined.</li> <li>✓ Examination of reasonableness of estimation method and accuracy of basic data for selling price and estimated additional manufacturing cost was not examined.</li> </ul>

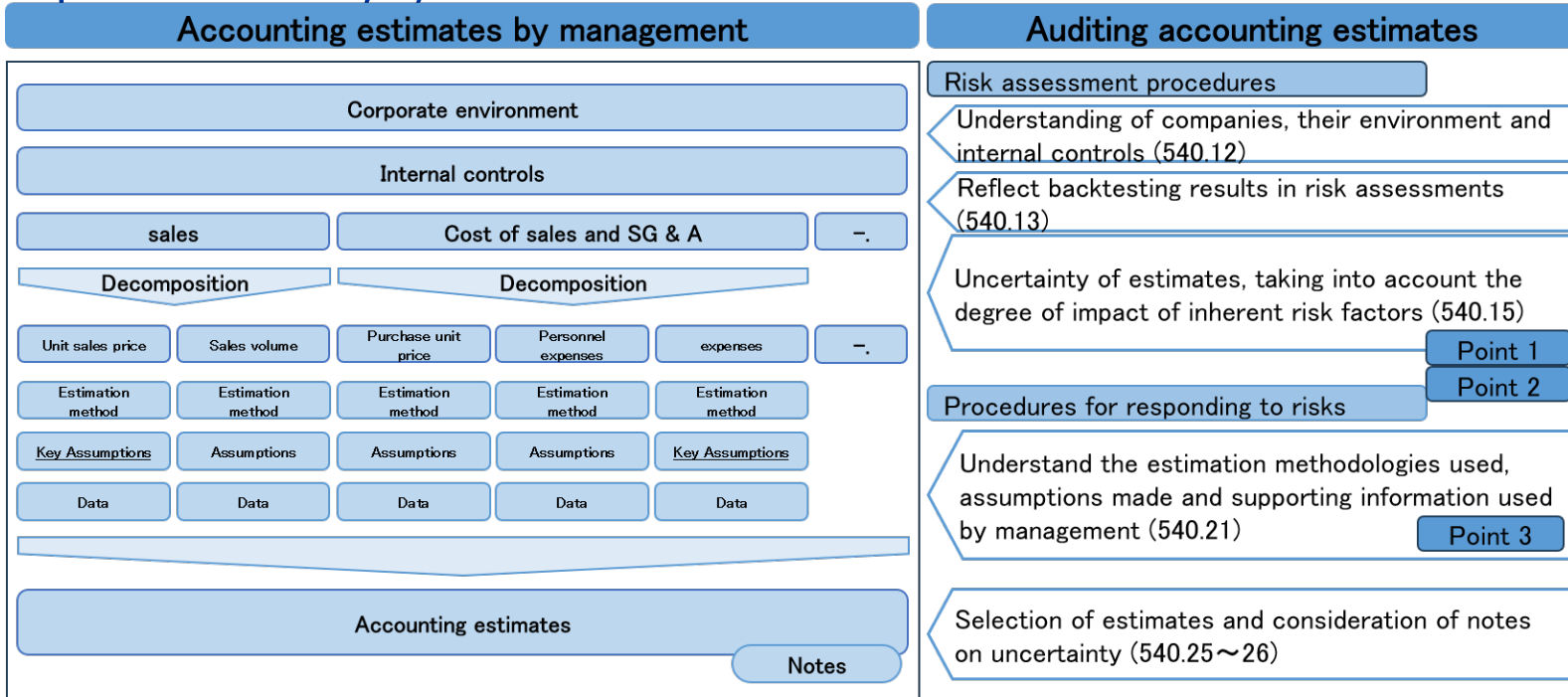
## 4. Auditing Accounting Estimates

(3/3)

Item	Major deficiencies
Valuation of receivables	<ul style="list-style-type: none"> <li>✓ The appropriateness of the estimation method for allowance for loan losses was not examined.</li> <li>✓ The reasonableness of the borrower's business plan is not sufficiently examined.</li> </ul>
Valuation of shares in subsidiaries and affiliates	<ul style="list-style-type: none"> <li>✓ Insufficient consideration was given to the impact of the downward revision to the business plan at the time of the share acquisition on the excess profitability that had been initially expected.</li> <li>✓ Examination of the reasonableness of business plans of affiliated companies was not conducted.</li> </ul>
Asset retirement obligations	<ul style="list-style-type: none"> <li>✓ No examination was given to the finalized amount of the previous year's estimate or re-estimate.</li> <li>✓ Examination of the appropriateness of not recording asset retirement obligations due to difficulty in estimating the implementation timing was not conducted.</li> </ul>

# 4. Auditing Accounting Estimates

(Required action 1/2)



## Point 1

- To assess appropriately the extent to which estimates are subject to uncertainty;

