2026 Monitoring Report

Certified Public Accountants and Auditing Oversight Board
July 2026

Introduction

The Certified Public Accountants and Auditing Oversight Board (CPAAOB) operates the certified public accountants (CPAs) examinations and conducts inspections, etc. (monitoring) of audit firms to improve audit quality and ensure the reliability of audits performed by CPAs, thereby safeguarding the public interest and protecting investors.

This report is intended not only for audit and accounting professionals, but also for market participants and the general public, including students and working professionals. It aims to promote a broader understanding of the importance of audits by providing accessible and relevant information on the CPAAOB's monitoring activities, and developments in the audit environment.

Since the launch the "Monitoring Report" in July 2016, the CPAAOB has updated data on audit firms and audited companies and incorporated the latest information obtained through its monitoring activities. The "2026 Monitoring Report" summarizes monitoring activities conducted in PY 2026 (from July 2025 through June 2026). Please note that the structure of this report has been partially revised from this edition.

(Composition of the Monitoring Report and major revisions for the 2026 version)

I. Monitoring by the CPAAOB

This part provides an overview of monitoring activities, including inspections. It outlines the Basic Policy for Monitoring Audit Firms, etc. and the Basic Plan for Monitoring Audit Firms, etc. for PY 2026, as well as the results of monitoring conducted in PY 2025. From this edition, it also introduces the CPAAOB's cooperation with international organizations and overseas audit oversight authorities.

II. Overview of the Audit Sector

This part presents an overview of CPAs, audit firms, and audited companies. It also includes the status of audit firms' responses to the Revised Standards on Quality Control of Audits.

III. Operation of Audit Firms

This part describes the structure and operations of audit firms, including audit digitalization and group audits. It also presents trends in changes of accounting auditors and audit fees.

IV. Responses to Changes in the Global Environment Surrounding Audits

This part outlines regulatory and institutional changes resulting from recent developments in the audit environment. It describes changes affecting small and medium-sized audit firms, whose role as auditors of domestic listed companies has become increasingly important, as well as developments in the disclosure and assurance of sustainability-related information.

To improve audit quality, the CPAAOB considers it important to increase public interest in and awareness of auditing among not only market participants, such as auditors and investors, but also the general public. We welcome comments and suggestions to further enhance the content of this Monitoring Report.

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Table of Contents

Introduction **1**
Table of Contents 2
(Abbreviations) 5
(Terms) 5
I. Monitoring by the CPAAOB **7**
A. Monitoring Perspectives and Objectives of the CPAAOB 8
1. Basic Policy for Monitoring Audit Firms 8
2. Basic Plan for Monitoring Audit Firms for PY 2026 9
3. Strengthening Monitoring 14
4. Cooperation with Related Organizations 14
5. Communication of Monitoring Information 15
B. Overview of System and Situation with Implementation 17
1. Legal Position of the CPAAOB 17
2. Overview of Examinations, Collection of Reports, and Inspections by the CPAAOB 17
3. Report of JICPA Quality Control Review 18
4. Examination 20
5. Collection of Reports 22
6. Inspections 25
7. Notification of Inspection Results 31
8. Recommendation 34
C. Cooperation with International Organizations Related to Audit Oversight 37
1. Participation in International Discussions through the International Forum of Independent Audit Regulators (IFIAR) 37
2. Cooperation with Foreign Audit Oversight Authorities 45
II. Overview of the Audit Sector **47**
A. CPAs 48
1. Introduction of the CPA system 48
2. CPAs 48
3. Proportion of Female CPAs 51
4. Age Structure of Persons who Passed the CPA exam 52
B. Audit Firms 53
1. Organizational Structure of Audit Firms 53
2. Development and Implementation of Systems of Quality Management by Audit Firms 55
3. Number of Audit Firms 58
4. Mergers of Audit Firms 59
5. Financial Condition (Operating Revenue, Proportion of Audit and Attestation Services and Non-audit and Attestation Services) 60

C. Audited Companies 63
1. Types of Audit and Attestation Services 63
2. FIEA and Companies Act Audits 64
3. Audits of Financial Institutions 70
4. IFRS Adopting Companies 70
5. Audits of Initial Public Offerings 71
D. Foreign Audit Firms 76
1. System for Foreign Audit Firms 76
2. Foreign Audit Firms 76
3. Audited Companies 77
III. Operation of Audit Firms 78
A. Operations Management System 79
1. Organizational Structure of Audit Firms 79
2. Efforts in Response to Audit Firm Governance Code 82
3. Human Resources of Audit Firms 88
4. Organizational Structure for Providing Audit Services 92
5. Organizational Structure for Supporting Audit Services 95
6. Use of Technology in Audit and Cybersecurity Initiatives 99
7. Responses to Overseas Expansion of Companies 105
8. Treatment of Key Audit Matters 110
9. Domestic Audit Firm Groups 112
B. Engagement Quality Reviews 116
C. Monitoring of the System of Quality Management 118
1. Periodic Inspections of Audit Engagements 118
2. Utilization of Global Reviews 119
3. Monitoring Before Issuance of Audit Opinions 120
D. Development and Retention, Education and Training, and Evaluation of Professional Personnel 121
1. Development and Retention of Professional Personnel 121
2. Education and Training of Professional Personnel 122
3. Evaluation of Professional Personnel 123
E. Acceptance of New Audit Engagements and Changes of Accounting Auditors 125
1. Reasons for Changes of Accounting Auditors Given in Timely Disclosures by Audited Companies 127
2. Reasons for Changes of Accounting Auditors during Fiscal Term 128
3. Reasons for Changes of Accounting Auditors as Identified Through CPAAOB Monitoring 129
F. Audit Fees 131
1. Rules on Audit Fees 131
2. Methods for Calculating Audit Fees 131

3. Audit Fees Before and After Changes in Accounting Auditors 132
4. Fee Dependency (Safeguards) 134
IV. Responses to Changes in the Global Environment Surrounding Audits 137
A. Trends Surrounding Small and Medium-Sized Audit Firms 138
1. Changes in the Environment Surrounding Audits by Small and Medium-Sized Audit Firms 138
2. Response by the JICPA to Small and Medium-Sized Audit Firms 139
3. Response by the CPAAOB 144
B. Recent Trends in Auditing 145
1. Trends in International Auditing and Assurance Standards and Ethical Standards 145
2. Revision of the JICPA Code of Ethics 146
3. Other Trends in Financial Reporting Systems 147
C. Trends in Sustainability Disclosure and Assurance 153
1. Trends in the Development of Disclosure and Assurance Frameworks for Sustainability-related Information 153
2. Response by Audit Firms 155
(Reference materials) 158

(Column)

Review of the Monitoring Approach to Audit Firms and the Basic Policy on Inspection and Supervision ・12
Developments in Monitoring Approaches to Audit Firms among Foreign Audit Oversight Authorities ・・・・13
Initiatives to Improve the Attractiveness of Audit and Assurance Engagements ・・・・・・・・・50
Efforts to Promote Gender Diversity ・・・・・・・・・52
Share of Large-sized Audit Firms ・・・・・・・・・67
Impact of the Expiration of Transitional Measures for the Tokyo Stock Exchange's Continued Listing Criteria on Audit Risk ・・・・・・・・・67
Trends in Accounting Fraud Based on Timely Disclosure Requirements ・・・・・・・・・69
IPO Support Services ・・・・・・・・・74
Responses to Accounting Fraud Cases Identified at the Time of IPO ・・・・・・・・・75
Initiatives at Large-Sized Audit Firms to Strengthen the Exercise of Professional Skepticism ・・・・・・・98
IT Tool Adoption and Its Impact on Average Working Hours at Large-sized and Mid-tier Audit Firms ・・103
Enhancing Audit Quality and Improving Profitability and Operational Efficiency ・・・・・・・・・135
Introduction of New Lease Accounting Standards ・・・・・・・・・152

(Abbreviations)

The formal names of the abbreviations used in this Report shall be defined as follows:

CPAAOB	Certified Public Accountants and Auditing Oversight Board
JICPA	Japanese Institute of Certified Public Accountants
Stock exchange	Financial instruments exchange
CPA Act	Certified Public Accountants Act
FIEA	Financial Instruments and Exchange Act
QCSCS	Quality Control Standards Commission Statements
ASCS	Auditing Standards Committee Statements

(Terms)

Terms used in this Report shall be defined as follows:

Monitoring	Monitoring consists of inspections and non-inspection monitoring. Non-inspection monitoring involves gathering information through the collection of reports related to audit firms, interviews, and exchange of opinions and cooperation with audit firms and others.
Fiscal year (FY)	The year starting in April and ending in March of the following year, unless otherwise stated
Program year (PY)	The year starting in July and ending in June of the following year
Audit firm	Audit firms, partnerships (persons providing audit and attestation services jointly with other CPAs), and solo practitioners
Large-sized audit firm	An audit firm that has approximately 100 or more domestic listed audited companies and has at least 1,000 full-time personnel engaged in audit work. In this report, large-sized audit firms refer specifically to KPMG Azsa LLC, Deloitte Touche Tohmatsu LLC, Ernst & Young ShinNihon LLC, and PricewaterhouseCoopers Japan LLC.
Mid-tier audit firm	An audit firm whose business scale is second only to large-sized audit firms. In this report, mid-tier audit firms refer to the following four audit firms: Gyosei & Co., BDO Sanyu & Co., Grant Thornton Taiyo LLC, and Crowe Toyo & Co.
Small and medium-sized audit firm	An audit firm other than large-sized and mid-tier audit firms
Foreign audit firm	An audit firm that is based in a foreign country but provides audit and attestation services for financial documents etc. that are disclosed domestically within Japan
Large audit firm	An audit firm that provided audit and attestation services to more than 100 listed companies etc., in the most recent fiscal year. In this report, this term refers to six audit firms: the four large-sized audit firms, BDO Sanyu & Co. and Grant Thornton Taiyo LLC.

Accounting auditor	A CPA or audit firm
Domestic listed company	A listed company other than foreign companies. Note that a listed company refers to companies that are listed on financial instruments exchanges.
Listed financial institution	A listed financial institution refers to a domestic listed companies classified as a bank, securities and commodity futures company or insurance company in the industry categories.
Audited company	Companies that undergo audits
Audit engagement	Audit and attestation services carried out by an audit firm for an individual audited company
Business report	A document submitted by an audit firm to the Financial Services Agency (FSA) each program year that contains the audit firm's financial statements and an overview of its operations
Audit Firm Governance Code	"Principles for the Organizational Operation of Audit Firms" published by the FSA on March 31, 2017, and amended on March 24, 2023
Big Four global accounting firms	The global networks of the four largest accounting firms: Deloitte Touche Tohmatsu, Ernst & Young, KPMG, and PricewaterhouseCoopers
Big Six global accounting firms	The global networks of the Big Four accounting firms, BDO and Grant Thornton
Member firm	An accounting firm directly belonging to the same global accounting firm
IFRS	International Financial Reporting Standards; accounting standards established by the International Accounting Standards Board (IASB) that have been adopted by many countries/regions
KAM	Key Audit Matters -- The FIEA requires audit firms to describe KAMs in their audit reports.
Professional personnel	Refers to partners of an audit firm (or, in the case of a sole practitioner, the individual responsible for audit engagements) and other individuals engaged in the professional activities of the audit firm.

(Sources)

Materials for which no source is indicated are based on internal CPAAOB documents or publicly available information.

(Timing and timeframe of data collection)

To reflect the most up-to-date information, the timing and timeframe of data collection are not uniform; the timing and timeframe of data collection are listed in the notes inside or underneath each figure. Component ratios have been rounded down to the nearest whole number, and may not add up evenly to 100.

I. Monitoring by the CPAAOB

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A. Monitoring Perspectives and Objectives of the CPAAOB

Since its establishment in April 2004, the CPAAOB has endeavored to reinforce trust that investors place in the capital markets based on its mission to enhance the fairness and transparency of Japanese capital markets by raising the quality and ensuring the reliability of audits by CPAs.

As part of these efforts, the CPAAOB formulates “Basic Policy for Monitoring Audit Firms” each term (three years) and “Basic Plan for Monitoring Audit Firms”, which is based on the Basic Policy, each program year. In this way, the CPAAOB articulates the objectives and approach for monitoring, priorities for each program year, and so on.

Further details on the framework for CPAAOB’s monitoring activities are provided in “B. Overview of System and Situation with Implementation”.

1. Basic Policy for Monitoring Audit Firms

The Basic Policy for Monitoring Audit Firms for the CPAAOB’s Eighth Term (April 2025 to March 2028) was formulated and published in May 2025. Subsequently, in light of changes in the environment surrounding audits and audit firms, including the occurrence of accounting fraud cases, the expansion of the range of audit firms auditing listed companies, and the advancement of audit digitalization, such as the introduction of AI, the CPAAOB revised the Basic Policy and published *“Revision of the Approach to the Monitoring of Audit Firms”* in June 2026. The revision is intended to enable more effective monitoring that is tailored to the circumstances and risks of individual audit firms. While the full text of the revised Basic Policy is available on the CPAAOB website, the main features of the new monitoring approach are outlined below.

[Key Points]

In response to the changing environment surrounding audits, the CPAAOB will ensure appropriate supervisory responses by more closely integrating offsite and onsite monitoring. Through off-site monitoring, it will identify in a timely and accurate manner the status of operations and risks of audit firms and, based on such assessments, conduct effective and efficient onsite inspections.

In addition, under the amended CPA Act (put into force in 2023), the CPAAOB is empowered to conduct verification regarding false or unjust attestation. In light of that, the CPAAOB will conduct verification regarding false or unjust attestation with respect to audit firms suspected of being involved in such fraud.

The CPAAOB will change the standard inspection frequency, which varies according to the size of audit firms. For large-sized audit firms, it will conduct year-round monitoring from a multifaceted perspective through a combination of on-site and off-site monitoring methods. In addition to traditional full-scope inspections and follow-up inspections, the CPAAOB will introduce inspections targeted specifically at the operations of firms’ systems of quality management, as well as horizontal review, which encompasses a comparative examination of multiple audit firms under specific themes.

For mid-tier audit firms, the CPAAOB will conduct inspections once every two years in principle. However, regarding audit firms whose quality management status has improved and whose business operations are consistently satisfactory based on inspection results, the CPAAOB will consider revising the inspection frequency in view of their risk profile and quality management status. In addition, the CPAAOB will consider applying an inspection approach similar to that used for large-sized audit firms in light of the situations and quality management methods of the global networks with which they are affiliated, among other factors.

For small and medium-sized audit firms, the CPAAOB will select audit firms to be inspected under a risk-based approach and may increase the number of audit firms inspected in view of the information gathering and analysis as off-site monitoring.

In addition, for audit firms whose business operations are found to be unsatisfactory in particular, the CPAAOB will encourage them to make effective improvements by strengthening follow-up examination regarding the status of improvements through off-site monitoring.

2. Basic Plan for Monitoring Audit Firms for PY 2026

Based on the above-mentioned *"Revision of the Approach to Monitoring of Audit Firms,"* the CPAAOB formulated the "Basic Plan for Monitoring Audit Firms for PY 2026" (July 2026 to June 2027), which was published on July 17, 2026. While the full text of the Plan is available on the CPAAOB website, the main priorities and other key aspects of the monitoring program are outlined below.

[Basic Plan for Monitoring Audit Firms]

a. Conduct of Inspections

In addition to conducting inspections under a risk-based approach, the CPAAOB will conduct verification regarding false or unjust attestation with respect to audit firms suspected of being involved in such fraud. In order to accurately ascertain the environment surrounding audits, audit challenges, and risks related to audit firms on a timely basis and conduct inspections effectively and efficiently based on the findings, the CPAAOB will allocate inspection resources more appropriately.

- For Large-sized audit firms, in addition to full-scope inspections and follow-up inspections (inspections that focus mainly on improvements related to findings in previous inspections), the CPAAOB will implement inspections targeted specifically at the operations of the system of quality management and year-round monitoring using on-site and off-site monitoring methods, including horizontal review, which encompasses a comparative examination of multiple audit firms under specific themes.
- For mid-tier audit firms, the CPAAOB will conduct inspections once every two years in principle. However, regarding audit firms whose quality management status has improved and whose business operations are consistently satisfactory based on inspection results, the CPAAOB will consider revising the inspection frequency in view of their risk profile and

quality management status. In addition, the CPAAOB will consider applying an inspection approach similar to that used for large-sized audit firms in light of the situations and quality management methods of the global networks with which they are affiliated, among other factors.

- For small and medium-sized audit firms, the CPAAOB will select audit firms to be inspected under a risk-based approach and conduct full-scope inspections, taking into account the results of Quality Control Reviews conducted by the Japanese Institute of Certified Public Accountants (JICPA) as well as audit firms' operational management systems, and the degree of risks underlying audited listed companies.
- When it is necessary to quickly verify an audit firm’s operations management or the system of quality management or verify suspected involvement in false or unjust attestations, the CPAAOB will conduct inspections on an ad hoc basis.

b. Post-Inspection Follow-up on Improvements
   - Regarding the deficiencies notified as inspection findings for mid-tier audit firms, the CPAAOB will conduct follow-up examination regarding the status of improvements through the collection of reports requested concurrently with the notification of inspection results.
   - Regarding the deficiencies notified as inspection findings for Small and medium-sized audit firms, the CPAAOB will encourage them to make effective improvements by understanding the status of responses through interviews after an appropriate period has elapsed following the notification of inspection results.
   - Regardless of firm size, with respect to audit firms whose business operations are found to be unsatisfactory in particular, the CPAAOB will encourage them to make effective improvements by strengthening follow-up examination regarding the status of improvements through the collection of reports and other means requested concurrently with the notification of inspection results.

c. Information Gathering and Analysis
   - To efficiently inspect large-sized and mid-tier audit firms, the CPAAOB will regularly collect and analyze quantitative and qualitative information concerning their operations management system.
   - From small and medium-sized audit firms, the CPAAOB will gather and analyze information in a timely manner according to their size and characteristics. When encouraging small and medium-sized audit firms to ensure and improve their audit quality on their own initiative, the CPAAOB will hold interviews to secure effects similar to those through inspections as necessary.
   - The CPAAOB will ascertain risks related to audit firms accurately on a timely basis in view of the results of the Quality Control Review conducted by the JICPA and corrections made to audited companies’ business results, etc.

d. Verification of False or Unjust Attestation

To ensure the fairness and reliability of audit attestation services, where false or unjust statements are identified in financial documents prepared by a company, the CPAAOB will verify whether false or unjust attestations occurred in connection with the relevant audit engagement. In conducting such verification, the CPAAOB will work closely with relevant organizations, including the Financial Services Agency (FSA), the Securities and Exchange Surveillance Commission (SESC), the JICPA, and financial instruments exchanges.

e. Matters of Particular Focus in Monitoring the Operational Status of Audit Firms

i. Operations management system

- Design and operating effectiveness of arrangements for conducting operational activities in accordance with the Audit Firm Governance Code
- Audit firm management's commitment to ensuring and improving audit quality

ii. Systems of Quality Management

- Effectiveness of the system of quality management
- Design and operating effectiveness of the system of quality management in compliance with the Quality Control Standards, etc.
- Securing, developing and allocating audit resources
- Background to new client acceptance and cancellation of audit contracts (including the adequacy of risk assessment for concluding new contracts, the design of audit performance systems and the implementation of takeover procedures)
- Effectiveness of engagement quality reviews
- Initiatives to develop an organizational culture emphasizing compliance with laws and professional ethics

iii. Individual Audit Engagements

- Implementation of audits regarding fraud risks
- Implementation of audits regarding revenue recognition
- Implementation of audits regarding accounting estimates
- Implementation of group audits

f. Inspection of foreign audit firms

When selecting foreign audit firms to be inspected, consideration should be given to the results of reports collected in PY2024 and the audit risks of foreign companies audited by the relevant foreign audit firms. The CPAAOB will conduct inspections of foreign audit firms appropriately based on the "Framework for Inspection/Supervision of Foreign Audit Firms, etc.," and the "Basic Policy for Collection of Reports and Inspection of Foreign Audit Firms, etc. by the CPAAOB."[1]

[1] Prescribes the specific procedures, key considerations, and other matters concerning the collection of reports from, and inspections of, foreign audit firms, etc. (last revised: June 2024).

■ Review of the Monitoring Approach to Audit Firms and the Basic Policy on Inspection and Supervision ■

The FSA reviewed its traditional framework for inspections and supervision and issued the Basic Policy on Inspection and Supervision, which continues to serve as the fundamental guidance shared across the FSA regarding its approach to inspections and supervision.[2]

The Policy was developed in response to concerns that traditional inspection and supervisory practices:

- tended to focus excessively on minor details at the expense of key issues;
- were not sufficiently forward-looking to address emerging challenges in a timely manner; and
- might have discouraged financial institutions from adopting diverse and proactive innovations.

Against this backdrop, the Basic Policy on Inspection and Supervision introduced new concepts and approaches to inspection and supervision, including:

- "Minimum standard verification with a holistic and substance-oriented focus," which emphasizes developing a thorough understanding of financial institutions and focusing on key issues;
- "Dynamic supervision," which analyzes future soundness and encourages discussion of issues from a forward-looking perspective; and
- "Visualization and exploratory dialogue," which provides incentives and insights for initiatives that are not based on uniform, one-size-fits-all approaches.

Through these initiatives, inspection and supervision, which had previously tended to focus on form, the past, and individual elements, were to be transformed into an approach emphasizing substance, the future, and the overall picture.

The Policy also set out specific measures for conducting inspections and supervision from the perspectives of substance, the future, and the overall picture, including:

- accurately understanding changes in the environment surrounding financial institutions and the characteristics of individual institutions;
- determining supervisory priorities based on such assessments;
- conducting continuous monitoring through an integrated use of onsite inspections and offsite monitoring tailored to the characteristics and issues of each financial institution; and
- utilizing both institution-specific and horizontal monitoring approaches, as appropriate.

The Basic Policy on Inspection and Supervision was not intended to apply solely to specific sectors such as banks. Rather, it was presented as a set of fundamental principles applicable to the inspection and supervision of all financial institutions and other entities subject to the FSA's inspection and supervisory authority. Accordingly, it inherently encompassed the inspection and supervision of audit firms.

However, looking back at the circumstances surrounding audit firms at that time, major improper accounting cases had emerged around 2015. In response, the frequency of inspections of large-sized audit firms, which had previously been conducted once every two years, was increased in an effort to enhance the timeliness and effectiveness of inspections. As a result, the monitoring of audit firms developed along a path somewhat different from that envisaged under the *Basic Policy on Inspection and Supervision*.

The CPAAOB's recent review of its approach to monitoring audit firms has been undertaken in response to changes in the environment surrounding audits, including the occurrence of improper accounting cases, the expansion of the range of firms auditing companies in the capital markets, and advances in technology and AI in the audit profession. The objective is to enable more accurate and effective monitoring in light of these developments. At the same time, the fundamental concepts underlying the revised monitoring approach are consistent with those set out in the *Basic Policy on Inspection and Supervision*.

[2] FSA, Supervisory Approaches and Practices (Basic Policy on Inspection and Supervision) (published June 2018). https://www.fsa.go.jp/news/30/wp/supervisory_approaches_revised.pdf

■ Developments in Monitoring Approaches to Audit Firms among Foreign Audit Oversight Authorities ■

Monitoring approaches adopted by audit oversight authorities across jurisdictions reflect differences in the size of audit markets and institutional environments and vary in such aspects as the availability of inspection resources, the number of firms subject to inspection, and the areas prioritized for examination. At the same time, major jurisdictions, including the United States, the United Kingdom, and Canada, share a number of common features in their monitoring approaches aimed at effectively ensuring audit quality under limited inspection resources.

For example:

- Conducting risk-based inspections focused on areas of greater significance or higher risk, based on information obtained through data analytics, offsite monitoring, and past inspection results.
- Performing thematic inspections and reviews that facilitate in-depth cross-firm analysis of matters of particular importance.
- Combining onsite and offsite monitoring to obtain a multifaceted and continuous understanding of audit firms' operations management and the system of quality management.

Against this backdrop, the environment surrounding audits has undergone significant changes in recent years, including advances in the use of artificial intelligence (AI), the institutionalization of sustainability-related disclosure and assurance, increasing diversity in audit firm ownership structures, and the growing involvement of small and medium-sized audit firms in the auditing of listed companies. In response to these developments, consideration of more effective and efficient monitoring approaches and resource allocation has become a common challenge for audit oversight authorities worldwide.

Recently, some jurisdictions have taken steps to strengthen the monitoring of systems of quality management. In March 2026, the UK Financial Reporting Council (FRC) announced a new supervisory approach centered on the assessment of audit firms' systems of quality management. The approach is intended to enhance firms' ability to operate and continuously improve their systems of quality management, thereby enabling them to respond flexibly to future changes in the audit market environment.[3] The approach is designed to reflect the size and risk characteristics of individual firms and is expected to contribute to a regulatory environment that supports the growth of UK businesses and the economy while reinforcing confidence in the market. It initially applies to the twelve largest audit firms from April 2026 and is planned to be introduced on a phased basis thereafter.

In the United States, the Chair of the Public Company Accounting Oversight Board (PCAOB), who assumed office in February 2026, has stated that the PCAOB will review and modernize its inspection program by leveraging technologies such as AI and building upon QC 1000, A Firm's System of Quality Control, the PCAOB's new quality control standard. In June 2026, the PCAOB issued proposed amendments to certain provisions of QC 1000 with the aim of enhancing consistency with other quality control standards while reducing regulatory compliance costs without compromising audit quality.[4]

It should be noted that audit oversight authorities do not place exclusive emphasis on inspections of systems of quality management. Inspections of individual audit engagements continue to be regarded as important, including from the perspective of evaluating the effectiveness of firms' systems of quality management.

The CPAAOB will continue to monitor changes in the environment surrounding audits and developments among foreign oversight authorities, while further considering and implementing more effective and efficient monitoring approaches.

[3] FRC Press Release: https://www.frc.org.uk/news-and-events/news/2026/03/frc-introduces-evolved-approach-to-audit-supervision/

[4] With respect to QC 1000, when the standard was approved by the U.S. Securities and Exchange Commission (SEC) in September 2024, its effective date was set for December 15, 2025. The effective date was subsequently postponed to December 15, 2026, to provide audit firms with additional time for implementation. The proposed amendments include, among other changes, the withdrawal of the "design-only" requirement (which would have required firms not subject to engagement-level regulatory requirements to design a quality control system compliant with QC 1000) and the requirement for large-sized audit firms to establish an external quality control function, whereby independent third parties oversee and evaluate the firm's system of quality control. As of the publication of the proposed amendments, no further postponement of the effective date is planned. PCAOB Press Release: https://pcaobus.org/news-events/news-releases/news-release-detail/pcaob-issues-proposed-amendments-to-qc-1000-and-seeks-public-comment

3. Strengthening Monitoring

a. Dialogue with Audit Firms

In order to conduct efficient and effective monitoring, the CPAAOB holds periodic dialogues with the management of large-sized and mid-tier audit firms, including their top management, and gathers information on the latest system of quality management at each audit firm. The information collected is used effectively, for example, as a reference for understanding industry trends and identifying points of focus in conducting inspections. In addition, since PY2022, the CPAAOB has been holding dialogues with the management of relatively larger firms among small and medium-sized audit firms that conduct audits of listed companies.

b. Enhancing the capacity to conduct monitoring

In order for the CPAAOB's monitoring to appropriately respond to issues surrounding audit firms and the internationalization of accounting practices, it is critical to enhance the monitoring framework such as by developing human resources and strengthening information collection and analysis. In PY2025, the CPAAOB continued to promote human resource development through active participation of its staff in international conferences and other events and also conducted training courses aimed at acquiring expertise necessary for monitoring.

4. Cooperation with Related Organizations

In order to ensure and improve audit quality, it is important not only to monitor audit firms, but also to cooperate with organizations related to auditing and to share awareness of issues and problems surrounding audit firms. To this end, the CPAAOB has been working with relevant bureaus within the FSA, as well as with the JICPA and other relevant organizations.

a. Cooperation with relevant divisions within the FSA

With regard to issues identified in individual audit engagements such as matters relating to disclosures by audited companies, more effective and efficient inspections can be conducted by cooperating with the FSA's relevant divisions responsible for supervision and inspections. To this end, the CPAAOB shares information and exchanges opinions with relevant FSA divisions and the SESC on issues relating to disclosure and audit of listed companies, and utilizes the obtained information in its monitoring activities. In addition, the CPAAOB also shares information with relevant FSA divisions on inspection results of audit firms.

b. Cooperation with JICPA

The CPAAOB encourages the JICPA to further improve the effectiveness of the Quality Control Review, by assessing its effectiveness through the CPAAOB inspections of audit firms and sharing with the JICPA the issues identified during those inspections.

Since PY 2015, the CPAAOB and the JICPA have held working-level meetings to discuss issues related to Quality Control Review. Further discussions are being held to ensure that the CPAAOB inspections and the JICPA Quality Control Review are as effective as possible overall.

During PY 2025, the CPAAOB and the JICPA discussed ways to strengthen cooperation between the two organizations, reviewed the implementation status of Quality Control Review and related activities, and considered measures to further enhance and improve review methodologies. In addition, the CPAAOB provided training seminars for Quality Control Reviewers hosted by the CPAAOB, and shared perspectives on key issues at the senior management level through exchanges of opinions between executives of the CPAAOB and the JICPA.

Going forward, the CPAAOB will continue these initiatives with the JICPA. The CPAAOB will also encourage the JICPA to further enhance the effectiveness of its Quality Control Review by sharing, on a timely basis, the results of the CPAAOB's assessments of the effectiveness of Quality Control Review, which have been identified as a priority area in CPAAOB's monitoring activities. In addition, discussions will continue regarding measures to strengthen the JICPA's guidance and oversight functions for small and medium-sized audit firms.

c. Cooperation with other related organizations

In order to conduct efficient and effective monitoring, the CPAAOB shares its awareness of issues by exchanging views with stock exchanges on the status of communication between auditors and audited companies and the status of changes in auditors, and also uses the information obtained in its monitoring.

In addition, as the roles and responsibilities of audit and supervisory board members etc. have become increasingly important in recent years, the CPAAOB regularly exchanges views with the Japan Audit & Supervisory Board Members Association on the status of communication between audit and supervisory board members etc. and auditors.

5. Communication of Monitoring Information

To raise public awareness of and interest in audits, and to enhance transparency regarding its monitoring activities, the CPAAOB publishes this Report, the Case Report from Audit Firm Inspection Results, and the Basic Plan for Monitoring Audit Firms (collectively, the "various monitoring information").

a. Development and publication of the Case Studies of Audit Firm Inspection Results

The CPAAOB annually publishes and updates the "Case Report from Audit Firm Inspection Results", which summarizes major inspection findings and examples of noteworthy practices identified through CPAAOB inspections of audit firms (the Case Report for PY2026 was published on July 17, 2026). The purpose of the Case Report is to communicate the CPAAOB's expectations regarding the audit quality, encourage audit firms to make voluntary efforts to ensure and improve audit quality, and provide reference information to directors, audit and supervisory board members, and other stakeholders of listed companies, as well as investors and other market participants.

b. Communication of various monitoring information

The CPAAOB actively shares various monitoring information by holding briefings for stakeholders in various fields and contributing articles to relevant magazines. In particular, the CPAAOB Chairperson and inspectors explain about the Case Report from Audit Firms Inspection Results at training sessions run by the JICPA. In PY20254, with the aim of encouraging audit firms to make voluntary efforts to ensure and improve audit quality, the CPAAOB gave lectures at the JICPA headquarters and seven regional associations across Japan. It also gave lectures at the Institute of Internal Auditors Japan and other relevant organizations.

B. Overview of System and Situation with Implementation

1. Legal Position of the CPAAOB

The CPAAOB is an administrative body[5] serving as a council that was established in April 2004 in accordance with Article 35-1 of the CPA Act and Article 6-2 of the Act for Establishment of the FSA. It comprises a chairperson and a maximum of nine members (who serve three-year terms). Although the members are part time, one full-time member can be appointed.

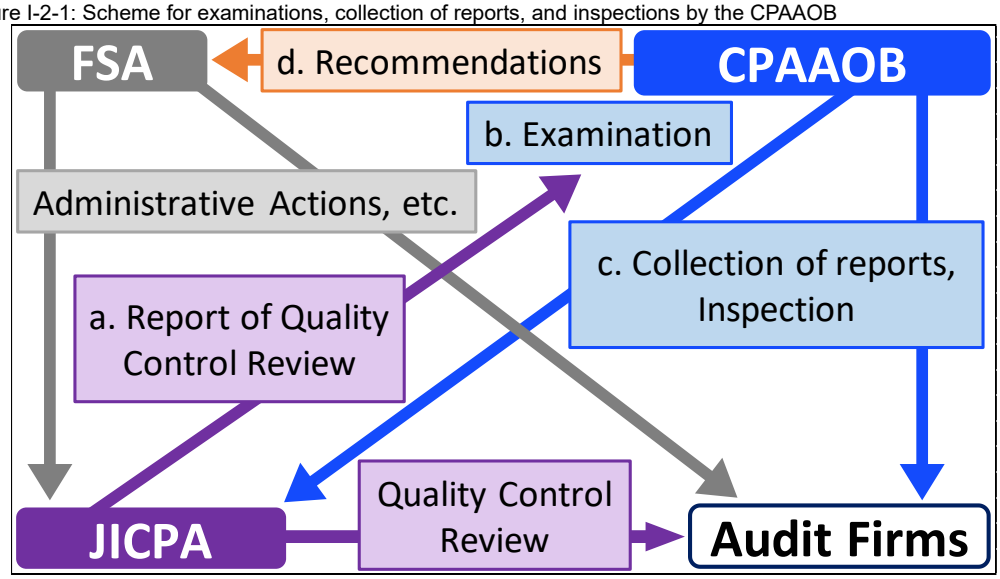
The CPAAOB receives and examines reports concerning Quality Control Review by the JICPA, collects reports from and conducts inspections of the JICPA and audit firms, etc. Based on the results of inspections etc., the CPAAOB recommends administrative actions or other measures to the FSA Commissioner when necessary.

2. Overview of Examinations, Collection of Reports, and Inspections by the CPAAOB

Figure I-2-1 shows the relationship between examinations, collection of reports, and inspections by the CPAAOB on the one hand, and the JICPA Quality Control Review, the FSA's administrative actions, etc. on the other.

Based on the JICPA Quality Control Review reports (a), the CPAAOB assesses whether the JICPA has carried out the Quality Control Review properly and whether the audit firms have properly performed their audit services (b), and collects reports from the JICPA, audit firms, etc. and conducts inspections when deemed necessary (c). If the CPAAOB deems it necessary as a result of its inspections, it recommends administrative actions or other measures to the Commissioner of the FSA (d).

Figure I-2-1: Scheme for examinations, collection of reports, and inspections by the CPAAOB



[5] Appointed by the Prime Minister with the consent of both houses of the Diet from persons with an understanding of and insight concerning matters relating to CPAs

3. Report of JICPA Quality Control Review

The JICPA is a professional body for CPAs in Japan, established in accordance with Article 43, para 1 of the CPA Act. To maintain the integrity of its member CPAs and audit firms and improve/promote audit and attestation services, the JICPA provides guidance to, liaises with, and supervises its members. The JICPA also registers CPAs and specified partners, and operates the registration system for listed company auditors (i.e., reviews whether or not to permit registration and cancellation of registration, registration on the list of listed company auditors, etc.).

The Quality Control Review is conducted by the JICPA to maintain and enhance the quality of audit services and sustain public trust in audits. More specifically, the JICPA reviews the operational status of audit engagements conducted by audit firms, reports its findings to the audit firms and, when necessary, issues recommendations for improvement, monitors the status of improvements, and determines appropriate measures to be taken[6].

The Quality Control Review system was introduced by the JICPA in FY1999 as a self-regulatory measure, and in 2003 a revision to the CPA Act made it mandatory for the JICPA to perform reviews of the administration of audit and attestation services by audit firms and report its findings of these reviews to the CPAAOB.

The JICPA submits monthly and annual reports to the CPAAOB on a regular basis and updates the status of Quality Control Review whenever necessary. The reports include the following:

a. Plan of Quality Control Review
b. Details on any deficiencies observed during the Quality Control Review and the audit firms' perspectives
c. "Quality Control Review Reports" and "Recommendation for Improvement Reports" provided by the JICPA to audit firms based on review findings
d. Specific measures based on findings identified through the Quality Control Review (warnings, severe warnings, recommendation to withdraw from audit engagements)
e. "Remediation plan on Quality Control Review" prepared by the audit firm and submitted to the JICPA

Quality Control Review evaluates the audit firms' systems of quality management by assessing how extensively they have been developed and how effectively they operate. Specifically, the review confirms whether their systems of quality management (all policies and procedures for quality management pertaining to audit, including quality management procedures relevant to individual audit engagements) have been suitably and sufficiently developed in compliance with quality management standards[7], and whether the system of quality management is operating effectively.

Japanese Quality Control Standards and Quality Control Standards Commission Statements were

[6] For details concerning the system of Quality Control Reviews, see the JICPA website and the annual report from the Quality Control Committee. https://jicpa.or.jp/about/activity/self-regulatory/quality/

[7] The provisions of the CPA Act and other laws and regulations, auditing criteria, correspondence criteria for addressing fraud risks in auditing, quality management criteria related to auditing, the JICPA's rules and regulations, which are related to audit quality management.

revised in response to changes in the international quality management standards. As a result, the JICPA is now responsible for confirming the design and operation of firms' systems of quality management, including the risk assessment process through which audit firms establish audit quality objectives and identify, assess, and respond to quality risks.

In addition, the Quality Control Review comprises "Regular Review", which assesses the overall status of quality management of an audit firm; "Special Review", which focuses on quality management in specific sector or particular audit engagements, and "Review for Application Review", which is conducted for applicants for the auditors of listed companies under the Registration System of Auditors of Listed Companies (introduced as a statutory registration system due to the revision of the CPA Act in May 2022 (effective from April 2023)). Following the statutory establishment of the Registration System for Auditors of Listed Companies, the JICPA conducts "confirmation of eligibility" of auditors of listed companies and the applicants during the Quality Control Review.

In the confirmation of eligibility, the JICPA has established points of focus and evaluation criteria in its Guideline for the Confirmation of Eligibility of Audit Firms Engaged in the Audit of Listed Companies[8] ("Eligibility Confirmation Guideline"). Based on this Guideline, audit firms conduct self-assessments, and the JICPA provides ongoing guidance through Quality Control Review.

When reviewing applications for registration in the Register of Auditors of Listed Companies, the JICPA has focused its Quality Control Review on assessing whether an applicant firm has appropriately established the system of quality management in accordance with the Eligibility Confirmation Guideline. Following registration, however, it is also necessary to assess whether their system of quality management is operating effectively. Accordingly, the JICPA plans to revise the Eligibility Confirmation Guideline to incorporate additional points of focus and evaluation criteria relating to deficiencies in the operation of systems of quality management.

In addition, in light of recent accounting fraud cases and the large number of improvement recommendations issued to audit firms concerning the identification and assessment of fraud risks and the audit procedures performed in response to such risks, the JICPA intends to apply a higher level of scrutiny to individual audit engagements in its Quality Control Review. To that end, future revisions to the Eligibility Confirmation Guideline will set out assessment criteria regarding the significance of deficiencies in fraud risk responses and related areas.

When extremely significant deficiencies or significant deficiencies are found as a result of a Quality Control Review, and a recommendation of withdrawal is made, the auditor is subject to a Review for Revocation of Registration.

As part of its measures to strengthen the Quality Control Review system, the JICPA plans to continue enhancing reviewers' expertise and professional mindset through training and other initiatives, while

[8] This Guideline sets out the points of focus and evaluation criteria used in Quality Control Review to assess whether an audit firm has established an appropriate framework for conducting audits of listed companies and other entities fairly and properly. Since their introduction in June 2023, the Guideline has been reviewed as appropriate in response to developments in the environment surrounding audits of listed companies. https://jicpa.or.jp/specialized_field/20250620cgj.html (Most recently revised on June 19, 2025.)

improving operational efficiency, including through the use of AI, and strengthening its support infrastructure. To strengthen the support infrastructure, the JICPA is considering enhancing middle-office functions, such as the review of Quality Control Review documentation, consultation services, and internal review processes. It is also considering clarifying due process procedures for cases where an audit firm does not agree with deficiencies identified through a Quality Control Review, including measures to ensure the objectivity of deficiency assessments.

In FY2025, the total number of reviewers was 42 (as of October 1, 2025). During this year, the JICPA conducted Regular Reviews of 56 audit firms, Special Reviews of three audit firms, and Reviews for Application Reviews of four audit firms.

4. Examination

a. Overview

The CPAAOB receives Quality Control Review reports from the JICPA, and then reviews the reports to examine the appropriateness of the Quality Control Review and audit services performed by the audit firms. More specifically, the CPAAOB confirms the content of Quality Control Review and the instructions to audit firms on necessary remediation measures, and analyses the findings of Quality Control Review as well as the details of remediation plans submitted to the JICPA. In addition to considering the need for inspection and collecting reports in light of the outcomes of the analysis, the CPAAOB engages in exchanges of opinions with the JICPA concerning matters such as the effectiveness of Quality Control Review. The CPAAOB also utilizes information from relevant FSA divisions, other relevant organizations in its examinations.

b. State of implementation of examinations and results

In PY 2025, the CPAAOB examined the results of the Quality Control Review that the JICPA conducted in FY 2025 and that were reported to the CPAAOB by the end of May. The summary of the review results is as follows:

i. FY2025 Quality Control Review

The implementation results and conclusions of the FY 2025 Quality Control Review (Regular Review) are summarized below. Of the 48 audit firms subject to Quality Control Review, 39 received review results with no significant deficiencies, six received review results identifying significant deficiencies, and three received review results identifying extremely significant deficiencies (Figure I-2-2).

Figure I-2-2: FY2025 Quality Control Review (unit: audit firms)

Classification	Reviewed parties	Conclusions			Recommendations for improvement	
		Conclusion finding no significant deficiencies	Conclusion finding significant deficiencies	Conclusion finding extremely significant deficiencies	Yes	No
Audit firms	45	38	5	2	44	1
Partnerships	2	1	1	0	2	0
Solo practitioners	1	0	0	1	1	0
Total	48	39	6	3	47	1

(Note1) Conclusion finding significant deficiencies is declared when there is significant concern about serious compliance violations of standards as well as laws and regulations applicable to an audit firm as a professional expert in the development and management of its system of quality management.
(Note2) Conclusion finding extremely significant deficiencies is declared when there is significant concern about extremely serious compliance violations of standards as well as laws and regulations applicable to an audit firm as a professional expert in the development and management of its system of quality management.
(Note3) Even if a conclusion finding no significant deficiencies is declared to an audit firm, a recommendation for improvement is made where an issue warranting such a recommendation is identified.
(Source) Prepared by the CPAAOB based on data from the JICPA.

In FY 2025, Quality Control Review (Review for Application Review) were conducted for eight audit firms: six received review results with no significant deficiencies, and two received review results identifying extremely significant deficiencies.

ii. Examination of FY2025 Quality Control Review

Based on the JICPA's report on the results of the FY 2025 Quality Control Review, the CPAAOB reviewed the implementation of the reviews of the system of quality management of the audit firms concerned and the selected individual audit engagements, including analyses of whether the JICPA had identified significant deficiencies or extremely significant deficiencies, as well as the nature and content of such deficiencies. As a result, the following observations were made:

- At the planning stage of the Quality Control Review, the JICPA increased both the number of review days and the number of reviewers in order to conduct the confirmation of eligibility associated with the introduction of the Registration System for Auditors of Listed Companies. In addition, after the commencement of the Quality Control Review, the JICPA revised its review plans flexibly in response to changing circumstances and conducted the reviews accordingly.
- In Regular Reviews, compared with FY 2024, the average number of deficiency categories and individual findings relating to quality management per audit firm auditing listed companies and other entities increased. In addition, the average number of findings per audit engagement at small and medium-sized audit firms also increased.
- With respect to findings identified through Regular Review, quality management-related findings frequently concerned information security, the assembly, management and retention of audit documentation, and the establishment of policies and procedures regarding consultation on professional judgments. At the individual audit engagement level,

findings frequently related to the audit of accounting estimates and the identification, assessment and response to risks of material misstatement, including those arising from fraud.

In the “FY 2025 Quality Control Review Policy,” the JICPA stated that, in order to assess whether audit firms registered as auditors of listed companies and other entities maintain an appropriate level of audit quality, it would review not only the design of the system of quality management but also their operation. The increase in quality management-related findings is considered to reflect this enhanced focus.

The CPAAOB will continue to assess the effectiveness of the Quality Control Review system and engage in discussions with the JICPA aimed at further enhancing and improving its effectiveness.

5. Collection of Reports

a. Overview

The CPAAOB may require the JICPA or audit firms to submit reports whenever it deems such action necessary. Given the CPAAOB’s limited inspection resources, it is important to make effective use of collection of reports to obtain up-to-date information on audit firms and maintain an ongoing understanding of the issues and risks they face, thereby helping to maintain and improve audit quality across the audit profession in Japan.

From this perspective, and with a view to encouraging audit firms to establish and maintain appropriate operations management systems, etc. the CPAAOB conducts the collection of reports as described below, taking into account factors such as the size and characteristics of audit firms, the results of CPAAOB inspections, and the results of Quality Control Review. These collection of reports focus on the status of the design and operation of operational and quality management arrangements at audit firms, including the implementation of remedial measures.

i. Collection of reports from large-sized and mid-tier audit firms

In the case of large-sized audit firms and mid-tier audit firms, the CPAAOB periodically analyzes quantitative and qualitative information concerning their operations management system etc. to contribute to more effective inspections. Particularly, it collects information related to the status of development and implementation of operations management system etc. under effective governance and efficiently functioning management (including the efforts to optimize operations such as developing audit methods utilizing digital technology and the efforts to develop and secure human resources).

Further, it utilizes the information obtained through the collection of reports to perform comparative analysis of audit firms and to identify sector-wide issues, etc.

With regard to large-sized audit firms, the CPAAOB generally conducts inspections (regular inspections) once every two years, followed in the subsequent program year by a follow-up

review to verify the status of improvements made in response to findings identified during the inspections. For details, see “6. Inspections, b. State of implementation of inspections, i. Recent conduct of inspections”). In principle, such follow-up reviews are conducted through collection of reports. However, depending on the results of the regular inspection conducted in the preceding program year and other relevant circumstances, the follow-up review may be carried out through onsite inspections

ii. Collection of reports from small and medium-sized audit firms, partnership and solo practitioner

In the case of small and medium-sized audit firms, partnership and solo practitioner, the CPAAOB selects firms partly based on the results of Quality Control Review. It then gathers and analyzes information about measures taken to address issues pointed out during Quality Control Review, their operations management system, their system of quality management, and so on. Furthermore, in many cases, as small and medium-sized audit firms are especially influenced by the Chief Executive Officer (CEO), the CPAAOB seeks to understand CEO's awareness of the current state of audit quality and their efforts to improve it, and conducts interviews as necessary.

iii. Collection of reports from small and medium-sized audit firm (follow-up after notification of inspection results)

Regarding deficiencies notified to small and medium-sized audit firm as inspection findings, the CPAAOB ascertains the progress of improvement through the collection of reports from the firms after a certain period has elapsed following the notification of inspection results, thereby encouraging voluntary improvements by the firms. The CPAAOB also follows up on the firms’ remedial measures, including through interviews where necessary.

iv. Collection of reports from audit firms in need of particularly immediate remediation

As a result of inspection, where the overall rating of the firm's operations is "Unsatisfactory and in need of immediate remediation in operations management system, etc. (Overall rating 4)," the CPAAOB conducts the collection of reports at the time of the notification of the inspection results and prompts the firms to make improvements (for information about overall ratings, see "7. Notification of Inspection Results").

b. Implementation

i. Collection of reports from large-sized audit firms and mid-tier audit firms

In PY2024, the CPAAOB collected reports from all large-sized and mid-tier audit firms covering matters relating to their operations management system etc., including their measures in response to the revised Quality Control Standards and related requirements. The collection of reports also covered matters relating to use of digital technologies in audits and other services, initiatives relating to assurance on non-financial information including sustainability-related information, and the provision of audit and other services to companies preparing for IPOs.