## Point 2

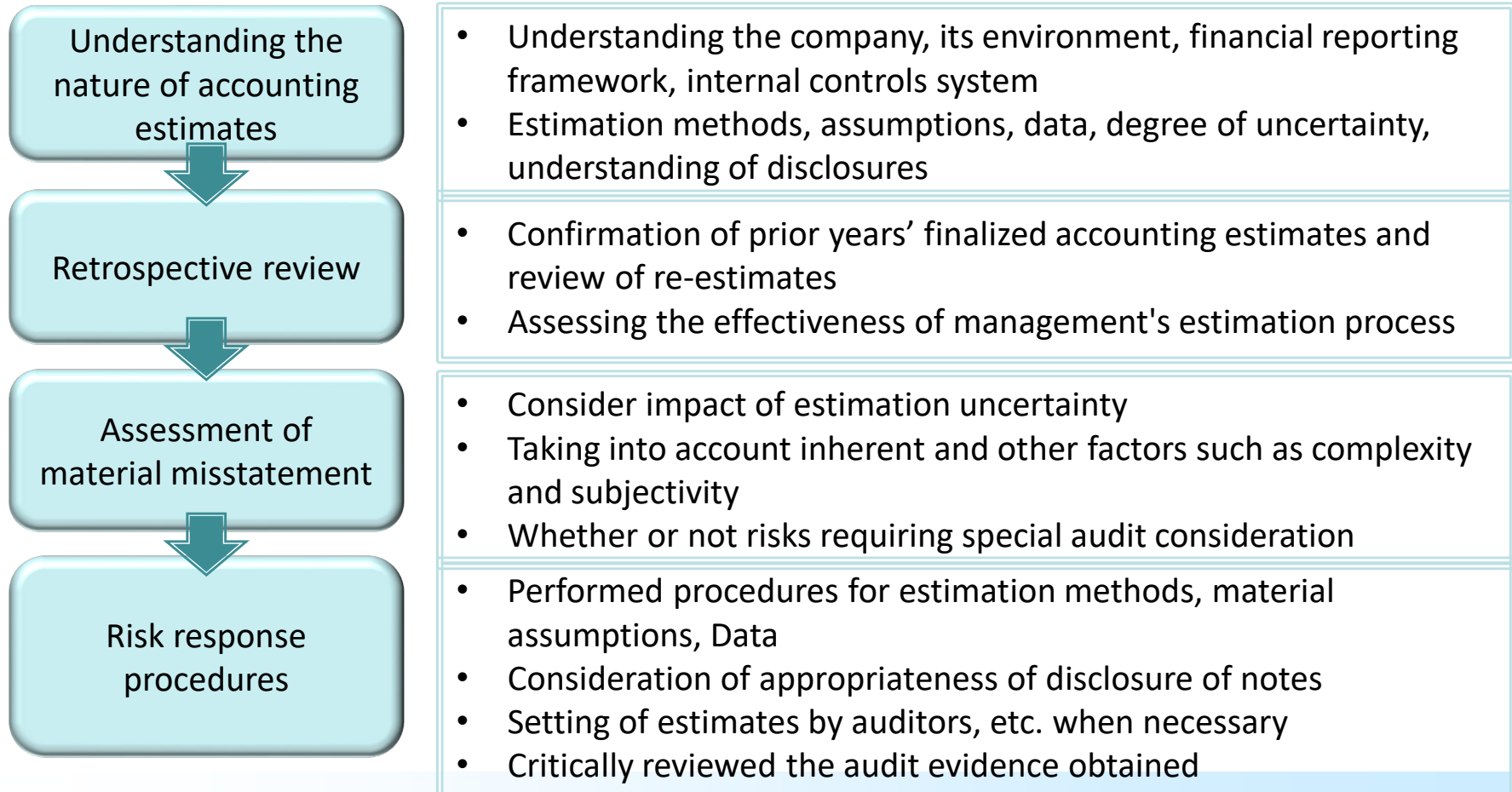
- Understand how management has identified the key assumptions by breaking down the components into appropriate units
- Consider whether the estimation method is realistic and compliant with standards.

## Point 3

- A “quantitative” review of the basis for management’s assumptions, taking into account all audit evidence obtained, as to the appropriateness of material assumptions.