In addition, the CPAAOB confirmed their improvement measures in response to deficiencies identified through CPAAOB inspections, Quality Control Review and other external reviews.

ii. Collection of reports from small and medium-sized audit firms

In PY2025, reports were collected from 44 small and medium-sized audit firms, selected mainly from among firms subject to Quality Control Review in FY2024. The reports contained items related to efforts to address deficiencies identified through Quality Control Review, matters related to operations management system etc., matters concerning the quality management environment, and matters concerning audit engagements and related services.

In addition, from the perspective of encouraging voluntary efforts to ensure and improve audit quality, individual interviews were conducted, either in person or remotely as necessary, with audit firms that had received repeat findings, firms that had accepted a large number of new audit engagements with listed companies, and firms whose audited companies presented audit risks or other matters requiring particular attention. In order to conduct in-depth interviews, inspectors also participated.

During the interviews, in light of the circumstances surrounding small and medium-sized audit firms, the CPAAOB sought to encourage the establishment of the system of quality management capable of reasonably ensuring audit quality. While communicating the CPAAOB's concerns and expectations, the CPAAOB focused on matters such as the status of the development and operation of the system of quality management, including measures taken in response to the results of JICPA Quality Control Review, the management policies of chief executive officers, the development and operation of governance arrangements, policies for recruiting and developing personnel, and measures to revisions to auditing standards and other professional requirements.

The results of the interviews will be utilized as important reference information for future reviews, inspections, and other monitoring activities.

iii. Collection of reports from small and medium-sized audit firms (follow-up after notification of inspection results)

In PY2025, among small and medium-sized audit firms that had been notified of inspection results by the CPAAOB in past program years, no audit firms were identified as requiring monitoring of their responses to the notified deficiencies. Accordingly, the CPAAOB did not collect any reports after a certain period of time has elapsed following the notification of inspection results. However, the CPAAOB plans to conduct follow-up activities for an audit firm whose overall rating of operations of the audit firm, based on an inspection conducted in PY2025, was "Unsatisfactory due to presence of significant deficiencies that need to be fixed".

iv. Collection of reports from audit firms in need of particularly urgent remediation

In PY2025, the CPAAOB continued to receive reports on the status of corrective actions from four audit firms whose overall rating of operations of the audit firm, based on inspections conducted in PY2020, PY2022, and PY2023, concluded that they were "unsatisfactory and in need of immediate remediation."

6. Inspections

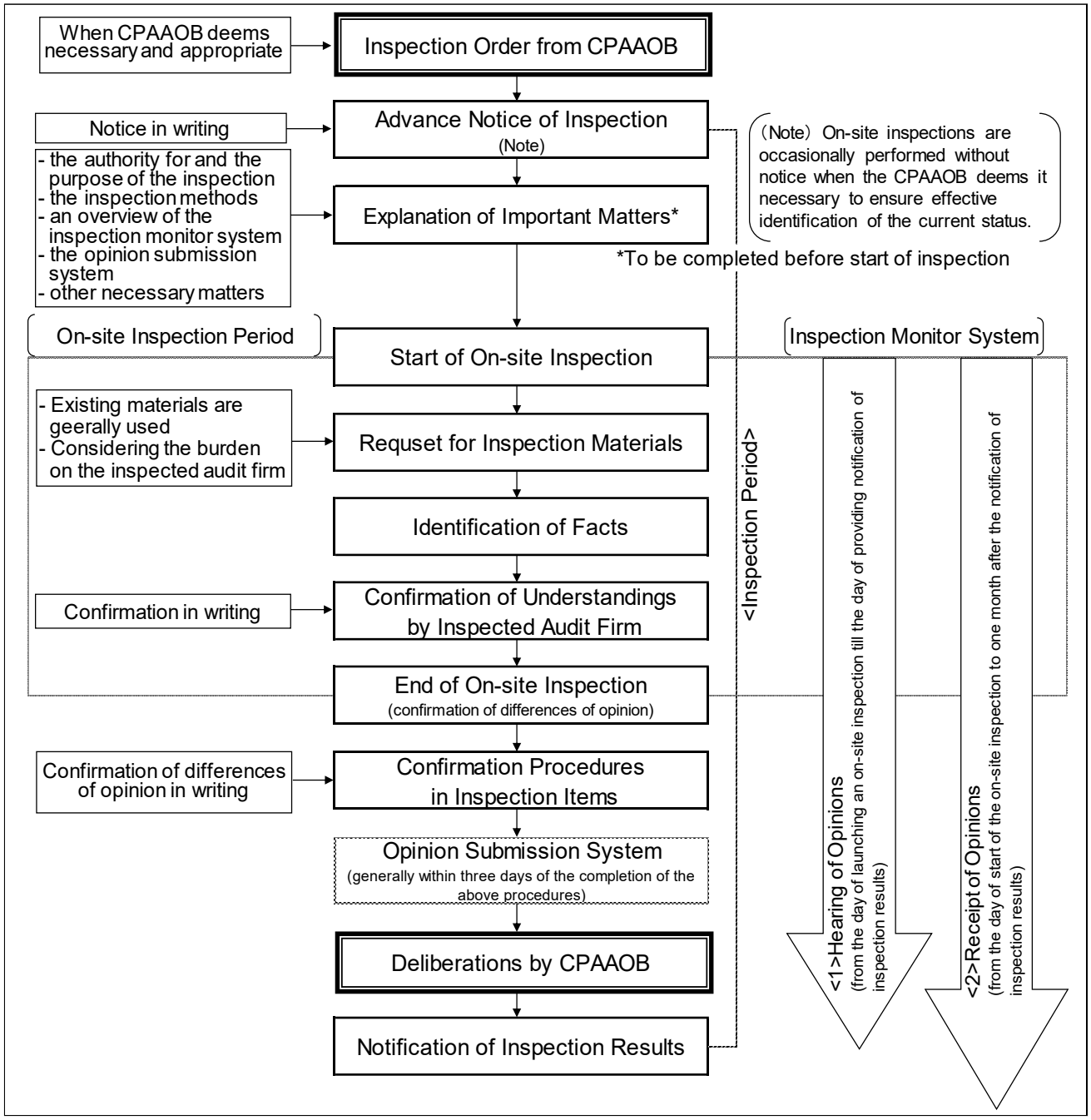
a. Overview

When deemed necessary and appropriate for the public interest or the protection of investors as a result of examination or collection of reports described in Sections 4. and 5. above, the CPAAOB inspects audit firms (Article 49-3-2 of the CPA Act). Furthermore, when deemed necessary for ensuring proper administration of the JICPA, the CPAAOB also inspects the JICPA (Article 46-12-1 of the CPA Act).

Basic matters concerning the CPAAOB's inspections, procedures for inspections, the handling of inspection results, etc. are prescribed in the "Basic Guidelines on Inspections Conducted by the Certified Public Accountants and Auditing Oversight Board" (last revised in June 2024).

The standard workflow for inspections for audit firms in accordance with the Basic Guidelines is depicted below (Figure I-2-3).

Figure I-2-3: The standard workflow for inspections



The following is an explanation of the main components of the standard workflow:

i. Inspection order from the CPAAOB

The CPAAOB issues an order to inspectors to inspect an audit firm.

ii. Explanation of important matters

Before the on-site inspection, the inspectors explain to the responsible person at the audit firm the authority for and the purpose of the inspection, the inspection methods, an overview of the inspection monitor system and the opinion submission system, and other necessary matters.

iii. On-site inspection[7]

Generally, the inspectors visit the audit firm and inspect its operations management system, the system of quality management, and audit engagements. The audit engagements inspected are selected based on the size of the audit firm, the key points of the basic plan on monitoring, and the audited company's audit risks.

Inspectors examine whether the audit firm's procedures on quality management comply with regulations, auditing standards and quality control policies established by the audit firm through the inspection of books, records and other materials and interviews with the audit firm's executives and staff.

Furthermore, inspectors obtain confirmation of facts and background information (findings) identified during the inspection in writing from the person responsible for the audit firm.

Since FY2020, the CPAAOB has used remote inspections, such as reviewing audit reports, etc., using a laptop borrowed from the audit firm and conducting interviews via a web conferencing system, in addition to the traditional in-person interviews. The CPAAOB will continue to conduct inspections utilizing both inspection methods.

iv. Confirmation procedures on inspection items

After the on-site inspection, the CPAAOB communicates to the audit firm any problems discovered during the inspection, solicits the views of the audit firm on these problems, and confirms whether there are any differences of opinion between the CPAAOB and the audit firm regarding those matters.

v. Opinion submission system

If there is a difference of opinion, the audit firm may submit its opinion to Secretary-General of the Executive Bureau in writing, usually within a three-day period (excluding weekends and public holidays) from the day on which the procedures for confirmation of inspection items were completed. Furthermore, if it receives a request from the audit firm to extend the submission period, the CPAAOB considers extending the submission period by up to two days.

If an opinion is submitted by an audit firm, a person designated by the head of the Planning, Management and CPA Examination Division ("CPA Examination Division"), of the CPAAOB Executive Bureau or the head of the CPA Examination Division, reviews the opinion and facts concerned, compiles the results of the review, and submits them to the Board of the CPAAOB.

The results, if approved by the Board of the CPAAOB, are conveyed to the audit firm through the head of the CPA Examination Division.

vi. Inspection monitor system

The CPAAOB accepts opinions from audit firms on matters such as inspectors' inspection methods to obtain an understanding of the CPAAOB's inspections and help ensure that they

[9] The CPAAOB conducts the following types of inspections: "regular inspections," "ad-hoc inspections," which focus on inspection items and are conducted in a flexible and simple manner, and "follow-up inspections," which are targeted at large-sized audit firms.

are conducted properly and efficiently.

Inspection monitoring is conducted by “receiving opinions” and “asking for opinions,” and the head of the CPA Examination Division takes action, when necessary, such as giving instructions to inspectors.

b. State of implementation of inspections

i. Recent conduct of inspections

The frequency of inspections differs depending on the size of the audit firm. For large-sized audit firms, the CPAAOB will conduct inspections (regular inspections) once every two years in principle, and will follow up on these inspections in the following program year (verifying improvements in deficiencies identified in the inspections conducted in the previous program year). In principle, follow-up shall be conducted through collection of reports, but may be conducted through inspections based on the results, etc. of regular inspections conducted in the previous program year. From PY 2016 to PY 2021, the CPAAOB conducted follow-up inspections to verify improvements in the program year following the program year in which it conducted regular inspections.

Mid-tier audit firms will be inspected once every two years from PY2025.

Inspections of small and medium-sized audit firms are conducted as necessary, in light of deficiencies pointed out in Quality Control Review.

Details of the inspections during the past five years are as below (Figures I-2-4 and I-2-5).

Figure I-2-4: Status of implementation of inspections in the past five years (based on commencement of inspections)
(unit: audit firms)

Fiscal/PY	2021 (Note 1)	2022	2023	2024	2025
Large-sized audit firms	4(2)	2	2	2	2
Mid-tier audit firms	1	2	2	2	2
Small and medium-sized audit firms, partnerships and solo practitioners	4	5	5	3	5
Foreign audit firms, etc. (Note 2)	0	1	0	0	0
Total	9(2)	10	9	7	9

(Note1) Figures in parentheses are the number of follow-up inspections.
(Note2) See “II. Overview of the Audit Sector, D. Foreign Audit Firms” for information on foreign audit firms etc.
(Source) Prepared by the CPAAOB based on results of inspections by the CPAAOB

Figure I-2-5: Number of inspections, inspectors, inspection periods and number of audit engagements

	Large-sized audit firms	Mid-tier audit firms	Small and medium-sized audit firms
Number of inspections(case)	9	8	7
Average number of inspectors(headcount)	8.6	8.0	5.0
Average inspection period(calendar days)	250.7	193.8	145.0
Average number of inspected audit engagements (companies)	6.0	4.9	2.9

(Note1) Inspections conducted and completed in the five years from PY2021 through PY2025 are covered. Inspections of foreign audit firms and others, follow-up inspections, cases involving the submission of opinions and cases recommended to the Commissioner of the FSA were excluded because they involved procedures different from those of normal inspections.
(Note2) Inspection period means the period (calendar day basis) between the date on which notice of the inspection was made (in the case of inspections with no advance notice; the date on which the on-site inspection started) and the date on which notification of the inspection results was issued.
(Source) Prepared by the CPAAOB based on the results of inspections

ii. Deficiencies

(i) Characteristics of deficiencies identified through inspections of the system of quality management

Characteristics of the deficiencies identified through the CPAAOB inspections in and after PY2023 were as follows:

Large-sized audit firms tended to shift primary responsibility for quality management from the quality management section at their headquarters to the audit services section, which was closer to the audit teams. The results of recent inspections presented outstanding issues; for example, although cooperation between the quality management section and audit services sections has progressed, there is still a need to embed improvement measures within audit teams (where audit services are actually performed) and to verify the effectiveness of those measures. (For information on the organization of large-sized audit firms, see "III. Operation of Audit Firms, A. Operations Management System, 1. Organizational Structure of Audit Firms").

While mid-tier audit firms have undertaken initiatives to establish organizational structures to support firm-wide responses, their head-office functions responsible for quality management remain less robust than those of large-sized audit firms, and the personnel available to perform such functions continue to be limited. In addition, management, including CEOs, does not always demonstrate a sufficient level of awareness regarding the importance of maintaining and improving audit quality or the need for close coordination with quality management departments. Furthermore, at firms that are expanding their business operations, the development of systems of quality management has not always kept pace with the speed of growth. Another challenge is to verify whether improvement measures have been effectively implemented and sufficiently embedded in audit practice.

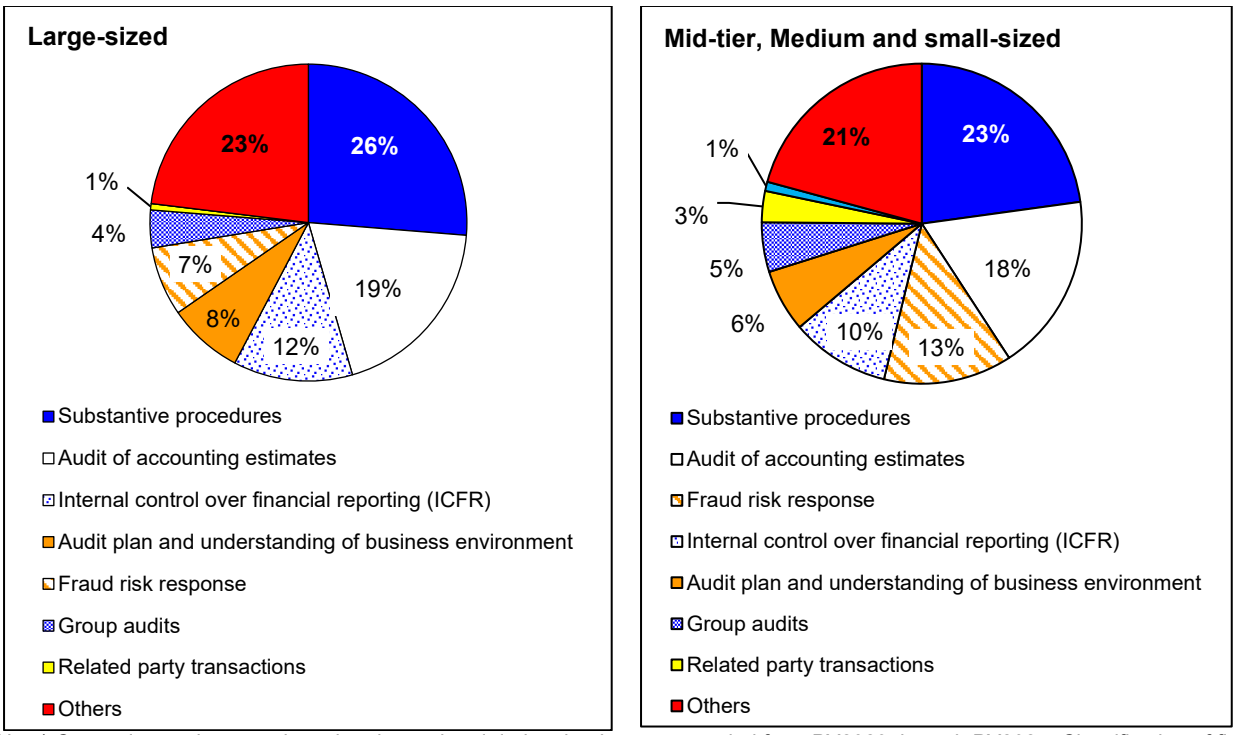
At small and medium-sized audit firms, challenges remain, including insufficient awareness of quality management on the part of CEO and quality management leaders, an inadequate

understanding of the level of quality management and audit procedures required under the current auditing standards, and a failure to identify the human resources (in terms of competence and time) necessary for the proper operation of the system of quality management. In addition, deficiencies were observed in audit firms' measures to address findings identified through Quality Control Review and other external reviews. In some cases, certain corrective actions were overlooked, while in others, remediation measures were merely formal in nature and their appropriateness and effectiveness were not adequately validated.

(ii) Characteristics of deficiencies identified through inspections of audit engagements

Deficiencies identified through inspections of audit engagements from PY2023 to PY2025 can be classified in line with the ASCS structure as follows (Figure I-2-6).

Figure I-2-6: Deficiencies in PY2023-2025



(Note) Covers inspections conducted and completed during the three-year period from PY2023 through PY2025. Classification of findings identified at large-sized audit firms (seven firms in total), mid-tier audit firms (six firms in total), and small and medium-sized audit firms (nine firms).

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

Regardless of the size of audit firms, deficiencies in substantive procedures (audit procedures, such as analytical procedures and tests of details, performed in relation to classes of transactions, account balances, and disclosures to address the risks of material misstatement) were the most common, followed by deficiencies related to the audit of accounting estimates. Deficiencies concerning audits of internal control over financial reporting, audit planning and understanding of the entity and its environment, and responses to fraud risks also continued to be identified. The CPAAOB therefore performed inspections taking into account these trends in the nature of deficiencies identified.

The CPAAOB encourages inspected audit firms to take voluntary initiatives to improve their operations by analyzing the causes of deficiencies identified during inspections and sharing the results of such analyses through dialogue with the inspected audit firms. Examples of deficiencies identified during inspections and analyses of their underlying causes are described in detail in the Case Report from Audit Firm Inspection Results. (For an overview of the Case Report, see "A. Monitoring Perspectives and Objectives of the CPAAOB, 5. Communication of Monitoring Information".)

7. Notification of Inspection Results

a. Inspection results notification

The responsible person at the audit firm is notified of the inspection results in writing. The current inspection results notification contains the information shown in Figure I-2-7[10].

Figure I-2-7: Items included in inspection results notification

1. Key points
2. Inspection viewpoints
3. Measures against deficiencies developed by the inspected audit firm to ensure the proper execution of services with the aim of maintaining and improving quality management (quality management environment)
4. Conduct of audit services (audit engagements)

b. “Key points” section

Among the sections in an inspection results notification, the “Key points” section elaborates deficiencies identified during the CPAAOB inspections that are regarded as significant. It comprises three subsections (operations management system, the system of quality management and audit engagements) and confers an overall rating according to the status of these subsections.

The overall rating of the operations at the inspected audit firm is presented at the beginning of the “Key points” section of the inspection results notification, as shown in Figure I-2-8.

Figure I-2-8: Example of key points

1. Key points

   As a result of our inspection of your audit firm and within the scope of our inspection, we determined the operations of your firm are … (one of five overall rating categories).

   (1) Operations management system
   … (presents problems with the audit firm’s governance and operations)

   (2) Quality management system
   …(presents deficiencies in the system of quality management)

   (3) Audit engagements
   …(presents deficiencies in audit services)

The CPAAOB has included overall ratings in the inspection results notification since the inspections commenced in PY2016. The aims are to accurately convey the CPAAOB’s assessment of audit firms and to ensure proper understanding of their level of quality

[10] As Overall ratings will not be given for ad-hoc inspections or follow-up inspections of large-sized audit firms, the inspection results notifications in those cases differ from the ones of regular inspections

management among audit and supervisory board members etc. of audited companies, to whom the inspection results notification is provided. It is expected that this will contribute to further enhancing two-way communication based on the results of inspections.

c. Overall rating category

The overall rating takes the form of one of the following five categories and is based on the assessment results of audit firms' operations management system, system of quality management and audit engagements. Each category is assessed with the following descriptions.

"Satisfactory" (Overall rating: 1)

The description is used when the operations of the audit firm are deemed to be satisfactory, e.g., there are almost no deficiencies in the operations management system, quality management and audit engagements.

"Generally Satisfactory with minor deficiencies" (Overall rating: 2)

The description is used when the operations of the audit firm are deemed to be satisfactory overall although there are issues that need to be fixed, e.g., there are no significant deficiencies despite the presence of some deficiencies in the operations management system, quality management or audit engagements.

"Unsatisfactory due to presence of significant deficiencies that need to be fixed" (Overall rating: 3)

The description is used when the operations of the audit firm are deemed to be unsatisfactory, e.g., there are significant deficiencies in the operations management system, quality management or audit engagements that need to be fixed.

"Unsatisfactory and in need of immediate remediation in operations management system, etc." (Overall rating: 4)

The description is used when the operations of the audit firm are deemed to be unsatisfactory and in need of immediate remediation.

"Extremely unsatisfactory" (Overall rating: 5)

The description is used when material deficiencies with the system of quality management and audit engagements are identified, and voluntary remediation cannot be expected to be implemented by the audit firm.

In the case of an audit firm rated as "unsatisfactory and in need of immediate remediation (Overall rating 4)," the CPAAOB collects a report at the time of the notification of inspection results and encourages the firm to promptly make improvements (for more details, see "5. Collection of Reports, b. Implementation, iv Collection of reports from audit firms in need of particularly urgent remediation". In addition, the CPAAOB makes recommendations to the Commissioner of the FSA regarding administrative actions and other measures with respect to audit firms that are rated as “extremely unsatisfactory (Overall rating: 5)” or for which such measures are considered necessary based on the results of inspections.

d. Distribution of overall ratings

The distribution of overall ratings in the last five years of inspections (regular inspections launched and completed between PY2021 and PY2025) is shown below (Figure I-2-9).

No audit firms were rated as "Satisfactory (Overall rating: 1)," the highest category in the overall rating scheme. All audit firms, therefore, were rated as "Generally satisfactory with minor deficiencies (Overall rating: 2)" or lower based on the assessment of their operations management system, quality management and audit engagements.

Many small and medium-sized audit firms had overall ratings lower than those of large-sized and medium-tier audit firms. This may be due in part to the fact that when inspecting small and medium-sized audit firms, the CPAAOB mainly selects audit firms whose system of quality management needs to be confirmed immediately based on recommendations in the Quality Control Review, etc.

At small and medium-sized audit firms with low overall ratings, there was insufficient awareness of quality management among the CEO. In addition, partners and staff members lacked awareness of recent environmental changes pertaining to accounting and auditing and did not understand adequate levels required by the current audit standards.