# 4. Auditing Accounting Estimates

(Required action 2/2)



## 5. Group Audit

item	Major deficiencies
Involvement in the work carried out by the component auditor;	<ul style="list-style-type: none"> <li>✓ Discussion has not yet been held as to whether a minimum significant amount identified in a component should also be identified in the group financial statements as a minimum significant amount.</li> <li>✓ Failure to assess the appropriateness of procedures for dealing with Rio cults that require special consideration by component auditors</li> </ul>
Communication with component auditors	<ul style="list-style-type: none"> <li>✓ Related party information is not communicated exhaustively to component auditors</li> <li>✓ The impact of misstatements discovered by components on internal controls and the possibility of fraud were not examined.</li> </ul>
Consolidated branches	<ul style="list-style-type: none"> <li>✓ Insufficient consideration of component financial information and consolidated adjusting entries</li> </ul>
Subsequent events	<ul style="list-style-type: none"> <li>✓ Examination of existence of subsequent events in components not performed</li> </ul>
Evaluation of audit evidence	<ul style="list-style-type: none"> <li>✓ Examination of the necessity of additional procedures for component auditor procedures that have not yet been completed was not conducted.</li> </ul>

## 5. Group Audit

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### Required response

- The group engagement partner recognizes that they are responsible for the audit opinion on the group financial statements, including the work of the component auditors
- Communicate fully with the component auditors and obtain sufficient appropriate audit evidence relating to the component's financial information and its consolidated process
- Appropriate group audits require additional skills suited to the situation, such as language skills and knowledge of accounting systems in specific countries. Therefore, attention should be paid to the appropriate selection of component auditors and the composition of group engagement teams.
- Respond to changes in Auditing Standards Report 600

## 6. Using the Work of an Auditor's Expert

item	Major deficiencies
Determining the Need for an Auditor's Expert	✓ The necessity of using experts' work has not been discussed.
The Capabilities, Competence and Objectivity	✓ Assessment of the competence, capabilities and Objectivity of the experts used was not performed.
Agreement with the Auditor's Expert	✓ Insufficient communication between the engagement team and the expert about the scope of work to be used, the costs, etc.

## 6. Using the Work of an Auditor's Expert

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### Required response

- The engagement team is solely responsible for the audit opinion expressed and assesses the work of the experts it uses, always bearing in mind that the use of the experts' work does not relieve the audit team of its least responsibility.
- (i) determine the need for an auditor's experts, (ii) evaluate the capabilities, competence and objectivity of the experts, and (iii) evaluate the adequacy of the expert's work for the purposes of the audit.
- The engagement team shall obtain sufficient appropriate audit evidence suitable for "audit purpose" by, for example, having sufficient discussions with experts on the purpose and scope of services to be used, without leaving everything to the experts.

# 7. Audit of Internal Control over Financial Reporting

item	Major deficiencies
Consideration of scope of assessment	<ul style="list-style-type: none"> <li>✓ Other relevant internal controls that require special consideration Other important operations Examination of reasonableness of the fact that other risks are within the scope of assessment was not conducted</li> </ul>
Evaluation method	<ul style="list-style-type: none"> <li>✓ The appropriateness of the sampling population and the sufficiency of the sample size were not examined.</li> <li>✓ In evaluating the status of internal controls, only the results from the previous fiscal year have been confirmed.</li> <li>✓ Inadequate procedures for evaluating the operation of day-to-day internal controls, such as IT general controls and IT application controls</li> </ul>
Assessment of the degree of deficiency;	<ul style="list-style-type: none"> <li>✓ Details of deficiencies in internal controls related to misstatements discovered and the impact on financial reporting were not examined.</li> </ul>
Use of the work of internal auditors;	<ul style="list-style-type: none"> <li>✓ Did not examine the appropriateness of the sampling population and sampling method used by the internal auditor;</li> </ul>

# 7. Audit of Internal Control over Financial Reporting

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## Required response

- From the perspective of effective and efficient auditing, auditors are required to perform financial statement audits and internal control audits in an integrated manner
- On the other hand, it should also be noted that auditors are required to perform a leadership function in constructing internal controls that take into account the characteristics of audited companies, such as their size and organizational structure.
- It is necessary to reconsider the timing, scope, and appropriateness of required audit procedures, instead of performing procedures uniformly and formally.
- In particular, the engagement team should carefully evaluate whether sufficient appropriate audit evidence has been obtained for areas that are expected to be high risk, such as newly processes included in the scope of assessment and processes related to risks requiring special consideration.
- Comply with the revision of Auditing Standards Report No. 1 for Internal Control over Financial Reporting

## 8. Key Audit Matters

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item	Major deficiencies
Description of details of KAM and reasons for decision	✓ Inaccurate reference to notes in financial statements
Descriptions of audit responses to KAM	✓ Some audit procedures described as audit responses were not performed.

## 8. Key Audit Matters

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### Required response

- Auditors should fully understand the purpose of KAM and take appropriate actions to prevent KAM from becoming boilerplate or mere formality.
- Active communication with the management and company auditors of audited companies is required when determining KAM.
- It should be noted that the "content of KAM and reasons for decisions" included in the audit report should be directly linked to the company's specific circumstances by identifying the areas and the amount that are subject to KAM.
- "Audit response" included in the audit report shall describe procedures, etc. that conform to the factors listed in the reason for the KAM determination in as specific a manner as possible.