Figure I-2-9: Overall ratings for inspections in the last five years (based on commencement of inspections) (unit: audit firms)

Overall rating	Large-sized audit firms	Mid-tier audit firms	Small and medium-sized audit firms
Satisfactory (Overall rating: 1)	-	-	-
Generally satisfactory with minor deficiencies (Overall rating: 2)	4	-	-
Unsatisfactory due to presence of significant deficiencies that need to be fixed (Overall rating: 3)	-	4	2
Unsatisfactory and in need of immediate remediation in operations management system (Overall rating: 4)	-	1	5
Extremely unsatisfactory (Overall rating: 5)	-	-	10

(Note1) Totals for audit firms subject to regular inspections that were commenced and completed between PY2021 and PY2025
(Note2) For audit firms that underwent multiple regular inspections in the period under review, overall ratings in the latest inspection are tallied.
(Source) Prepared by the CPAAOB based on information obtained through the CPAAOB inspections

e. Communication of “key points” to audit and supervisory board members etc. of all audited companies

Audit firms are required to communicate the “key points” in their inspection results notifications and the action they are taking in response to them to audit and supervisory board members etc. of all audited companies[11].

In addition, audit firms are required to communicate the details of the deficiencies and the action taken in response to them to the audit and supervisory board members etc. of audited companies where their audit engagements were selected for the inspections.

It is expected that the audit and supervisory board members etc. of audited companies will use the communicated information not partially but comprehensively to better understand the status of the design and operation of the audit firm's system of quality management and engage in meaningful communication with the audit firm.

f. Handling of inspection results

An inspected audit firm is required to obtain prior consent from the CPAAOB to disclose[12] inspection results to a third party. Recently, CPAAOB has received a large number of requests from audit firms for prior consent to disclose inspection results and other information as requested by potential audited companies (e.g., companies considering which auditors to appoint) etc.

However, an inspected audit firm is not required to obtain the CPAAOB's prior consent if it conveys inspection results to auditors and others at audited companies, mentioned above in e., and presents them to the JICPA based on rules of the JICPA Quality Control Committee's detailed operational rules for handling of notification documents for inspection results.

This approach is expected to facilitate communication between auditors and others of audited companies and audit firms through the utilization of inspection results and improve the effectiveness of the JICPA’s Quality Control Review.

It is desirable that not only audit members etc. of audited companies but also potential audited companies make use of the CPAAOB inspection results etc. in order to confirm the status of the establishment and implementation of the system of quality management by accounting auditors.

8. Recommendation

The CPAAOB recommends that the Commissioner of the FSA take administrative disciplinary actions or other measures based on Article 41-2 of the CPA Act, if deemed necessary as a result of the inspection. On October 30, 2025, the CPAAOB made a recommendation to the Commissioner of the FSA with respect to one audit firm whose operations were assessed as extremely unsatisfactory.

[11] The ASCS requires audit firms to communicate the details of inspection results notifications and the measures for improvements to the audit and supervisory board members etc., in writing or by electronic record. (ASCS 260, No. 18-2JP, A32-4JP).
[12] Details on disclosing inspection results to third parties are posted on the CPAAOB website (Revised in June 2026).

In addition, following the amendments to the CPA Act in May 2022, the CPAAOB has, in cases where there are grounds to suspect false certifications or similar misconduct, conducted verifications of such matters in addition to examining the firm's operations during inspections. On July 3, 2026[13], the CPAAOB made a recommendation to the FSA with respect to one audit firm based on the results of such verification.

Outlines of the deficiencies identified through inspections in the recommendations are provided below.

[Recommendation Based on Inspection Results Concerning Frontier Audit Corporation (October 30, 2025)]

Numerous and wide-ranging deficiencies were identified, including significant deficiencies (approval of conflict-of-interest transactions), arising from, among other factors, an insufficient awareness of the need to comply with laws and regulations and quality management standards necessary for establishing effective operations management system and the system of quality management.

In addition, numerous and wide-ranging deficiencies were identified in the individual audit engagements reviewed, including significant deficiencies (inappropriate audit procedures relating to the valuation of shares of subsidiaries), arising from an insufficient understanding of auditing standards and the level of procedures required under the current auditing standards.

[Recommendation Based on Inspection Results Concerning Yamabuki Audit Corporation (July 3, 2026)]

It was found that the firm's operations were extremely unsatisfactory and that, in the audit of the financial statements of Aqua Line Co., Ltd., it failed to exercise due professional care and certified financial statements containing material misstatements as if they were free from material misstatements.

In addition, numerous and wide-ranging deficiencies were identified in the firm's operations management system, the system of quality management, and the individual audit engagements examined, including significant deficiencies in substantive audit procedures relating to revenue recognition. Furthermore, the firm failed to appropriately assess the reasonableness of the valuation of corporate bonds and crypto-assets held by Aqua Line Co., Ltd. As a result, it certified financial statements containing material misstatements as if they were free from material misstatements.

Based on recommendations arising from the results of CPAAOB inspections such as those described above, the Commissioner of the FSA may impose administrative actions and other measures. Over the past five years, administrative actions imposed on audit firms following CPAAOB recommendations have included partial suspensions of business operations, such as prohibitions on entering into new audit engagements for periods ranging from approximately six months to one year, short-term suspensions of all business operations for one month, and business improvement orders requiring

[13] Although this case falls outside PY 2025, a brief outline of the deficiencies is provided because it was the first case in which the CPAAOB made a recommendation to the FSA based on an inspection that included a verification of false certifications.

improvements to operations management system.[14] Such measures are imposed when the operation of an audit firm is found to be extremely unsatisfactory, including where significant deficiencies are identified in audit quality or operations management system etc. They play an important role in promoting corrective actions aimed at strengthening compliance with laws and regulations and enhancing the system of quality management at audit firms.

For further details regarding CPAAOB recommendations, please refer to the CPAAOB website.
https://www.fsa.go.jp/cpaaob/shinsakensa/kankoku/index.html

[14] Where a partner of an audit corporation engages in a false certification, administrative disciplinary action may be imposed on that partner. In addition, pursuant to Article 30(2)(i) of the CPA Act where the false certification resulted from the intentional misconduct of the partner, or pursuant to Article 30(2)(ii) where it resulted from the partner's failure to exercise due professional care, the audit corporation to which the partner belongs may be subject to a reprimand, an order to improve its operations, suspension of all or part of its business for a period not exceeding two years, or dissolution. Furthermore, where a false certification is made intentionally or through gross negligence, the Prime Minister (the relevant authority having been delegated to the Commissioner of the FSA) may issue an order requiring payment of an administrative monetary penalty. In addition, a formal interview procedure is provided for under the Act.

C. Cooperation with International Organizations Related to Audit Oversight

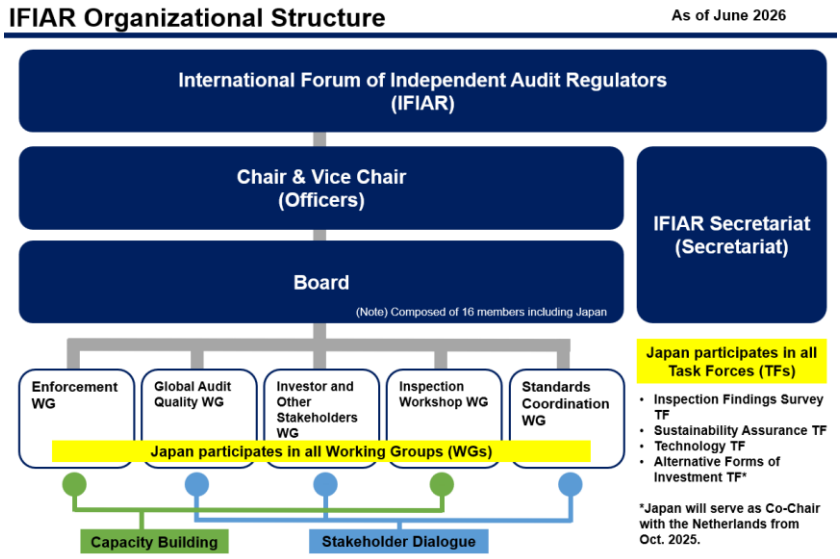
1. Participation in International Discussions through the International Forum of Independent Audit Regulators (IFIAR)

In response to a series of accounting scandals that occurred between 2001 and 2002, including the accounting fraud at Enron Corporation in the United States, independent audit oversight authorities were established in many jurisdictions, including Japan. As a forum for sharing knowledge and fostering cooperation among these audit oversight authorities, the IFIAR was established in 2006. Since its inception, the CPAAOB and the FSA have been active members of IFIAR and have contributed to the implement of global audit quality through its activities.

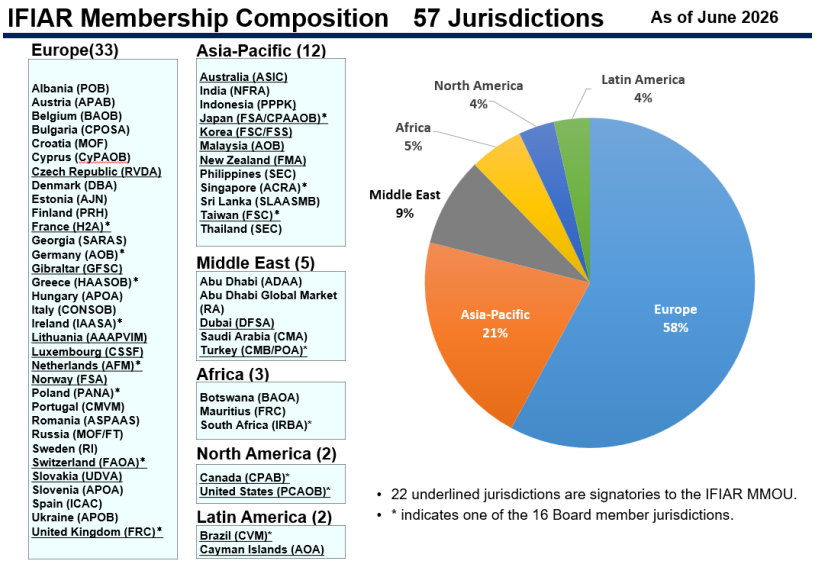
As business activities have become increasingly globalized, the importance of ensuring consistently high-quality audits worldwide has grown in order to maintain the reliability of corporate reporting. Reflecting this need, IFIAR's membership has expanded from 18 jurisdictions at the time of its establishment to 57 today (Figure I-3-1). IFIAR's permanent Secretariat is located in Otemachi, Tokyo, and Japan, as the host country of the Secretariat, provides support for its smooth operation. In October 2025, Ms. Julia Rendschmidt, formerly of Germany's Auditor Oversight Body (AOB), succeeded Mr. Carl Renner as IFIAR's Executive Director. The CPAAOB will continue to support to facilitate the smooth and effective operation of the IFIAR Secretariat under the new leadership.

In addition, since the establishment of IFIAR's Board, Japan has served as a Board member and has played a leading role in IFIAR's governance, activities, and discussions. These contributions include engaging in dialogue with the six largest global audit networks[15] and actively participating in various working groups and task forces addressing specific audit-related topics. The following section provides an overview of IFIAR's activities and recent developments.

Figure I-3-1: IFIAR Organizational Structure and Membership Composition (as of June 2026)



[15] Referring to the global networks of Deloitte, EY, KPMG, PwC, BDO, and Grant Thornton.



(Source) Prepared by the CPAAOB based on IFIAR data.

[Major Activities of IFIAR]

Under the leadership of the IFIAR Chair, the Board, which meets five times a year (including three in-person meetings), determines IFIAR's strategic plans and operational policies and conducts a wide range of discussions and activities aimed at enhancing audit quality globally. Until April 2025, the former Secretary-General of the CPAAOB served as IFIAR Chair, leading these discussions and initiatives and making significant contributions to expanding IFIAR's membership and communicating the outcomes of its work to external stakeholders. Following the transition of the chairmanship to another jurisdiction, the CPAAOB and the FSA have continued to support the IFIAR Secretariat as the host country while striving to ensure that Japan continues to play an active role in Board deliberations.

At present, five working groups and four task forces ("WG/TF") have been established under the Board to address key audit-related issues. Each WG/TF engages in active discussions through several in-person meetings and virtual conferences each year. Japan participates in all of these WG/TFs and actively contributes to their activities. Currently, the Director, Office of International Audit and IFIAR Affairs contributes to Board discussions as Japan's representative and, in particular, serves as Co-Chair of the Task Force addressing issues related to private equity (PE) investment in audit firms, as discussed later in this report.

The outcomes of discussions and activities undertaken by the Board and the various WG/TF are shared at the IFIAR Plenary Meeting, the annual general meeting attended by the majority of IFIAR members. In April 2026, the 26th Plenary Meeting, commemorating IFIAR's 20th anniversary, was held in Paris, France. Panel discussions were conducted with external speakers on key topics such as PE investment in audit firms, the use of artificial intelligence (AI) in auditing, and responses to sustainability assurance. Japan actively contributed to the event, including serving as moderator for one of the panels. In addition to IFIAR members, the CEOs of the six largest global audit networks also attended the Plenary Meeting and exchanged views on major issues affecting the audit profession. Furthermore, the Chair of the CPAAOB attended the 26th Plenary Meeting as head of the Japanese delegation and took the

opportunity to strengthen relationships with overseas authorities, including through a bilateral exchange of views with the Chair of the PCAOB, who assumed office in February 2026.

The following section outlines the activities of IFIAR's principal WG/TF and recent international developments in auditing that provide the background to those activities.

a. Survey of Inspection Findings

Since 2012, IFIAR has conducted an annual survey of its member authorities, aggregating inspection findings relating to the system of quality management and individual audit engagements of member firms of the six largest global audit networks and publishing the results in its Survey of Inspection Findings.[16] The survey serves as a tool for IFIAR members to identify overall trends in inspection findings and provides the six largest global audit networks with quantitative trend information on inspection findings reported by IFIAR member authorities.

The 2025 survey covered inspection reports issued to member firms of the six largest global audit networks during the twelve-month period from 1 July 2024 to 30 June 2025. The Survey of Inspection Findings presents a "finding rate," defined as the percentage of inspected Public Interest Entity (PIE) audit engagements in which at least one significant deficiency was identified. For 2025, the average finding rate across participating IFIAR members[17] was 35%, representing an increase of one percentage point from the previous year. While the finding rate generally declined from 47% in 2014 to 26% in 2022, it has risen again from 2023 through 2025.

The 2025 report identified several areas with particularly high rates of significant deficiencies. With respect to systems of quality management, this included engagement performance, monitoring and remediation processes, and independence and ethical requirements. For individual audit engagements, significant deficiencies were most frequently identified in areas such as accounting estimates (including fair value measurements), internal control testing, and audit sampling. The recent increase in finding rates suggests that further efforts may be needed to enhance the effectiveness of initiatives undertaken by the audit networks to improve audit quality.

In light of these findings, IFIAR has continued to engage with the global audit networks through communications and dialogue, encouraging them to conduct root cause analyses, develop and implement appropriate and effective remedial measures based on those analyses, and continuously monitor and evaluate the effectiveness of such measures in order to further improve audit quality globally.

The CPAAOB will also continue to closely monitor these areas, particularly those in which significant deficiencies are frequently identified at the global level, and will continue to conduct oversight and monitoring in these areas.

[16] CPAAOB, Publication of IFIAR's Report on 2025 Survey of Inspection Findings: https://www.fsa.go.jp/cpaaob/sonota/kokusai/20260413.html

[17] Excluding members that did not respond to (i.e., did not participate in) the survey.

b. The Use of Technology in Auditing

Rapid advances in technology continue to transform the audit profession globally. Audit firms are increasingly integrating tools such as advanced data analytics, AI, and automation into their audit workflows with the aim of improving both efficiency and effectiveness. While the use of these technologies has the potential to enhance audit quality through more sophisticated analyses and strengthened professional skepticism, it may also give rise to challenges relating to supervision, the ethical use of technology, and the risk of excessive reliance on technology-generated outputs.

To better understand the impact of technology on audit quality and to facilitate discussions on ensuring transparency and accountability in the use of technology, IFIAR has established a Technology Task Force. Drawing on dialogue with the six largest global audit networks and insights obtained through the inspection and supervisory activities of IFIAR member authorities, the Task Force conducts analyses and discussions on these issues.

In April 2026, IFIAR issued a report entitled *"The Use of Technology in Audits: Innovation and Audit Quality"*.[18] In addition to outlining recent developments in the use of technology, the report presents key considerations regarding approval and evaluation processes, monitoring frameworks, and other governance arrangements related to the implementation of technology tools by audit firms. The principal findings of the report are summarized below:

- Trends in the use of technology. Development of AI-enabled audit tools continues to accelerate. In 2026, the number of AI-powered tools across the six largest global audit networks increased by approximately 30% compared with the previous year. In addition, plans to implement agentic AI, which is capable of autonomously initiating and performing tasks, are actively progressing.
- Governance and monitoring of technology tools. Audit networks and member firms need to ensure that advances in technology do not obscure professional judgment or reduce transparency. In particular, it is important to establish robust processes for the initial validation, approval, and updating of Automated Tools and Techniques (ATTs); provide appropriate guidance and training regarding their use; and effectively monitor their deployment. While responsibility for monitoring varies among audit networks, with some assigning primary responsibility to the global network and others to member firms, establishing a consistent monitoring framework remains a key challenge across the profession. Examples of monitoring practices include: (i) tracking usage through management dashboards; and (ii) conducting thematic reviews, benchmark testing, and assessments of the impact on audit quality using monitoring indicators.
- Maintaining human oversight. Audit engagement leaders should be involved at key decision points where significant judgments are supported by AI or other technologies. Comprehensive reviews of autonomous decision-making processes should also be

[18] Use of Technology in Audits - Innovation and Audit Quality 2026, FSA website: https://www.fsa.go.jp/ifiar/20260420.html

conducted to ensure appropriate accountability and maintain a human-led audit approach.

- Implications of technology used by audited entities. The extent to which audited entities use technology in their financial reporting processes varies significantly and may affect the nature and scope of audit procedures. For example, where AI-generated documents or data are used as audit evidence, traditional audit approaches may need to be reassessed. In addition to risks arising from errors inherent in AI outputs or limitations of particular models, auditors must also remain alert to the possibility that AI could be intentionally or maliciously misused[19], including through the deliberate generation or manipulation of data, documents, or transactions intended to mislead users of financial statements or circumvent internal controls.

As the use of technology in auditing continues to expand around the world, audit oversight authorities in Europe, Canada, and other jurisdictions have also begun issuing related guidance and reports, several of which are referenced in the IFIAR report discussed above. For example, the Accounting and Corporate Regulatory Authority of Singapore (ACRA) issued audit practice guidance summarizing matters that audit firms should consider when conducting technology-related risk assessments and monitoring activities as part of strengthening their systems of quality management.[20] Similarly, in March 2026, the UK Financial Reporting Council (FRC) issued guidance designed to support audit firms in adopting AI technologies, particularly generative AI and agentic AI, including practical use cases, anticipated risks, and suggested mitigation measures.[21]

As the use of technology in auditing continues to evolve, the CPAAOB will continue to collect and analyze information on the adoption of technology, particularly AI, in audit practices, while taking into account developments and emerging trends at the global level.

c. PE Investment in Audit Firms

In recent years, particularly in Europe and North America, there has been a rapid growth of PE funds and other investors acquiring ownership interests in audit firms. In the United Kingdom, PE investment in the accountancy profession has become especially active compared with the rest of Europe. The number of PE transactions involving accounting firms increased sharply from 18 in 2022 to 41 in 2023 and 77 in 2024.[22] Moreover, investment targets are no longer limited to small and medium-sized audit firms but are increasingly extending to firms of significant scale. In the United States, it has been noted that approximately one-third of the top 30 accounting firms by revenue have sold a portion of their ownership interests to PE funds.

PE funds are attracted by the stable cash flows generated by audit firms, as well as the potential for business growth and operational efficiencies. For audit firms, accepting PE investment can

[19] Examples include the intentional generation, or manipulation of data, documents, or transactions designed to mislead users of financial statements or to circumvent controls.
[20] ACRA, Audit Practice Guidance No. 1 of 2025: https://isomer-user-content.by.gov.sg/277/2ea53072-6488-4170-81db-66d94d6b84e4/audit-practice-guidance-no-1-of-2025.pdf
[21] FRC, Innovative New Guidance Supports Audit Firm Adoption of Emerging AI Technologies: https://www.frc.org.uk/news-and-events/news/2026/03/innovative-new-guidance-supports-audit-firm-adoption-of-emerging-ai-technologies/
[22] Accountancy Europe, Information Paper: Private Equity Investments in Accountancy Firms: https://accountancyeurope.eu/publications/private-equity-investments-in-accountancy-firms/

provide access to capital needed for investments in areas such as AI and specialized talent, while also strengthening competitiveness through increased scale and more efficient use of management resources. At the same time, the entry of PE funds into the audit profession is altering the ownership structures of audit firms, which have traditionally been owned primarily by partners, and the implications of these developments are attracting growing international attention.

In December 2024, IFIAR issued a statement outlining both the potential risks and benefits associated with PE investment in audit firms and expressing the shared view of IFIAR member authorities that the implications of these developments for audit quality and auditor independence should be closely monitored.[23]

During 2025, international organizations, foreign regulatory authorities, and professional accountancy bodies further advanced discussions and analysis regarding the impact of PE investment on audit quality, governance, and independence. A number of reports and alert publications reflecting these discussions were subsequently issued.[24]

In particular, concerns have been raised that audit quality could be adversely affected from the following perspectives:

- Excessive cost-cutting driven by short-term profit objectives
  Pressure from PE investors to generate short-term returns may encourage audit firms to reduce personnel and costs excessively or to accept audit engagements disproportionate to available audit resources, thereby potentially undermining audit quality.
- Impairment of audit firm and auditor independence resulting from more complex governance structures and an expanded group of stakeholders
  As organizational structures become more complex, PE investors may, depending on the governance framework, become involved in decision-making processes relating to business strategy, management, and compensation. In addition, concerns have been raised that conflicts of interest may increase as the scope of independence requirements could extend to PE funds and their portfolio companies.

In many jurisdictions in Europe and North America, regulations require CPAs to hold a majority ownership interest in audit firms.[25] As a result, a common organizational model has emerged whereby the entity providing statutory audit services (the audit firm) is separated from the entity providing non-audit services, such as accounting, tax, and advisory services (the non-audit firm), with service agreements established between the two entities. In many cases, PE funds invest in the non-audit entity rather than the audit firm itself.

Particularly in the United States, such arrangements are categorized as an Alternative Practice

[23] IFIAR, IFIAR Statement on Private Equity Investment in Audit Firms: https://www.ifiar.org/?wpdmdl=17670
[24] IESBA (International Ethics Standards Board for Accountants), IESBA Staff Alert - Private Equity Investment in Accounting Firms: https://ifacweb.blob.core.windows.net/publicfiles/2025-07/IESBA%20Staff%20Alert%20-%20PEI%20-%20Final%20%287.31.25%29_0.pdf
IFAC, Private Equity Investment in Accountancy: https://www.ifac.org/private-equity-investment-accountancy
[25] Some states, countries, or jurisdictions impose more stringent ownership requirements.

Structure (APS), distinguishing them from the traditional partnership model. In December 2025, the American Institute of Certified Public Accountants (AICPA) released an exposure draft proposing revisions to its Code of Professional Conduct to redefine and clarify the interpretation of APS arrangements.[26] Similarly, in March 2026, the FRC, reflecting increasing restructuring activity within the audit profession and the growth of PE investment, revised its PIE Auditor Registration Rules. Under the revised rules, audit firms are required to notify the FRC of significant changes to their governance or ownership structures in advance rather than after such changes have taken effect.[27] In addition, several jurisdictions where PE investment in the audit profession has become more prevalent have strengthened efforts to monitor changes in organizational structures through reviews of licensing applications and oversight of firms' systems of quality management.

Within IFIAR, a dedicated Task Force has been established, as noted above, to monitor developments relating to PE investment in audit firms, improve understanding of the evolving landscape, and consider potential responses by IFIAR. Japan and the Netherlands serve as co-chairs of this Task Force. Going forward, the Task Force plans to conduct literature reviews and stakeholder interviews to obtain a deeper understanding of these developments.

In addition, during a panel session at the 26th IFIAR Plenary Meeting in April 2026, moderated by Japan, representatives of audit oversight authorities, the audit profession, and PE investors discussed the factors driving audit firms to accept external investment, areas where value creation is expected, potential risks, and possible mitigation measures.

In Japan, meanwhile, the CPA Act restricts investment in audit corporations to partners, namely registered CPAs or registered specified partners. Consequently, there have been no observable instances of PE funds entering the Japanese audit profession to date. Nevertheless, the CPAAOB will continue to closely monitor international developments in this area, recognizing that changes in the policies or culture of global audit networks could indirectly affect the Japanese auditing environment.

d. Responding to the Institutionalization of Sustainability Disclosure and Assurance

In light of the increasing implementation of sustainability disclosure and assurance requirements across jurisdictions, IFIAR established the Sustainability Assurance Task Force in January 2023. The objective of the Task Force is to develop a comprehensive understanding of developments in member jurisdictions and to support consideration of future regulatory and supervisory issues. The Task Force conducts fact-finding activities and discussions on issues relating to sustainability reporting and assurance engagements.

To better understand the status of sustainability disclosure and assurance frameworks, as well as related supervisory and inspection arrangements, the Task Force conducted a survey of IFIAR

[26] The proposed revisions require assessments of independence and related matters in APS arrangements to be based on the substance of the relationship, taking into account factors such as influence, control, and the surrounding circumstances.
[27] FRC, FRC strengthens oversight of PIE audit firm restructuring:
https://www.frc.org.uk/news-and-events/news/2026/03/frc-strengthens-oversight-of-pie-audit-firm-restructuring/

member authorities.[28] In June 2026, IFIAR published its Fact Sheet summarizing the survey findings.[29]

Comparing the results with those of the previous survey conducted in 2023, significant cross-jurisdictional progress has been observed in the adoption of sustainability-related regulatory frameworks. Among the 46 jurisdictions that responded to questions regarding sustainability disclosure and assurance requirements, more than 60% have implemented or adopted mandatory requirements. The survey also showed increasing convergence in applicable disclosure standards. Jurisdictions are generally aligning with the European Sustainability Reporting Standards (ESRS), the International Sustainability Standards Board (ISSB) standards, or domestic standards based on the ISSB framework. Regarding assurance standards, the International Standard on Sustainability Assurance (ISSA) 5000 and the International Standard on Assurance Engagements (ISAE) 3000 were identified as the principal frameworks being applied. Regarding assurance levels, approximately 80% of the 44 jurisdictions responding to the relevant question indicated that they either require, or are likely to require, limited assurance, making it the predominant form of assurance globally.

Regarding supervisory frameworks, progress has been made in establishing registration and accreditation systems for sustainability assurance providers, as well as arrangements for monitoring independence and systems of quality management. However, only 12 jurisdictions reported that they had already commenced inspections of sustainability assurance engagements. As disclosure and assurance regimes become more widely established, supervisory and inspection activities, as well as the enhancement of supervisory methodologies are expected to become an increasingly important area of regulatory focus.

Against this backdrop, IFIAR will continue monitoring developments across member jurisdictions in order to promote the reliability of sustainability-related information. At the same time, it will support the advancement of supervisory and inspection practices and facilitate the sharing of knowledge among member authorities with responsibility for overseeing sustainability assurance providers.

Sustainability assurance was also discussed at the 26th IFIAR Plenary Meeting held in April 2026, where participants shared practical experiences relating to supervision and inspection in their respective jurisdictions. For example, some authorities described a phased approach under which the initial focus is placed on evaluating firms' systems of quality management, followed by a gradual expansion of supervisory activities to individual assurance engagements. Other jurisdictions reported conducting thematic reviews prior to launching routine inspections of sustainability assurance engagements and publishing the results to improve understanding among assurance providers and market participants regarding the nature, quality, and

[28] The survey examined the regulatory status of each jurisdiction as of 30 September 2025. Responses were received from 47 of IFIAR's 56 member authorities.
[29] CPAAOB, Publication of IFIAR's Fact Sheet on the Results of the 2025 Sustainability Survey: https://www.fsa.go.jp/cpaaob/sonota/kokusai/20260619.html

significance of sustainability assurance engagements, while also identifying practical challenges and emerging issues. At the same time, several challenges were highlighted. In particular, participants emphasized the importance of exercising professional skepticism in areas involving significant judgment, such as double materiality assessments and Scope 3 greenhouse gas emissions, as well as the need to appropriately document risk assessments and judgment processes.

In Japan, phased legislative and regulatory development relating to sustainability disclosure and assurance is also underway. Taking into account international developments and the experiences of jurisdictions that are further advanced in implementation, discussions continue regarding the design of assurance standards and the establishment of supervisory and inspection frameworks for sustainability assurance providers.

2. Cooperation with Foreign Audit Oversight Authorities

In addition to multilateral international cooperation through IFIAR, the CPAAOB is committed to strengthening bilateral relationships and regional cooperation with foreign audit oversight authorities. As part of these efforts, it actively participates in and contributes to conferences and regional forums organized by foreign audit oversight authorities, sharing information on challenges and initiatives relating to audit oversight.

In recent years, cooperation among Asian authorities has been strengthened in particular. In August 2025, a workshop organized by the ASEAN Audit Regulators Group (AARG), comprising the audit oversight authorities of Malaysia, Singapore, Thailand, Indonesia, and the Philippines, was held in Bangkok, Thailand. In addition to participants from ASEAN member countries, observers from outside the ASEAN region, including representatives from Japan and the IFIAR Secretariat, attended the workshop. Participants shared inspection and supervisory case studies from their respective jurisdictions and engaged in active discussions on emerging issues, including audits of IT-related resources and crypto-asset service providers. Representatives from Japan introduced the CPAAOB's supervisory framework, initiatives to strengthen monitoring of small and medium-sized audit firms, and measures to support improvements in audit quality.

In addition, major international forums in the fields of auditing and accounting organized by foreign audit oversight authorities include the PCAOB Institute, hosted by PCAOB, and the AFRC Regional Regulatory Forum (RRF), hosted by the Hong Kong Accounting and Financial Reporting Council (AFRC). Both events are held annually.

The PCAOB Institute provides a forum for audit oversight authorities, international organizations, and academic experts from around the world to engage in in-depth discussions on audit oversight practices and regulatory approaches. At its 17th meeting, held in Washington, D.C., in October 2025, participants discussed a broad range of issues, including strengthening the system of quality management, securing and developing audit talent, the use of AI in auditing, and PE investment in audit firms. A

representative from Japan served as a panelist for one of the sessions and participated in discussions concerning the growing shift of listed company audits from large-sized audit firms to small and medium-sized firms worldwide, as well as approaches to monitoring and improving audit quality among smaller firms. During the discussion, Japan introduced the recent developments in Japan and initiatives to strengthen monitoring.

The AFRC RRF brings together a broad range of stakeholders, including audit oversight authorities, audit firms, professional bodies, and market participants. At its second meeting, held in Hong Kong in November 2025, particepants discussed key issues relating to financial reporting and auditing from the perspective of the broader audit ecosystem, including governance, audit quality, sustainability-related disclosures and assurance, and the use of AI in auditing.

Continued engagement in these forums is important not only for strengthening networks with audit oversight authorities around the world but also for gaining a comprehensive understanding of international regulatory developments, regional perspectives, and the latest trends in practice and academic research. Such engagement enables the CPAAOB to appropriately reflect international discussions in its domestic audit oversight activities. The CPAAOB will continue to make use of these opportunities to monitor global developments in auditing and communicate Japan’s initiatives to the international community.

II. Overview of the Audit Sector

I. Overview of the Audit Sector

A. CPAs

1. Introduction of the CPA system

The origin of the Japanese CPA system is the Accountants Act, which was enacted in 1927. With the economic and social reconstruction and democratization proceeding after the end of World War II, the Accountants Act was abolished, and the CPA system was introduced in 1948 for the purpose of ensuring the reliability of financial statements by determining the qualifications of audit and accounting experts whose primary duty is audit and attestation. Specifically, the Securities and Exchange Act was promulgated in 1947, requiring companies that issue or solicit investment in shares, corporate bonds or other securities to submit reports. The issuer of listed securities is required to obtain audit attestation from CPAs by the full overhaul of the 1948 Securities and Exchange Act (currently the Financial Instruments and Exchange Act (FIEA)) as well as the promulgation/enforcement of the CPA Act.

Accordingly, the Certified Public Accountants Management Committee was established to conduct CPA examinations, etc. (becoming the CPA Examination and Investigation Board in 1952 after a transfer of jurisdiction and expanded/restructured into the current CPAAOB in 2004). The Corporate Accounting Principles were released in 1949, and the Audit Standards in 1950.

The present CPA Act clearly sets out the mission and professional responsibilities of CPAs as given below. CPAs must always be self-aware of this mission and these professional responsibilities in performing their duties regardless of audit attestation services or non-audit services.

“The mission of certified public accountants, as professionals on auditing and accounting, shall be to ensure matters such as the fair business activities of companies, etc., and the protection of investors and creditors by ensuring the reliability of financial documents and any other information concerning finance from an independent standpoint, thereby contributing to the sound development of the national economy” (Article 1).

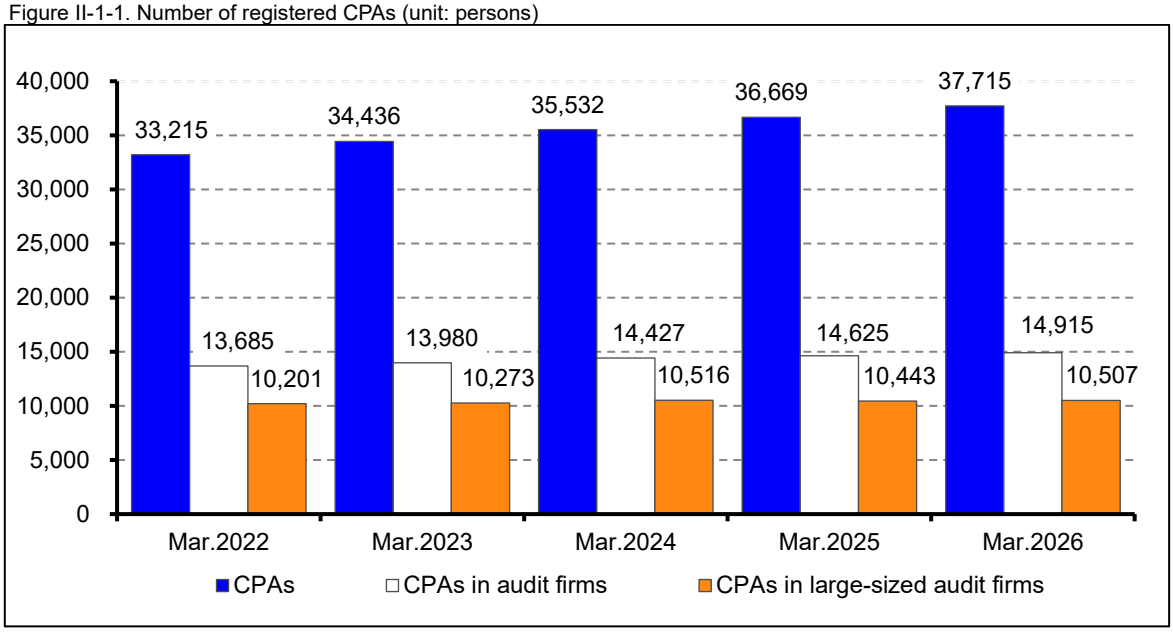
“A certified public accountant shall always maintain his/her dignity, endeavor to acquire knowledge and skills, and provide services with fairness and integrity from an independent standpoint” (Article 1-2).

2. CPAs

To become a certified public accountant, a person must pass the CPA examination, satisfy certain requirements (business assistance, professional accountancy education program, etc.), and be registered on the roster maintained by the JICPA (Articles 3, 17, and 18 of the CPA Act).

The number of registered CPAs has been increasing gradually for more than a decade. However, the number of CPAs working at audit firms has not increased as much as the number of registered CPAs. The ratio of the number of CPAs working at audit firms to the total number of registered CPAs has been declining year by year, and continued to decline from 41.2% at the end of March 2022 to 39.5% at the end of March 2026. Of the registered CPAs belonging to audit firms, around 70% belongs to large-sized audit firms (Figure II-1-1).

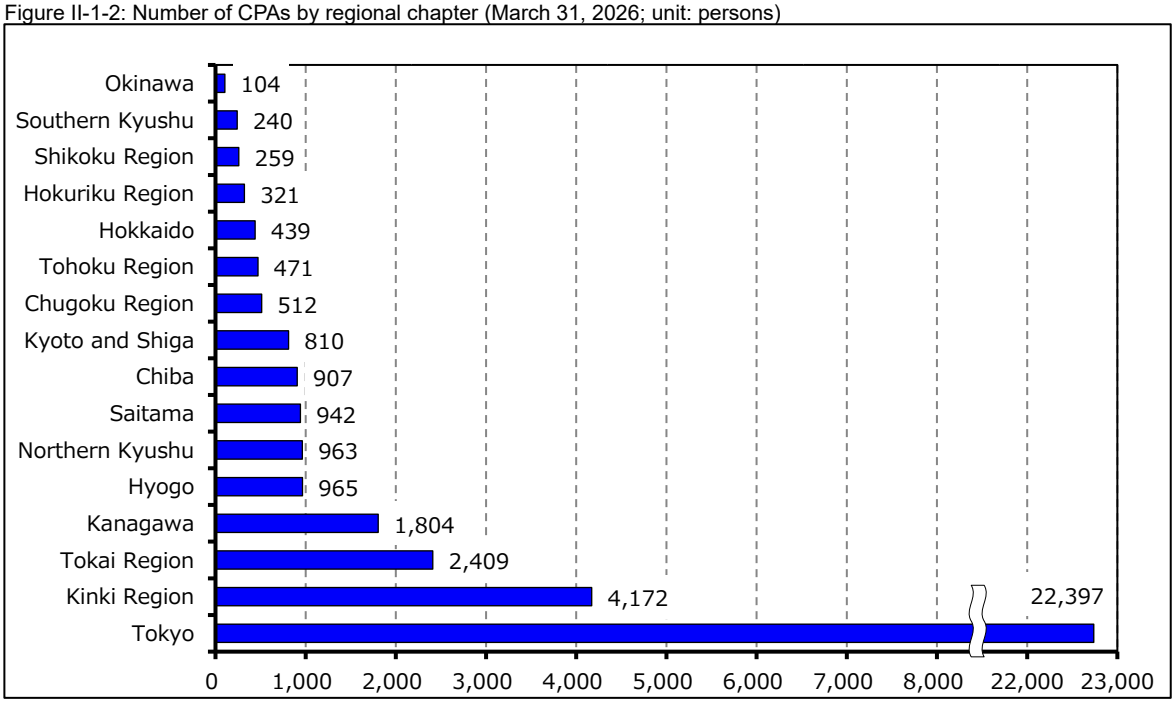
Figure II-1-1. Number of registered CPAs (unit: persons)



(Source) Prepared by the CPAAOB based on data from the JICPA

CPAs must be members of the JICPA (Article 46-2 of the CPA Act) and must belong to a regional chapter, i.e., one of the JICPA branches established across Japan (16 regional chapters as of March 31, 2026). Around 70% of CPAs are based in the Tokyo metropolitan area (Tokyo, Kanagawa, Saitama, Chiba) (Figure II-1-2).

Figure II-1-2: Number of CPAs by regional chapter (March 31, 2026; unit: persons)



(Source) Prepared by the CPAAOB based on data (e.g. survey of numbers of members) from the JICPA

■ Initiatives to Improve the Attractiveness of Audit and Assurance Engagements ■

In many jurisdictions, growth in the overall number of CPAs has been slowing, prompting various measures to address the issue. For example, under the U.S. CPA qualification system, candidates were traditionally required to complete 150 credit hours (or five years) of accounting and business-related education at the university level. In December 2025, however, the system was revised to introduce an alternative pathway allowing qualification with 120 credit hours (or four years) of study, subject to an additional one-year practical experience requirement. In Singapore, meanwhile, a committee comprising professional accounting bodies and other stakeholders has taken the lead in expanding awareness of and interest in the accounting profession among students. In addition to outreach activities through schools and social media, innovative initiatives such as campaigns involving influencers and popular animated characters have been implemented, contributing to an increase in the number of aspiring accountants. In Japan, the JICPA has likewise undertaken initiatives to promote understanding of the significance and importance of accounting, including accounting seminars for elementary and junior high school students and explanatory sessions on the CPA qualification system at high schools and universities, while also highlighting the important role played by CPAs in society.

Against the backdrop of these efforts to secure accounting talent, the number of registered CPAs in Japan increased from 24,964 as of March 31, 2013, to 37,715 as of March 31, 2026, representing a growth rate of 51.1%. However, while the number of personnel employed by audit firms also increased from 12,799 to 14,915 during the same period, the growth rate was only 16.5%, indicating slower growth compared with the overall increase in the number of registered CPAs. In addition, sustainability-related disclosures, whose importance has increased significantly in recent years, are expected to generate growing demand for assurance engagements. At the same time, the provision of such services requires highly specialized expertise, making it difficult to secure personnel with the necessary knowledge and skills.

Recently, career opportunities for CPAs have expanded considerably. Increasingly, accountants are choosing positions where they can more directly perceive their contribution to organizations and society, such as Chief Financial Officers (CFOs), heads of accounting departments, consultants, and positions within non-profit organizations. One illustration of this trend can be seen in the JICPA's "In-House Accountant Network." Excluding audit firms, tax corporations, and network firms, the number of registered CPAs employed by companies, other organizations, or government entities nearly doubled over the past decade, increasing from 1,377 at the end of 2016 to 2,545 at the end of 2025. Under these circumstances, some observers have pointed out that the traditional message that "auditing is a social infrastructure that underpins the fairness of capital markets," long regarded as a primary source of the profession's appeal, has become relatively less persuasive than in the past.

In response to these environmental changes, the large-sized audit firms have introduced a variety of human resource initiatives aimed at improving retention among younger CPAs. These measures include greater flexibility in career paths, shortening the time required for promotion to partner, enhancing lateral recruitment efforts, including the rehiring of professionals who previously left the audit profession, and raising compensation levels. At the same time, firms have sought to improve operational efficiency by standardizing workloads through centralized assignment management and by promoting the use of information technology, including artificial intelligence (AI), to standardize and automate audit processes. In addition, firms have reduced staff workloads by transferring routine, judgment-free tasks, such as the dispatch and collection of confirmation requests, to dedicated delivery centers established for that purpose. As a result of these efforts, turnover rates among managers and staff at large-sized audit firms have shown a declining trend in recent years.

Furthermore, as AI adoption continues to expand, routine tasks traditionally performed by junior accountants, such as data-processing work associated with audit sampling and document reconciliation, as well as the preparation of draft meeting minutes and audit working papers, are increasingly being automated. This has reduced the time required for such tasks and shortened the period traditionally spent acquiring experience through routine assignments. Consequently, CPAs are able to devote more time to higher-value activities, including evaluating and effectively utilizing AI-generated outputs. In particular, large-sized audit firms have begun incorporating agentic AI capable of performing tasks autonomously into their audit systems, and further reductions in time spent on activities such as reviewing audit documentation are anticipated. These developments are enabling even junior accountants to participate in more substantive and value-added work at an earlier stage of their careers.

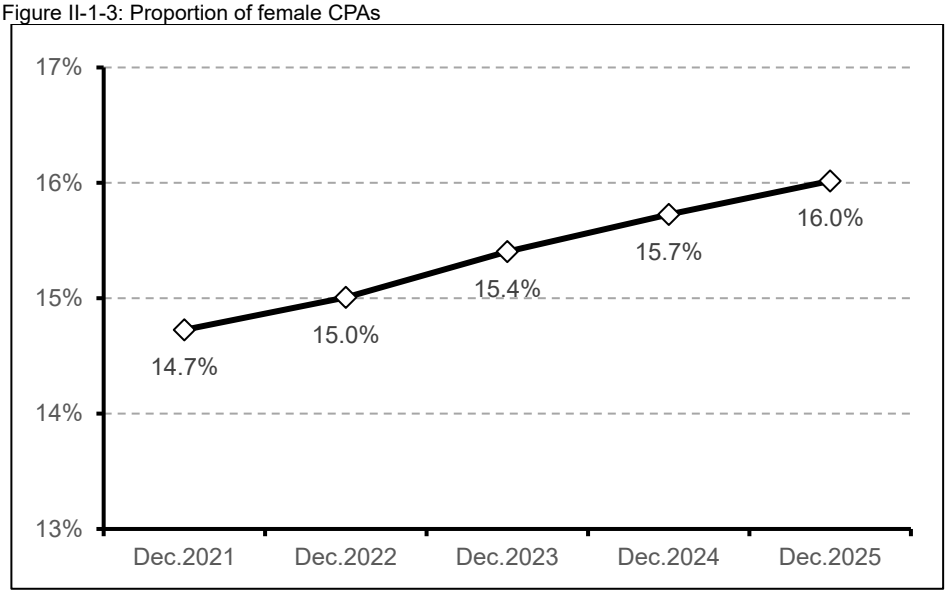
Moreover, areas such as generative AI, data analytics, and sustainability-related information provide CPAs with a wide range of opportunities for professional growth and are expected to enhance the attractiveness of audit and assurance work. To support the development of expertise in these fields, particularly among large-sized audit firms, specialized training programs and internal certification systems have been established.

Many audit firms recognize that the expertise and experience gained through advisory services, including those relating to sustainability and digital technologies, can contribute significantly to the effective performance of audit engagements. From the perspective of creating professional development opportunities, firms have therefore implemented personnel development initiatives that enable audit professionals to participate in advisory work. Although the concept of managing audit and advisory services in a mutually complementary manner through an integrated organizational structure, commonly referred to as the multidisciplinary model, has existed for many years, its importance has increased further as auditing practices continue to evolve. Audit firms' efforts to promote such integrated operations are expected not only to strengthen organizational effectiveness but also to enhance the attractiveness of audit and assurance engagements. Accordingly, developments in this area will continue to attract close attention.

3. Proportion of Female CPAs

The percentage of women among the total number of registered CPAs is steadily increasing (Figure II-1-3), and at the end of 2025 the figure reached 16.0%.[30] On the other hand, it is still lower than the proportion of female attorneys and female CPAs in the UK.[31]

Figure II-1-3: Proportion of female CPAs



(Source) Prepared by the CPAAOB based on data from the JICPA

[30] According to "2025 Survey on Women's Participation in Policy and Decision-making Processes" by the Cabinet Office's Gender Equality Bureau, the proportion of female attorneys was 20.6% at the November 1st, 2025.
[31] According to the UK Financial Reporting Council's "Key Facts and Trends in the Accountancy Profession 2025," there are several CPA institutes in the UK, and the average female membership for them is 40%.

■ Efforts to Promote Gender Diversity ■

The auditing profession has been actively promoting initiatives to enhance the participation and advancement of female CPAs. For example, JICPA has established key performance indicators (KPIs) to increase the proportion of women to 30% among successful candidates in the CPA Examination by FY 2030 and to 30% among members and associate members by FY 2048. In addition, JICPA has implemented various measures to improve workplace accessibility and inclusiveness, including support for the use of maiden names, assistance with employment and return-to-work opportunities, exemptions from or reductions in membership fees, and Continuing Professional Development (CPD) arrangements for members on leave due to childbirth, childcare, or other family-related responsibilities. JICPA also promotes career development through initiatives such as networking opportunities for female CPAs and the introduction of female role models.

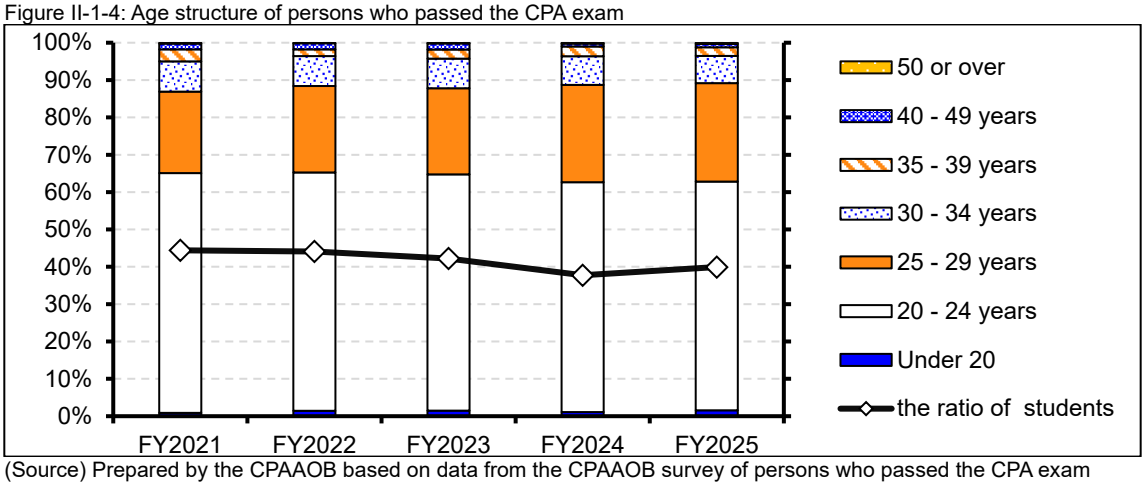
Large-sized audit firms have likewise advanced a range of initiatives, including the establishment of KPIs related to the proportion of women in managerial positions, programs to support women's career development, support measures tailored to different life stages such as childcare and eldercare responsibilities, encouragement of paternity leave uptake, and the promotion of networking opportunities among female professionals. According to the Audit Quality Reports of large-sized audit firms, women account for an average of approximately 9% of partners and equivalent positions, while the average proportion of women in management positions (including senior managers and managers) is approximately 23%.

The FSA, in collaboration with the JICPA, has published a brochure entitled Career Opportunities for CPAs and Successful CPA Examination Candidates. With a view to increasing the number of female CPA Examination applicants, the brochure highlights the attractiveness and rewards of the CPA profession, as well as possible career paths, through messages from female CPAs. In the 2025 CPA Examination, the pass rate for female candidates was 6.41% (compared with 7.81% for male candidates), representing an increase from the 2024 examination. Women accounted for 24.0% of successful candidates, an increase from the previous year, and the number of successful female candidates also rose year on year. Furthermore, both the number of female applicants and the number of successful female candidates have shown an upward trend over the past several years.

4. Age Structure of Persons who Passed the CPA exam

The age distribution of CPA exam passers shows that the persons aged 20 to 24 constituted the largest group, accounting for 61.2% of all persons who passed the CPA exam in 2025. Students (excluding those enrolled in vocational schools and similar institutions) represented the largest occupational category. Although the proportion has been declining, university students (including junior college students) still accounted for 39.9% in the 2025 examination (Figure II-1-4). In addition, the number of university student applicants has continued to increase, rising by 59.5% over the past five years.

Figure II-1-4: Age structure of persons who passed the CPA exam



(Source) Prepared by the CPAAOB based on data from the CPAAOB survey of persons who passed the CPA exam

B. Audit Firms

As of March 31, 2025, there were 2,411 audit offices in Japan; however, their services, organizational structures, and operational characteristics vary considerably. Audit and attestation services cover both statutory audits and non-statutory audits. Statutory audits are CPA audits required by law. When CPA audits were first introduced, the only statutory audits were FIEA audits, but thereafter CPA audits under the Companies Act were introduced, and then educational corporation audits under the Act on Subsidies for Private Schools. There are now a multitude of statutory audits, including audits of labor unions, credit unions, credit associations, agricultural cooperatives, social welfare corporations and medical corporations, etc. Further explanation of audit and attestation services is provided in C. Audited Companies, 1. Types of Audit and Attestation Services.

There are three types of entities providing audit and attestation services: audit firms, partnerships, and solo practitioners. Audit firms are established pursuant to the CPA Act for the purpose of organizationally performing audit and attestation services. When the audit corporation system was introduced in 1966, audit and attestation services were increasing in both volume and complexity as corporate activities expanded and business operations became more diversified. At the same time, numerous accounting fraud cases were emerging, leading to heightened scrutiny of the role and significance of CPA audits. The audit corporation system was therefore introduced to improve audit quality by enabling audits to be conducted on an organizational basis.

The approximate size of each category of audit offices classified by the CPAAOB based on firm size is shown below (Figure II-2-1). [32]

Figure II-2-1: Classifications of audit offices (as of March 31, 2025)

Audit Firm		Number of Firms
Large-sized audit firms		4
Mid-tier audit firms		4
Small and medium-sized audit firms		2,403
(Breakdown)	Small and medium-sized audit firms	(288)
	Partnerships (Note 1)	(48)
	Solo practitioners (Note 1, 2)	(2,067)

(Note 1) The number of audit offices in FY2024 (book closing date from April 1, 2024, till March 31, 2025) listed in copies of audit summaries or audit implementation reports submitted to the JICPA.
(Note 2) In order for solo practitioners to conduct an audit for a listed company it is required by the CPA Act and each exchange's securities listing regulations to conduct the audit jointly with other CPAs, etc.
(Source) Prepared by the CPAAOB based on data from the JICPA

1. Organizational Structure of Audit Firms

Audit firms are established through investment by persons including five or more CPAs, and their defining characteristics are that the persons who invested (partners) are directly engaged in management and that they ensure organizational discipline via mutual monitoring. Some audit firms comprise only partners, but those of a certain scale ordinarily employ CPAs (CPAs who have not

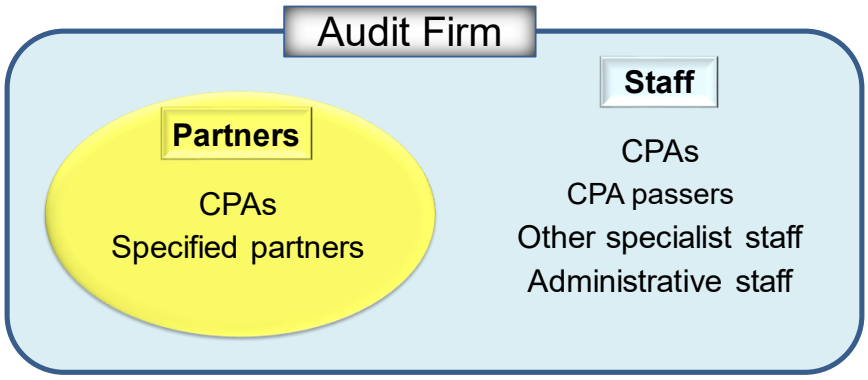
[32] Registration as a registered auditor of listed companies etc. is required to audit listed companies. For information on the registration system for listed company auditors, see "IV. Responses to Changes in the Global Environment Surrounding Audits, 1. Trends Surrounding Small and Medium-sized Audit Firms".

invested in order to become partners of the audit firm), CPA examination passers (persons who have passed the CPA exam but have not been registered as CPAs after undergoing practical training and providing assistance with audit work), and other experts as staff.

In the past, partners of audit firms were limited to CPAs, but in today's more sophisticated economy and society, partners are required to have knowledge and experience in a wide range of areas, including management, law, IT, pension mathematics to ensure appropriate operations at the audit firm and to provide effective organizational audit activities. Accordingly, as a result of the legal revisions in 2007, a "specified partner system" allowed non-CPAs to be partners at an audit firm. However, CPAs must comprise at least 75% of the audit firm's partners if specified partners join the firm. In FY2025 large-sized audit firms had 139 specified partners among a total of 1,811 partners.

The personnel composition of an audit firm is outlined below (Figure II-2-2), and explained in more detail in "III. Operation of Audit Firms, A. Operations Management System, 3. Human Resources of Audit Firms".

Figure II-2-2: Personnel composition at audit firms



(Source) Prepared by the CPAAOB with reference to page 55 of “New CPA/Audit firm Audit System - Ensuring Fair Financial/Capital Markets” (Dai-Ichi Hoki Co., Ltd., 2009), Yuichi Ikeda and Hidenori Mitsui, ed.

	Large-sized audit firm	Mid-tier audit firm	Small and medium-sized audit firm
Partners	Approx.250 to approx. 550	Approx. 40 to 100	Up to approx. 50(Note2)
Full-time staff	Approx. 3,400 to approx. 6,800	Approx. 230 to 950	Up to approx. 120(Note2)

(Note1) See “Figure III-1-3: Characteristics of each type of audit firm” (page 81) for the characteristics of organizational structure based on audit firm size.
(Note2) The fiscal years of small and medium-sized audit firms cover a wide range of months, and the figures for FY2025 have not yet been compiled. For this reason, small and medium-sized audit firms are included up to FY2024. Excluding an audit firm whose number of partners and full-time staff members is much higher than that of other firms.
(Source) Prepared by the CPAAOB based on business reports submitted by audit firms.

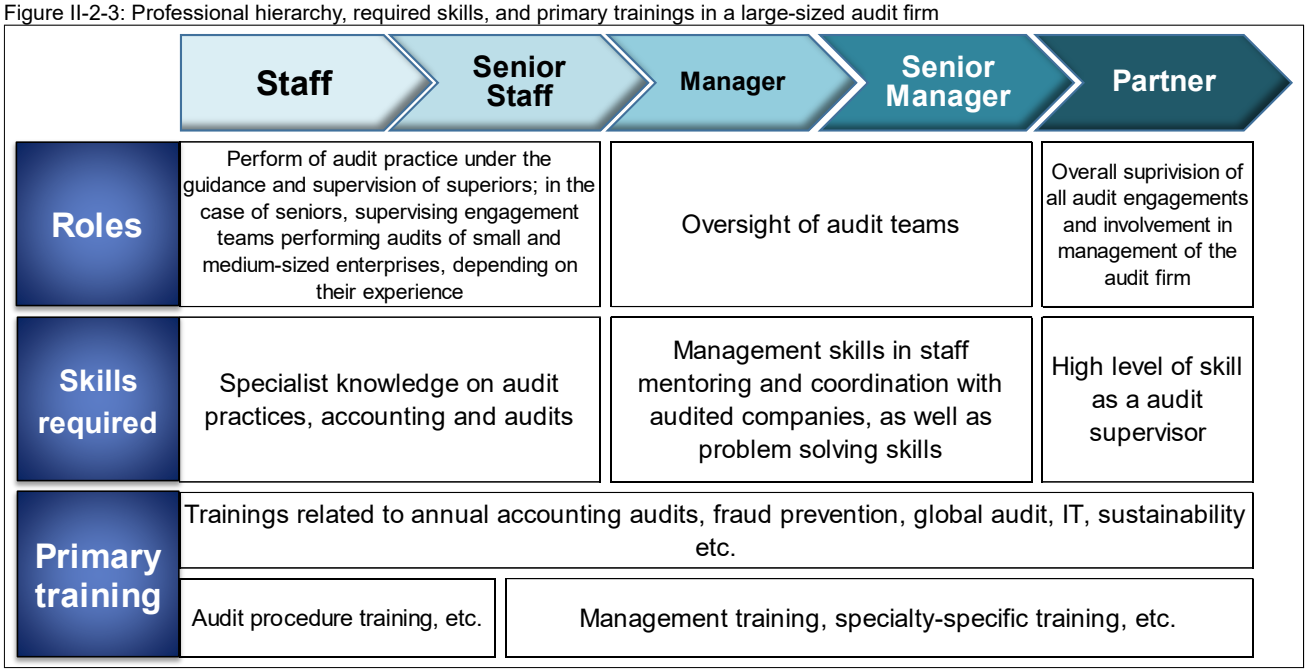
In response to the increasing complexity and internationalization of business activities of domestic listed companies, particularly large listed companies, audit firms have grown in size. Large-sized audit firms, which conduct the majority of audits of major listed companies, employ several thousand personnel, while even mid-tier audit firms now have more than 200 personnel.

As audit firms grow in scale, they need to introduce job classification systems based on factors such as competencies and experience in order to manage their organizations effectively. (Figure II-2-3). It is standard practice for personnel to progress through the ranks from staff and senior staff to manager,

senior manager, and, where selected, partner. In recent years, some large-sized audit firms have also recruited audit assistants (staff who do not hold qualifications related to financial statement audits, such as the CPA qualification) to reduce the workload of CPAs and enable them to focus on duties requiring professional judgment.

As audit firms have expanded and their organizational structures have become more complex, ensuring audit quality has become increasingly challenging. In response to these developments, the Audit Firm Governance Code, originally formulated in March 2017, was revised in March 2023. As a result of this revision, audit firms registered on the List of Auditors of Listed Companies are required to establish operational frameworks in accordance with the Code and frameworks for enhanced disclosure. For details, refer to III. Operation of Audit Firms, A. Operations Management System, 2. Efforts in Response to Audit Firm Governance Code.

Figure II-2-3: Professional hierarchy, required skills, and primary trainings in a large-sized audit firm



(Note) For details, see "III. Operation of Audit Firms, A. Operations Management System, 4. Organizational Structure for Providing Audit Services" and "5. Organizational Structure for Supporting Audit Services".
(Source) Prepared by the CPAAOB

2. Development and Implementation of Systems of Quality Management by Audit Firms

To ensure audit quality, it is important that audit firms develop and operate appropriate quality management structures to serve as a foundation for having their partners provide audit services properly.

The Standards on Quality Control for Audits were formulated for audit and attestation services in 2005, and revised in November 2021 in response to the establishment or revision of international quality management standards, including the International Standard on Quality Management 1 (ISQM1), Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements. Audit firms need to comply with professional ethics in

their services other than audit and attestation services as well.

The Revised Standards on Quality Control for Audits (“Revised Standards") require individual audit firms to introduce the system of quality management based on a risk-based approach, under which they should

a. Set their own quality objectives,
b. Identify and assess quality risks that could adversely affect the achievement of those quality objectives,
c. Design and operate policies or procedures for addressing the assessed quality risks, and
d. Make improvements based on the root cause analysis of deficiencies, if any.

Additionally, the Revised Standards state that the system of quality management should include the following as components:

a. The firm’s risk assessment process;
b. Governance and leadership;
c. Professional ethics and independence;
d. Acceptance and continuance of audit engagements;
e. Engagement performance;
f. Resources for operational management of the audit firm;
g. Information and communication;
h. The monitoring and remediation process of the system of quality management; and
i. Communication between predecessor and successor auditors.

Furthermore, the Revised Standards newly require the individual assigned ultimate responsibility for the audit firm's system of quality management to evaluate the system at least once a year by setting a base date and to conclude whether the system provides the audit firm with reasonable assurance that the objectives of the systems are being achieved.

The Revised Standards are effective for audits of financial statements for a business year or an accounting period starting on or after July 1, 2023 (for audit firms other than large-sized audit firms under the CPA Act, for a business year or an accounting period starting on or after July 1, 2024).

With respect to the establishment and implementation of the system of quality management at large-sized audit firms, firms belonging to global networks have received tools from their global networks to support the design and operation of their systems of quality management. Based on the quality objectives and quality risks established by global networks, they have incorporated additional evaluation items and taken other measures to comply with the Revised Standards. The number of quality objectives, quality risks, and policies and procedures established to address those risks varies among firms.

Regarding the operation of the system of quality management, at many large-sized audit firms, the persons responsible for each division oversee processes owners’ identification of quality risks and the design and operation of policies and procedures for dealing with those risks as well as the assessment

of those risks. A steering committee provides comprehensive oversight of these activities. Some firms have also established positions responsible for independently monitoring compliance with the Revised Standards.

The timelines for the evaluation of the system of quality management also vary from firm to firm, depending on the evaluation date established by each firm. Regarding the overall evaluation results, at all large-sized audit firms, the chief responsible officer for the system of quality management has concluded that “the firm’s system of quality management provides reasonable assurance that the objectives of the system are being achieved.”

While the operation and monitoring of the system of quality management have become increasingly embedded at large-sized audit firms, some firms continue to recognize the need to further enhance awareness and understanding of the system among engagement teams. In addition, some firms identify as a challenge the need to further collect and analyze risk information in order to improve the accuracy of identifying high-risk audit engagements, control processes, and key areas of focus for monitoring activities.

All mid-tier audit firms have applied the Revised Standards since July 1, 2024. Regarding the risk assessment process for the system of quality management, similar to large-sized audit firms, they establish quality objectives, identify and assess quality risks, and design and implement policies and procedures to address those risks based on the items presented in tools provided by their global networks, and add quality risks and other items arising from requirements specific to the Revised Standards. Regarding the overall evaluation results, at all mid-tier audit firms, the chief responsible officer for the system of quality management concludes that “the firm’s system of quality management provides reasonable assurance that the objectives of the system are being achieved.”

In addition, as part of their efforts to promote firm-wide understanding and effective implementation of the system of quality management throughout their firms, they conduct meetings, including partner meetings, and training sessions. Some mid-tier audit firms hold quality management committee meetings once every three months, with at least one participant from each regional office.

Small and medium-sized audit firms have also begun applying the Revised Standards. According to the results of reports collected in PY2025, many audit firms have taken measures such as establishing quality objectives, quality risks, and policies and procedures to address those risks by using tools published by the JICPA. As the evaluation date for the system of quality management differs from firm to firm, the evaluation results are being published on a rolling basis.

Under the Revised Standards, conclusions on the system of quality management are classified into the following three categories:

A) The system of quality management provides the firm with reasonable assurance that the objectives of the system are being achieved.

B) Except for identified deficiencies that are significant but not pervasive in the design and operation of the system of quality management, the system of quality management provides the firm with

reasonable assurance that the objectives of the system are being achieved.

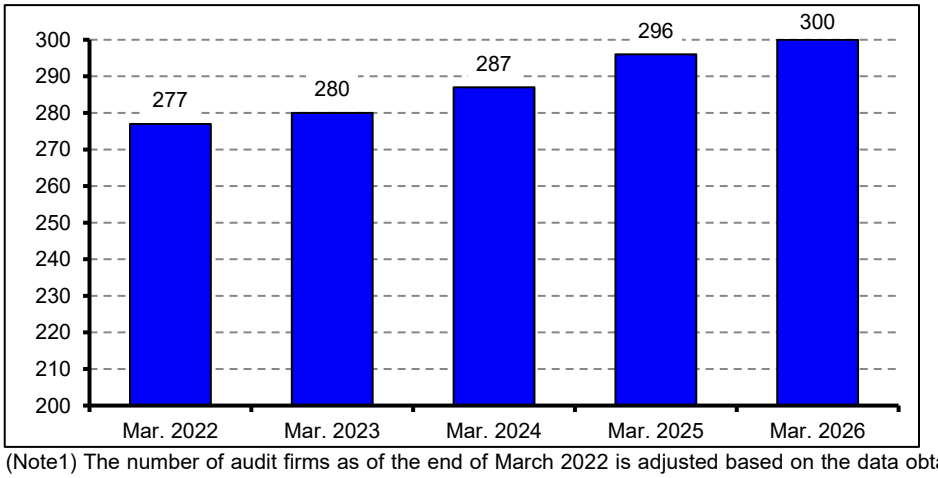
C) The system of quality management does not provide the firm with reasonable assurance that the objectives of the system are being achieved.

Both large-sized audit firms and mid-tier audit firms reached conclusions falling under category A). However, among small and medium-sized audit firms that have already published their evaluation results, some firms reached conclusions falling under category B), indicating the existence of identified deficiencies that are significant but not pervasive. In some cases, such conclusions were attributable to the results of JICPA Quality Control Review in which extremely significant deficiencies or significant deficiencies had been identified. According to reports collected during PY2025, some small and medium-sized audit firms recognized challenges in responding to the Revised Standards, including securing sufficient resources for quality management activities and selecting quality objectives, quality risks, and policies and procedures to address those risks that are appropriate to the size and characteristics of the firm. In this regard, a key challenge is to steadily operate the PDCA cycle through the firm's own evaluation process for the system of quality management by promptly identifying matters requiring improvement, analyzing their root causes, and developing and implementing necessary remedial actions.

3. Number of Audit Firms

The number of audit firms has continued to increase in recent years. As of March 31, 2026, there were 300 audit firms. During the period from April 2025 to March 2026, five firms ceased to exist due to dissolution or merger, while nine new firms were established, resulting in a net increase of four firms year on year (Figure II-2-4). For details on mergers since FY 2022, see "4. Mergers of Audit Firms".

Figure II-2-4: Change in the number of audit firms (unit: firms)

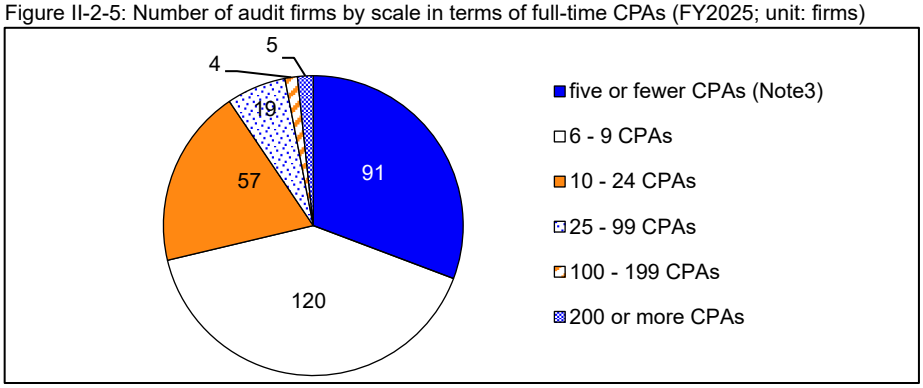


(Note1) The number of audit firms as of the end of March 2022 is adjusted based on the data obtained after the previous Monitoring Report was published.
(Note2) The number of limited liability audit firms[33] as of the end of March 2026 was 38.
(Source) Prepared by the CPAAOB based on data (e.g. survey of numbers of members) from the JICPA and reports of individual audit firms. The list of limited liability audit firms is published on the FSA website.

[33] An audit firm in which designated limited liability partners are jointly and severally liable only for specified attestations in which they participate, whereas liability for other business activities is limited to the amount of each partner's contribution.

Classification by the number of full-time CPAs belonging to each audit firm reveals that firms with fewer than 25 CPAs make up over 90% of the total (Figure II-2-5).

Figure II-2-5: Number of audit firms by scale in terms of full-time CPAs (FY2025; unit: firms)



(Note 1) The number of full-time CPAs is the total of partners who are CPAs and full-time staff who are CPAs.
(Note 2) Data on 296 audit firms was collected from business reports submitted by these firms in FY2025. The timing of the submission of the business reports of each audit firm differs depending on the financial year.
(Note 3) An audit firm where the number of partners who are CPAs drops to four or fewer should be dissolved, but a six-months grace period is provided under the CPA Act.
(Source) Prepared by the CPAAOB based on business reports submitted by audit firms.

4. Mergers of Audit Firms

Since FY2021, seven mergers of audit firms have taken place (Figure II-2-6). The main reasons cited for these mergers were to strengthen management foundations and broaden geographic coverage.

Figure II-2-6: Audit firms involved in mergers from FY2021 (March 31, 2026)

FY	Surviving firm	Disappearing firm
2021	Yasaka Kaikeisha Audit Corporation	Keihin Audit Corporation
2022	Kyoritsu Audit Corporation	Shinmei Audit Corporation
	Moore Shisei Audit Corporation (Moore Mirai Audit Corporation)	Kisaragi Audit Corporation
	SKIP Audit Corporation	Godai Audit Corporation
2023	Souken Nichiei Audit Corporation (Fujimi Audit Corporation)	Seinan Audit Corporation, Nagoya Audit Corporation
	PricewaterhouseCoopers Aarata LLC (PricewaterhouseCoopers Japan LLC)	PricewaterhouseCoopers Kyoto Audit Corporation
2024	(No mergers)	
2025	Nanatsuboshi Audit Corporation	Sourei Audit Corporation

(Note) Names in parentheses show the new name after the merger as of March 31, 2026.
(Source) Prepared by the CPAAOB from materials made publicly available by audit firms

Reports collected from mid-tier audit firms in PY2025 showed that many of them considered mergers as an option for their future business strategies. The collection of reports from small and medium-sized audit firms (involving 44 firms) in the same program year showed that approximately 43% of small and medium-sized audit firms would consider a merger if they could find a good partner.

5. Financial Condition (Operating Revenue, Proportion of Audit and Attestation Services and Non-audit and Attestation Services)

In addition to audit and attestation services, audit firms provide non-audit services, including assurance services other than audit and attestation services, financial advisory services such as support for initial public offerings (IPOs), IFRS adoption, and organizational restructuring, as well as sustainability-related advisory services.

Operating revenues over the five years until FY2025 (FY2024 in the case of small and medium-sized audit firms) showed an uptrend across large-sized, mid-tier and small and medium-sized audit firms (excluding the impact of the merger between PwC Aarata and PwC Kyoto).

Revenues from audit and attestation services roughly accounted for 70% of operating revenues at large-sized audit firms, while the corresponding ratios at mid-tier and small and medium-sized audit firms were approximately 95% and 90%, respectively (Figure II-2-7). For audit firm groups' operating revenues, see "III. Operation of Audit Firms, A. Operations Management System, 9. Domestic Audit Firm Groups".

Characteristics of audit firms, classified by size, are as follows:

a. Large-sized audit firms

The ratio of audit and attestation service revenues to total operating revenues has remained in the low 70% range for large-sized audit firms as a whole. However, the composition varies across firms. Of the four large-sized audit firms, three have maintained ratios at approximately the low 80% range, the high 70% range, and around 50%, respectively. The remaining firm recorded a ratio in the mid-60% range for some time, but this has recently risen to the mid-70% range, indicating differences among firms.

Large-sized audit firms generally consider it necessary to maintain a certain level of non-audit services. This approach is based on the view that non-audit services provide personnel with opportunities to gain diverse professional experience, that such a broad range of experiences and knowledge contributes to improving audit quality, and that non-audit services are effective in attracting and retaining talent. At the same time, some large-sized audit firms have transferred certain non-audit services to other entities within their audit firm groups. As a result, the proportion of audit and attestation service revenues has increased at some firms.

b. Mid-tier audit firms

Audit and attestation service revenues have shown an upward trend, and their share of total operating revenues has remained at around 95%.

As mid-tier audit firms operate primarily with a focus on audit and attestation services, they limit their provision of non-audit services to those that are considered beneficial when performed in conjunction with audit and attestation engagements or to services that can be provided with their available staffing and operational capacity.

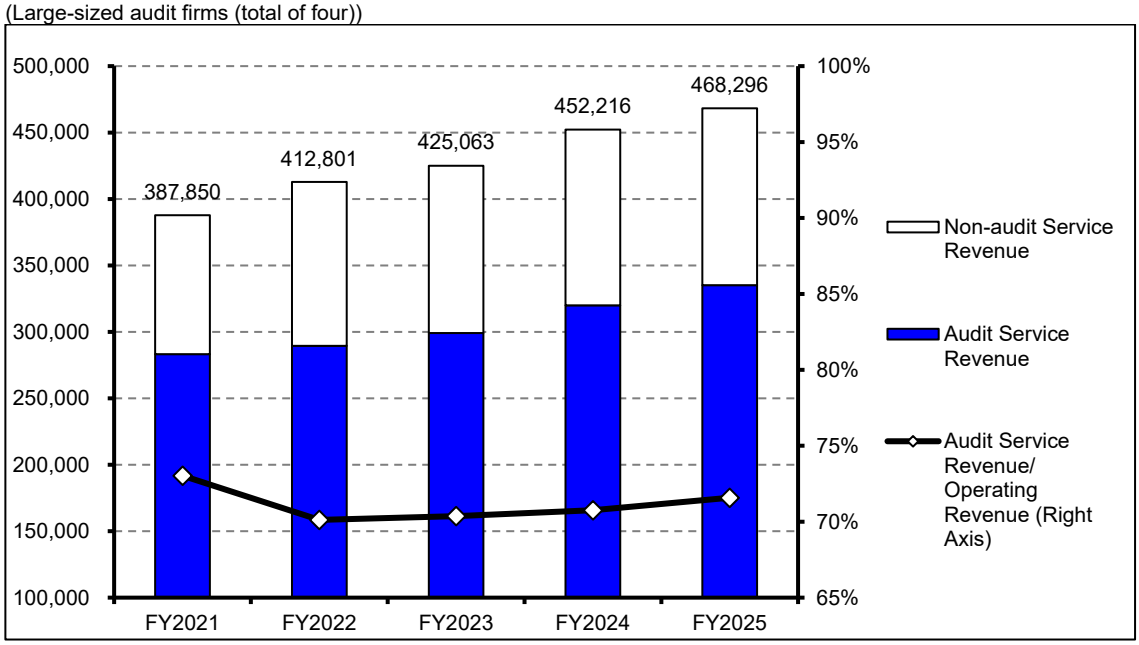
c. Small and medium-sized audit firms

The ratio of audit and attestation service revenues to total operating revenues has remained at around 90%.

While small and medium-sized audit firms generally have relatively low levels of operating revenue, some of the larger firms within this category have expanded their business by accepting audit engagements from listed domestic companies whose previous auditors, primarily large-sized audit firms, had terminated or declined to continue the audit engagements. As changes in accounting auditors among listed domestic companies have led to an increase in the number of audit clients of small and medium-sized audit firms, these firms have experienced substantial growth in audit and attestation service revenues. For changes in accounting auditors, see "III. Operation of Audit Firms, E. Acceptance of New Audit Engagements and Changes of Accounting Auditors".

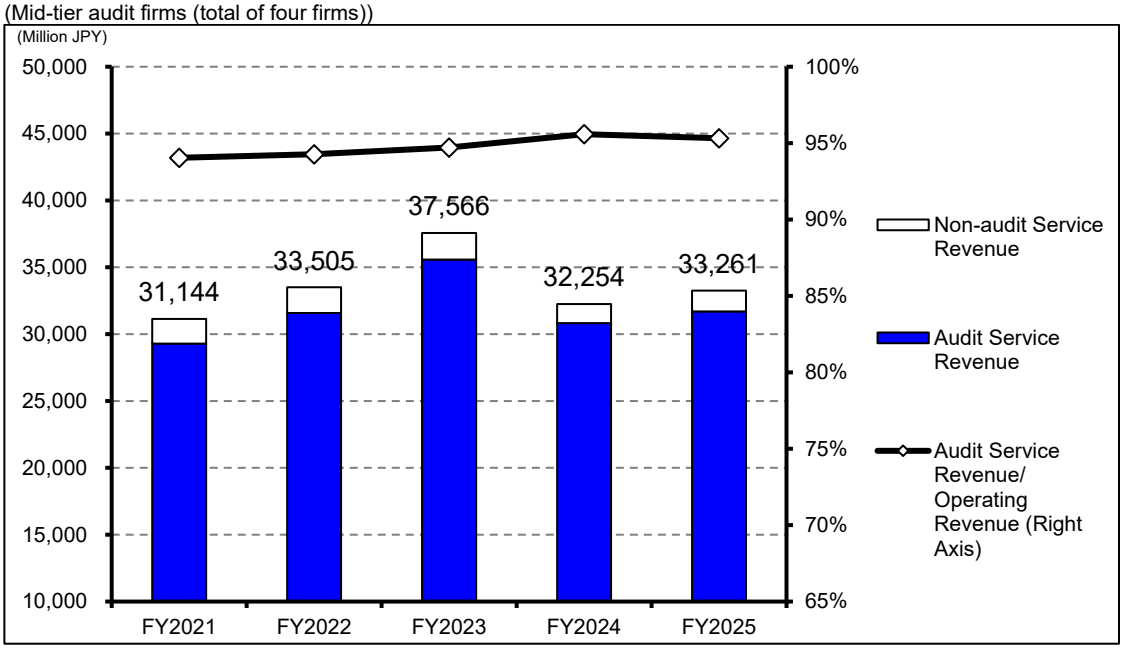
Figure II-2-7: Operating revenues, breakdowns of operating revenues, and proportions of audit and attestation service revenues to total operating revenues

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



(Note 1) For FY2021 through FY2023, the data are compiled based on the fiscal years prior to the establishment of PwC Japan. Accordingly, the impact of the merger between PwC Aarata and PwC Kyoto is not reflected in the figures.
(Note 2) From FY2024 onward, operating revenues and the amounts of their components increased due to the establishment of PwC Japan LLC through the merger of PwC Aarata and PwC Kyoto.
(Source) Prepared by the CPAAOB based on business reports submitted by audit firms.

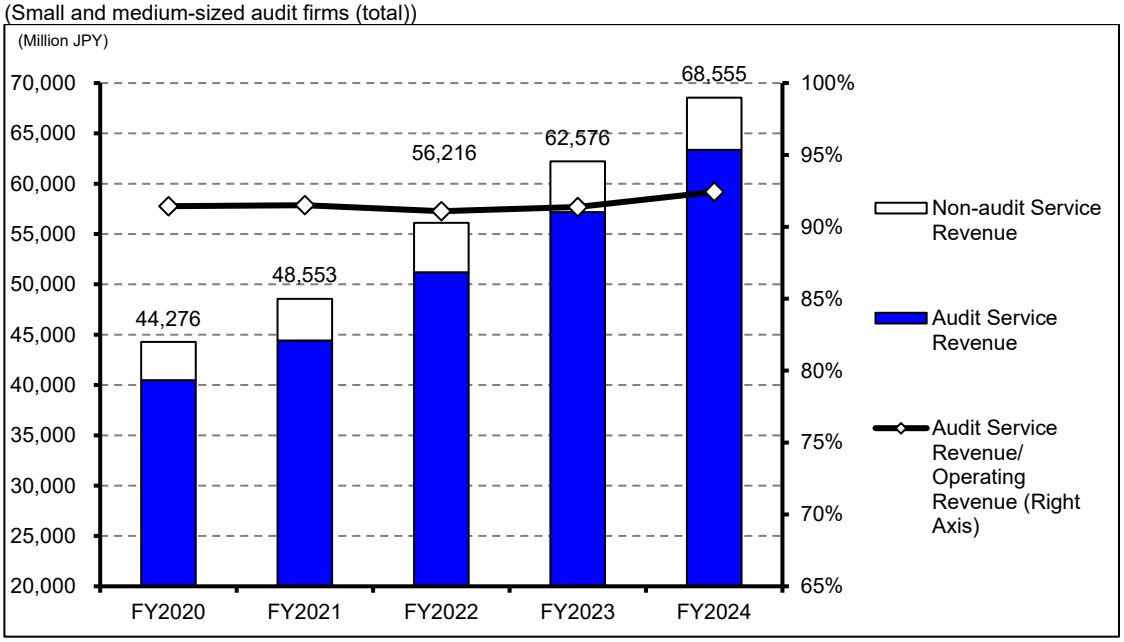
(Mid-tier audit firms (total of four firms))



(Note) For FY2021 through FY2023, the figures represent the combined totals of Gyosei & Co., BDO Sanyu & Co., Grant Thornton Taiyo LLC, and Crowe Toyo & Co., and PwC Kyoto. From FY2024 onward, following the merger of PwC Aarata and PwC Kyoto in December 2023, the figures represent the combined totals of four firms: Gyosei & Co., BDO Sanyu & Co., Grant Thornton Taiyo LLC, and Crowe Toyo & Co. As a result, operating revenues and the amounts of their components decreased.

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

(Small and medium-sized audit firms (total))



(Note) Due to the wide range of fiscal year-end dates among small and medium-sized audit firms, data for FY2025 have not yet been compiled. Therefore, the figures for small and medium-sized audit firms cover only up to FY2024. The number of firms included in the compilation differs by fiscal year, and 281 firms were included for FY2024.

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

C. Audited Companies

1. Types of Audit and Attestation Services

As previously noted in "B. Audit Firms", audit and attestation services include statutory audits, which are under laws such as the FIEA, the Companies Act, the Act on Subsidies for Private Schools, and the Labor Union Act, as well as non-statutory audits whose objectives and scope are determined by the parties involved. The types of audit and attestation services provided by audit firms are shown below (Figure II-3-1).

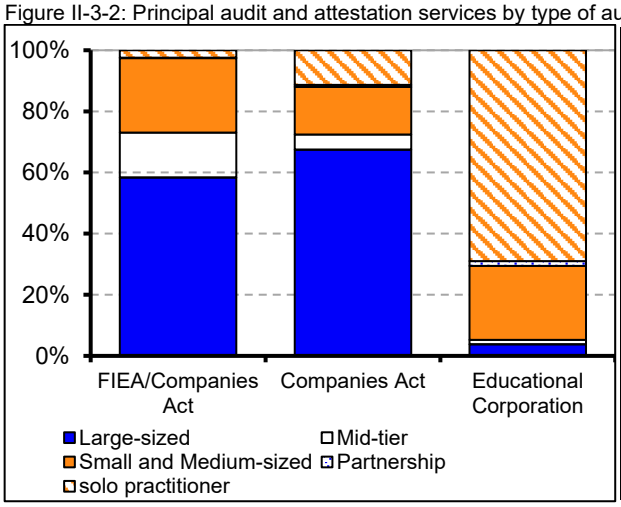
Figure II-3-1: Types of audit and attestation services by audit firm

Type	Statutory audits						Non-statutory audits	Total
	FIEA & Companies Act	FIEA	Companies Act	Act on Subsidies for Private Schools	Labor Union Act	Other		
Number of companies	4,173	305	5,550	1,483	417	4,733	5,871	22,532
Percentage	18.5	1.4	24.6	6.6	1.9	21.0	26.0	100.0

(Note 1) The number of audited companies has been aggregated from business reports submitted by audit firms in FY2024
(Note 2) "FIEA & Companies Act" denotes operations where audit and attestation under both the FIEA and Companies Act are required, while "FIEA" and "Companies Act" denote operations where audit and attestation under the FIEA only or the Company Act only, respectively.
(Source) Prepared by the CPAAOB based on business reports submitted by audit firms.

Audit firms, partnerships and solo practitioners are the entities that provide audit and attestation services. Looking at the entities providing audit and attestation services, about 60-70% of FIEA & Companies Act audits and Companies Act audits are conducted by large-sized audit firms, while about 70% of educational corporation audits are conducted by solo practitioners (Figure II-3-2).

Figure II-3-2: Principal audit and attestation services by type of audit provider (unit: companies)



Type		FIEA & Companies Act	Companies Act	Educational Corporation
Audit firms		4,117	5,519	1,387
(Breakdown)	Large-sized	(2,410)	(4,212)	(180)
	Mid-tier	(631)	(309)	(71)
	Small and medium-sized	(1,076)	(998)	(1,136)
Partnership		6	42	71
Solo practitioner		103	737	3,157

(Note 1) Data were aggregated from audits conducted from the term ended April 2024 to the term ended March 2025. The figures do not match the figures in Figure II-3-1 because the collection period is different.
(Note 2) The figures in the column "FIEA & Companies Act" include services requiring audit and attestation only under the FIEA, in addition to services requiring audit and attestation under the FIEA & Companies Act.
(Source) Prepared by the CPAAOB based on data from the JICPA

2. FIEA and Companies Act Audits

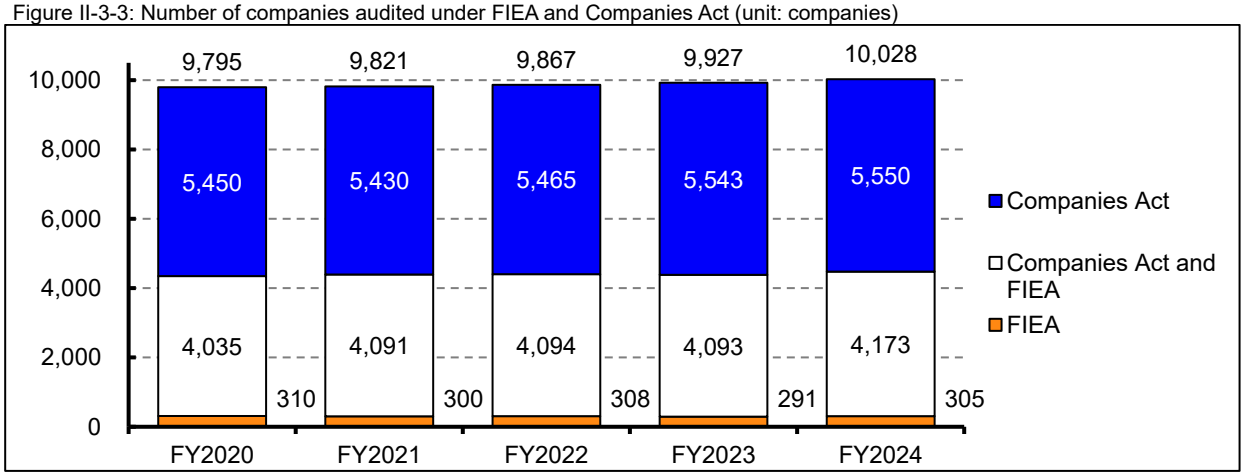
The results of analysis of audited companies etc. and listed companies that are subject to statutory audits under the FIEA and the Companies Act are as follows:

a. Number of companies audited under the FIEA and the Companies Act and share by scale of audit firm

There has been no significant change in the number of companies audited under the FIEA or the Companies Act (Figure II-3-3). With regard to share by scale of audit firm, large-sized audit firms' share has declined, while the shares of mid-tier and small and medium-sized audit firms have increased annually (Figure II-3-4).

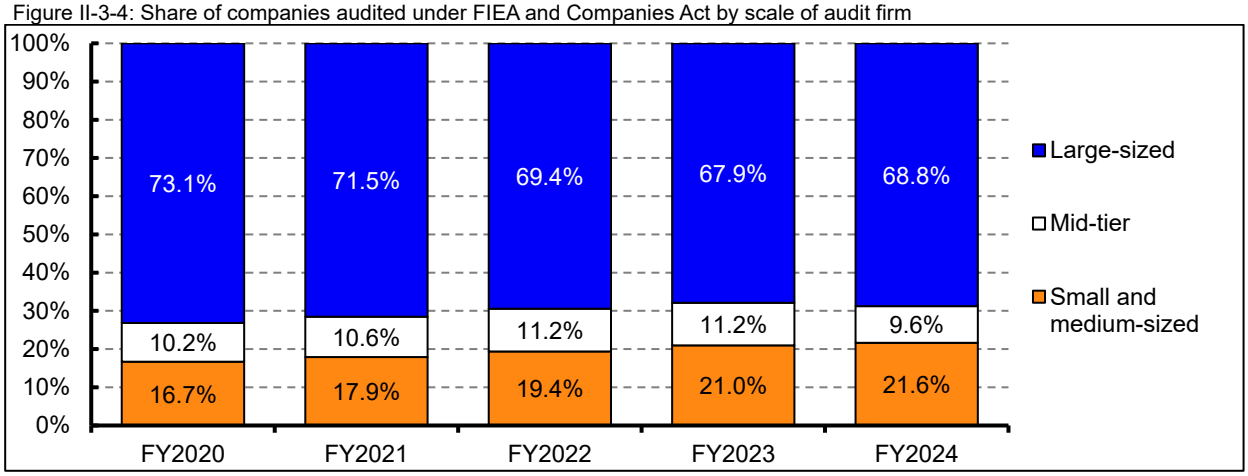
Note that the decline in the share of mid-tier audit firms and the increase in the share of large-sized audit firms from FY2023 to FY2024 were primarily attributable to the merger of PwC Aarata and PwC Kyoto in December 2023.

Figure II-3-3: Number of companies audited under FIEA and Companies Act (unit: companies)



(Note) Because fiscal year-end months vary across audit firms, the horizontal axis shows the fiscal year in which the CPAAOB obtained the business reports. The figures represent the aggregated number of audited companies and other audited entities reported in the business reports submitted by each audit firm in each fiscal year.
(Source) Prepared by the CPAAOB based on business reports submitted by audit firms.

Figure II-3-4: Share of companies audited under FIEA and Companies Act by scale of audit firm



(Note) Because fiscal year-end months vary across audit firms, the horizontal axis shows the fiscal year in which the CPAAOB obtained the business reports. The figures represent the aggregated number of audited companies and other audited entities reported in the business reports submitted by each audit firm in each fiscal year.
(Source) Prepared by the CPAAOB based on business reports submitted by audit firms.

b. Share of listed domestic companies by scale of audit firms

Figure II-3-5 shows the auditors of 3,843 domestic listed companies as of March 2026.

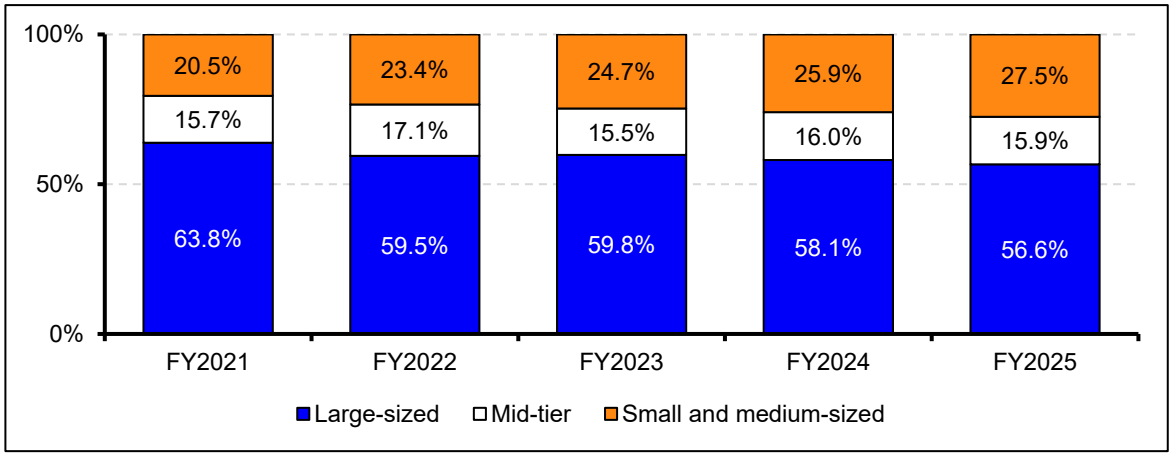
Figure II-3-5: Number and market capitalization of listed domestic companies by scale of auditor (as of the end of March 2026)

	Domestic listed companies	
	Number of companies	Market capitalization (billion yen)
large-sized audit firms	2,177	1,163,702.4
Mid-tier audit firms	610	25,006.1
Small and medium-sized audit firms	1,056	33,987.4
Total	3,843	1,222,695.8

(Source) Prepared by the CPAAOB based on data from Quick and exchanges

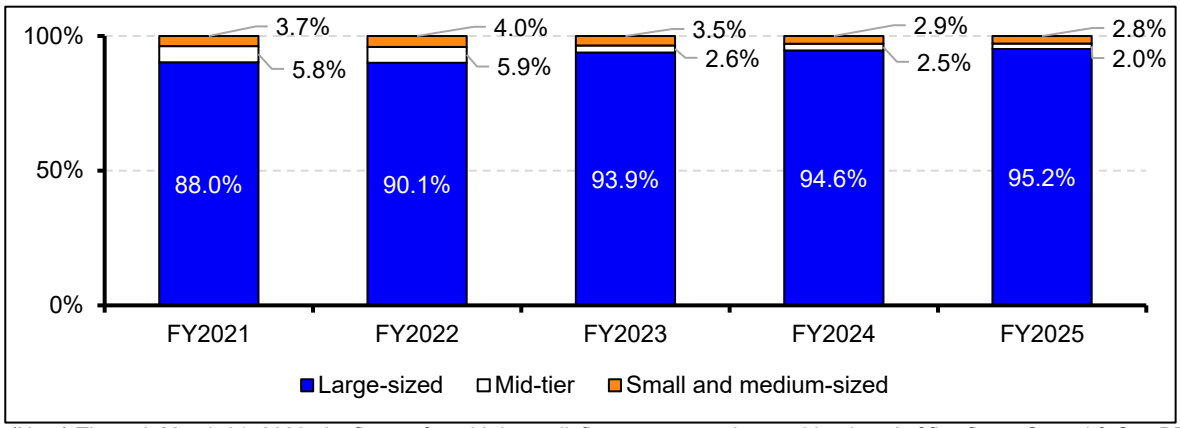
Although large-sized audit firms have gradually reduced their market share in terms of the number of companies audited, they still audit about 60% of listed domestic companies and approximately 90% of the total market capitalization of listed domestic companies. This pattern has remained consistent over time. One possible explanation is that listed domestic companies with large market capitalizations generally have larger business operations and often engage in complex and international activities. Auditing such companies requires not only a large number of audit personnel but also a wide range of specialized expertise, making it difficult for audit firms other than large-sized audit firms to undertake these audits (Figures II-3-6 and II-3-7).

Figure II-3-6: Number of listed domestic companies by audit firm size



(Note) Through March 31, 2023, the figures for mid-tier audit firms represent the combined total of five firms: Gyosei & Co., BDO Sanyu & Co., Grant Thornton Taiyo LLC, Crowe Toyo & Co., and PwC Kyoto. Following the merger of PwC Aarata LLC and PwC Kyoto in December 2023, the figures from March 31, 2024 onward represent the combined total of four firms: Gyosei & Co., BDO Sanyu & Co., Grant Thornton Taiyo LLC, and Crowe Toyo & Co.
(Source) Prepared by the CPAAOB based on data from Quick and exchanges

Figure II-3-7: Share by total market value of listed domestic companies by scale of accounting auditor

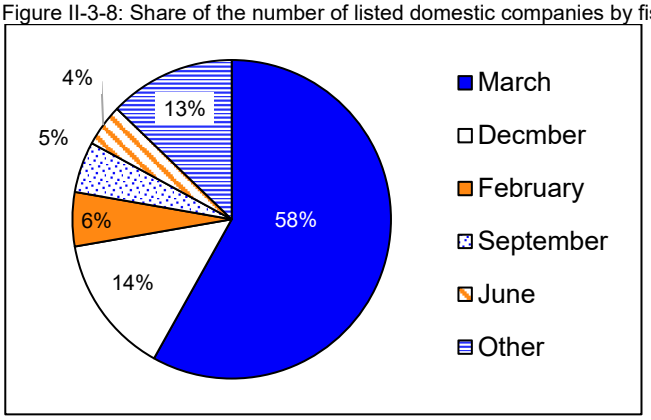


(Note) Through March 31, 2023, the figures for mid-tier audit firms represent the combined total of five firms: Gyosei & Co., BDO Sanyu & Co., Grant Thornton Taiyo LLC, Crowe Toyo & Co., and PwC Kyoto. Following the merger of PwC Aarata LLC and PwC Kyoto in December 2023, the figures from March 31, 2024 onward represent the combined total of four firms: Gyosei & Co., BDO Sanyu & Co., Grant Thornton Taiyo LLC, and Crowe Toyo & Co.
(Source) Prepared by the CPAAOB based on data from Quick and exchanges

c. Number of listed domestic companies and total market value by fiscal year-end

59% of listed domestic companies close their books at the end of March, and these companies account for 82% of the total market capitalization. This fact explains why audit operations are heavily concentrated in specific periods (Figures II-3-8 and II-3-9).

Figure II-3-8: Share of the number of listed domestic companies by fiscal year-end (March 31, 2026) (unit: companies)

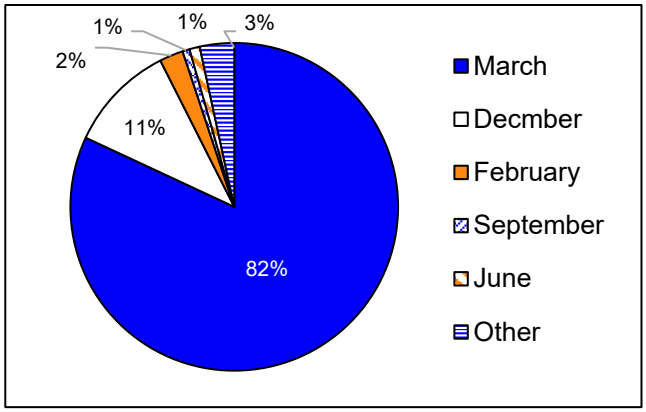


March	2,233
December	544
February	211
September	199
June	164
Other	492
Total	3,843

(Source) Prepared by the CPAAOB based on data from QUICK and exchanges

Figure II-3-9: Share of market value of listed domestic companies by fiscal year-end (March 31, 2026)

(unit: hundred million JPY)



March	10,017,676
December	1,298,821
February	285,846
September	85,865
June	124,593
Other	414,158
Total	12,226,958

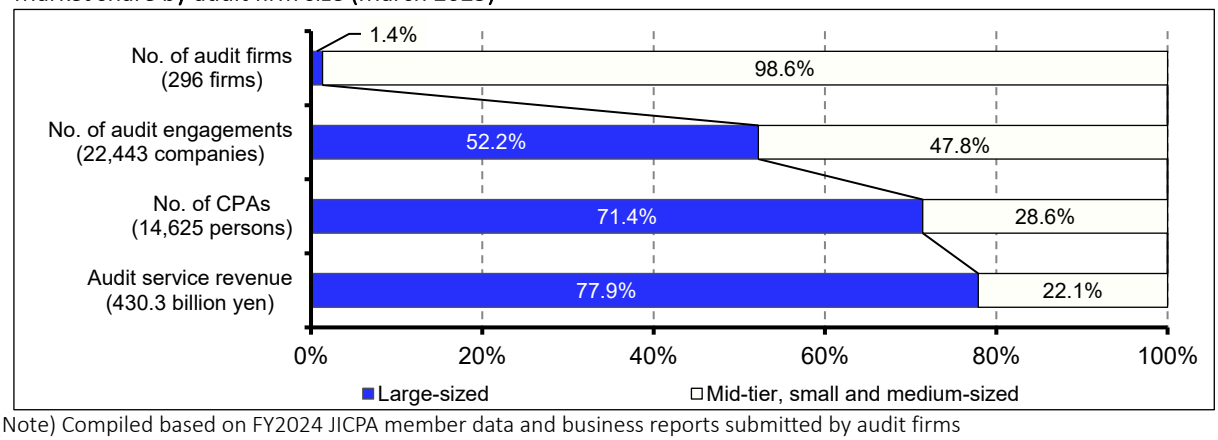
(Source) Prepared by the CPAAOB based on data from QUICK and exchanges

■ Share of Large-sized Audit Firms ■

Among the 296 audit firms as of the end of March 2025, large-sized audit firms accounted for a large shares of audit and attestation engagements, CPAs, and audit and attestation service revenues.

The share of large-sized audit firms in the number of audit and attestation engagements, audit service revenues and other categories has been on the decline in recent years as a result of audit firms' policies and decisions regarding the continuance of audit engagements. See "III. Operation of Audit Firms, E. Acceptance of New Audit Engagements and Changes of Accounting Auditors".

< Market share by audit firm size (March 2025) >



(Note) Compiled based on FY2024 JICPA member data and business reports submitted by audit firms

■ Impact of the Expiration of Transitional Measures for the Tokyo Stock Exchange's Continued Listing Criteria on Audit Risk ■

Following the Tokyo Stock Exchange's market restructuring in April 2022, the transitional measures that had been applied to companies that did not meet the continued listing criteria expired. Consequently, the regular continued listing criteria have applied to assessments of compliance with the continued listing criteria for recoded dates falling on or after March 1, 2025.

If a company falls to meet the continued listing criteria, it will enter an improvement period of one year in principle (six months for the trading volume criterion). If it fails to meet the criteria within this period, it will be delisted after a period of designation as a Security Under Supervision or a Security to be Delisted (six months in principle).

<Listing Maintenance Criteria for Each Market Segment>

Item	Prime Market	Standard Market	Growth Market
Number of Shareholders	800 or more	400 or more	150 or more
Number of Tradable Shares	20,000 trading units or more	2,000 trading units or more	1,000 trading units or more
Market Capitalization of Tradable Shares	JPY 10 billion or more	JPY 1 billion or more	JPY 500 million or more
Ratio of Tradable Shares	35% or more	25% or more	25% or more
Trading Value	Average daily trading value of JPY 20 million or more	Average monthly trading volume of 10 trading units or more	Average monthly trading volume of 10 trading units or more
Net Assets	Positive net assets	Positive net assets	Positive net assets
Market Capitalization	–	–	JPY 4 billion or more (applicable 10 years after listing)*

(Note) From March 1, 2030, the threshold will be revised to ¥10 billion or more and applicable five years after listing.

For companies with a March fiscal year-end, the improvement period expired during March 2026. According to data published by the Tokyo Stock Exchange, as of April 1, 2026, one company had been designated as a Security to be Delisted following a decision to delist, while 21 companies had been designated as Securities Under Supervision (excluding companies not subject to the transitional measures and those designated as Securities Under Supervision due to non-compliance with criteria for which no transitional measures apply, such as the net assets criterion). Companies designated as Securities Under Supervision will be allowed to maintain their listings if they subsequently satisfy the continued listing criteria or meet the requirements for a change in market segment. Failure to do so, however, will result in delisting. In addition, a certain number of companies with fiscal year-ends other than March remain within improvement periods due to non-compliance with the continued listing criteria.

The continued listing criteria with which companies most frequently fail to comply are Tradable Share Market Capitalization in the Prime and Standard Markets and Market Capitalization in the Growth Market. Accordingly, companies that do not satisfy the continued listing criteria are increasingly expected to undertake initiatives that take into account the cost of capital and stock price performance. On the other hand, among companies that had been subject to the transitional measures, some have avoided domestic delisting by obtaining approval for a change in market segment or for dual listing on another stock exchange, while others have chosen to go private through management buyouts (MBOs) or similar transactions.

The primary objective of management that is conscious of the cost of capital and stock prices is to enhance medium- to long-term corporate value and achieve sustainable growth by promoting fundamental initiatives, such as growth investments and reviews of business portfolios, while giving due consideration to the cost of capital and capital efficiency. However, companies that do not satisfy the continued listing criteria may become overly focused on their stock prices and adopt a short-term orientation in an effort to obtain favorable evaluations from investors as quickly as possible.

Ordinarily, listed companies face a certain degree of pressure to achieve their business performance targets. In financial statement audits, auditors assess fraud risks arising from such pressures and design and perform audit procedures that appropriately respond to those risks. In contrast, management of companies that have entered an improvement period due to non-compliance with the continued listing criteria, or companies that may fail to satisfy those criteria as of future record dates, may face even greater pressure to produce favorable financial results that could help support stock prices and thereby avoid delisting. As a result, the risk of fraud may increase.

Accordingly, auditors should take into account the audited company's compliance with the continued listing criteria and carefully and promptly assess fraud risks, including the incentives and pressures that may give rise to fraudulent conduct. The CPAAOB will continue to monitor the impact of compliance with the continued listing criteria on audit risk and will also monitor whether audit firms are responding appropriately to such risks.

■ Trends in Accounting Fraud Based on Timely Disclosure Requirements ■

In general, “accounting fraud” refers to any intentional misconduct involving a company’s financial information or accounting records, including misrepresentation, concealment, or falsification. Recently, announcements of accounting fraud by listed Japanese companies have occurred with increasing frequency and have attracted significant public attention. In July 2025, the JICPA published Management Research Committee Research Material No. 12: Trends in Accounting Fraud at Listed Companies and Related Entities (2025 Edition).[34] The following provides an overview of some of its findings.

The report analyzes 196 listed companies and related entities (including listed companies and their affiliates) that publicly disclosed accounting fraud between April 2020 and March 2025 under the timely disclosure systems of Japanese stock exchanges. The data are classified by fiscal year based on the date of disclosure.

Over the five-year period from the fiscal year ended March 2021 to the fiscal year ended March 2025, the number of listed companies that disclosed accounting fraud increased every year. The number rose from 26 companies in FY2021 to 56 companies in FY2025, more than doubling during the period. Among the 177 listed companies whose investigation reports were publicly available, 184 fraud incidents were identified in which the location of the fraud could be determined. Approximately 45% occurred at headquarters, while about 55% occurred outside headquarters, including domestic subsidiaries, overseas subsidiaries, or both. In FY2025, the number of fraud cases discovered at overseas subsidiaries increased to eight, compared with three in the previous fiscal year. The report also classified 158 cases for which the method of detection could be identified. During the five-year period, the most common means of detection was investigations by regulatory authorities. This was followed by internal controls and related procedures, whistleblowing reports, inquiries from business partners, external audits conducted by certified public accountants, and internal audits.

Of the 184 accounting fraud cases identified at the 177 listed companies, those for which the fraud scheme could be determined were further classified by type. A total of 263 instances fell into the category of fraudulent financial reporting, while 76 instances were categorized as asset misappropriation. For fraudulent financial reporting, multiple schemes within a single case were counted separately, resulting in a total that exceeds 184 cases. In other words, out of 339 identified fraud schemes, approximately 77% were related to fraudulent financial reporting. Since fraudulent financial reporting generally has a greater impact on financial statements than asset misappropriation, the report suggests that a higher number of accounting fraud cases disclosed under stock exchange timely disclosure requirements fall into the former category. A more detailed analysis of fraudulent financial reporting found that common schemes included fictitious purchases and cost manipulation and overstatement of revenue. In FY2025, approximately 32% of fraudulent financial reporting cases involved revenue-related misconduct, such as fictitious or premature revenue recognition, circular transactions, and abuse of the percentage-of-completion method. The second most common category involved cost-related fraud, such as fictitious purchases and cost manipulation, accounting for approximately 27% of fraudulent financial reporting schemes. With respect to asset misappropriation, the most common schemes were cash embezzlement and the diversion of funds through third-party companies. Together, these accounted for approximately 70% of all asset misappropriation cases. The report also analyzed industries in which accounting fraud occurred. During the five-year period, the service industry accounted for the largest number of cases, with 46 companies representing approximately 24% of the total. This was followed by wholesale trade (27 companies), construction (21 companies), and information and communications (20 companies).

One explanation for the recent increase in accounting fraud disclosures is that the widespread adoption of remote work during the COVID-19 pandemic weakened supervisory and monitoring functions within companies, creating more opportunities for fraud. Subsequently, as employees returned to the workplace, internal control systems and whistleblowing mechanisms regained effectiveness, leading to the detection of previously undiscovered misconduct. Nevertheless, listed companies face continuing pressure to achieve financial performance targets due to the expectations of shareholders and other stakeholders. As a result, incentives for management and employees to engage in accounting fraud remain. Consequently, the importance of internal audits, audits conducted by corporate auditors and audit committees, and external audits performed by independent auditors continues to grow. The CPAAOB intends to continue its monitoring activities with close attention to developments in accounting fraud.

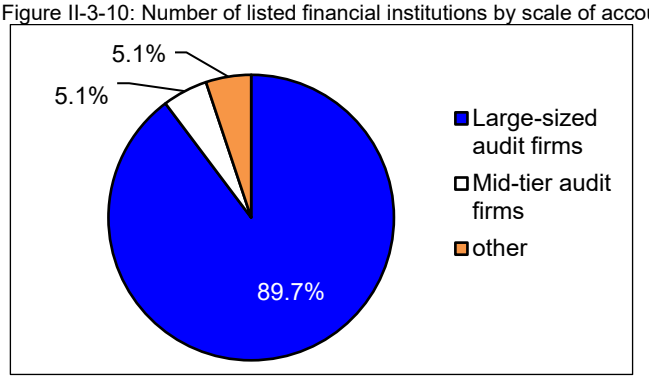
[34] Refer to https://jicpa.or.jp/specialized_field/20250724jqd.html

3. Audits of Financial Institutions

About 90% of listed financial institutions (117 companies) were audited by large-sized audit firms, and in terms of market capitalization, large-sized audit firms handled 99%. Accordingly, compared with domestic listed companies as a whole, the share audited by large-sized audit firms was even higher (Figures II-3-10 and II-3-11). For details, see "2. FIEA and Companies Act Audits".

To cope with accounting and audit practices that are specific to the listed financial institutions, large-sized audit firms are establishing departments specializing in financial services in their audit operations divisions, and some mid-tier audit firms have established support systems that specialize in handling inquiries about the accounting procedures of financial institutions.

Figure II-3-10: Number of listed financial institutions by scale of accounting auditor (As of March 31, 2026)

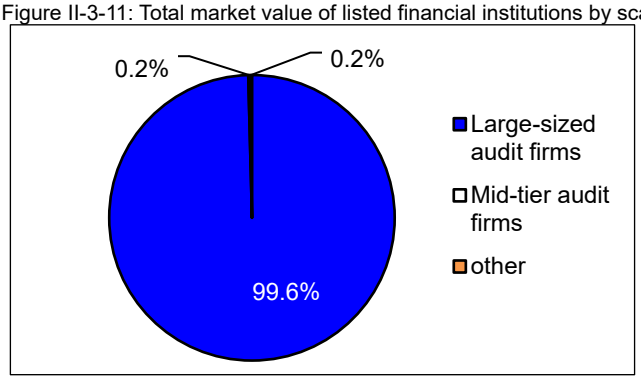


(unit: companies)

Large-sized audit firms	105
Mid-tier audit firms	6
Small and medium-sized audit firms, partnerships and solo practitioners	6
Total	117

(Source) Prepared by the CPAAOB based on data from QUICK and exchanges

Figure II-3-11: Total market value of listed financial institutions by scale of accounting auditor (As of March 31, 2026)



(unit: hundred million JPY)

Large-sized audit firms	1,524,977
Mid-tier audit firms	3,099
Small and medium-sized audit firms, partnerships and solo practitioners	3,275
Total	1,531,352

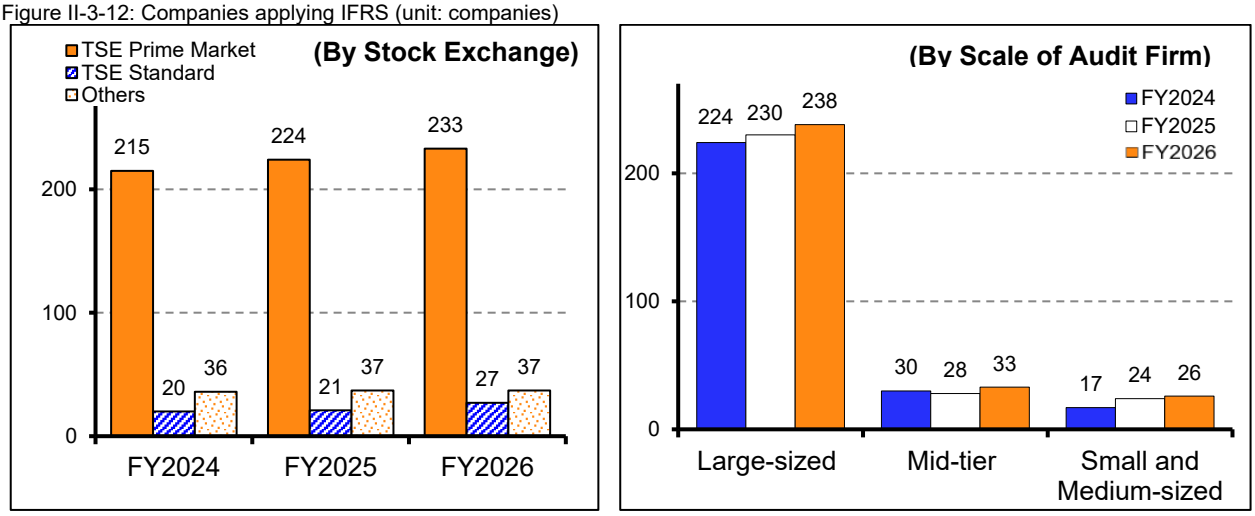
(Source) Prepared by the CPAAOB based on data from QUICK and exchanges

4. IFRS Adopting Companies

The following figures show the listing markets for companies applying IFRS and the scale of the accounting auditors for these companies as of the end of March 2026 (Figures II-3-12).

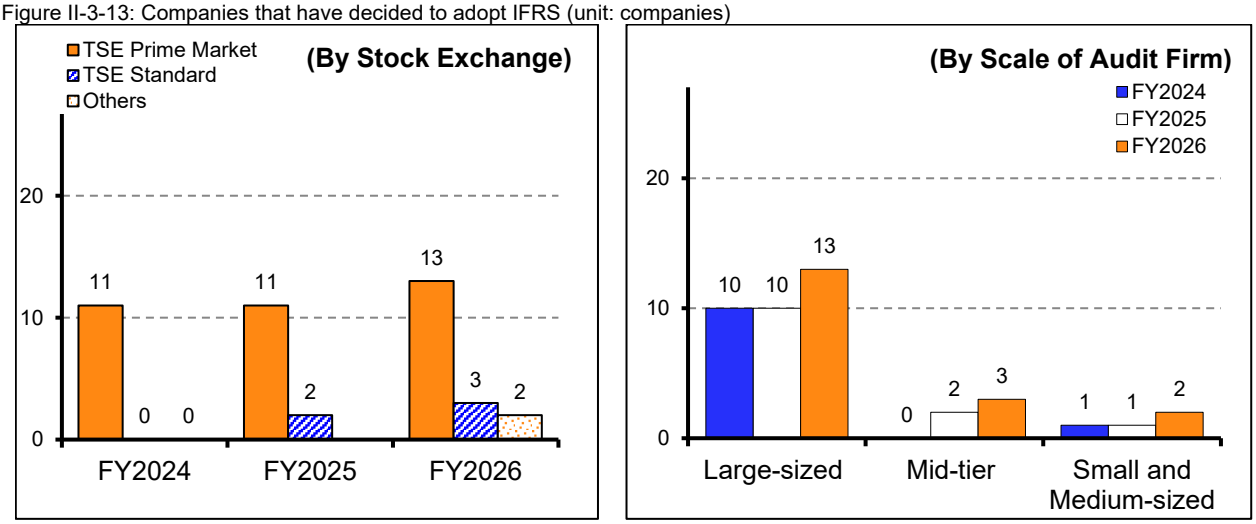
The majority of companies that have adopted IFRS are listed on the Prime Section of the Tokyo Stock Exchange, and many of them operate internationally. Audit contracts are concentrated in large-sized audit firms that are members of major global networks. A similar situation is seen with companies that have decided to adopt IFRS (companies in which the business execution body has decided to adopt IFRS and has disclosed this decision to the public) (Figure II-3-13).

Figure II-3-12: Companies applying IFRS (unit: companies)



(Note) PwC Arata and PwC Kyoto merged on December 1, 2023 to form PwC Japan, and the former PwC Kyoto is classified as a large-sized audit firm for the purpose of classification by audit firm size as of March 31, 2026.
(Source) Prepared by the CPAAOB based on data from exchanges

Figure II-3-13: Companies that have decided to adopt IFRS (unit: companies)



(Note) PwC Arata and PwC Kyoto merged on December 1, 2023 to form PwC Japan, and the former PwC Kyoto is classified as a large-sized audit firm for the purpose of classification by audit firm size as of March 31, 2026.
(Source) Prepared by the CPAAOB based on data from exchanges

5. Audits of Initial Public Offerings

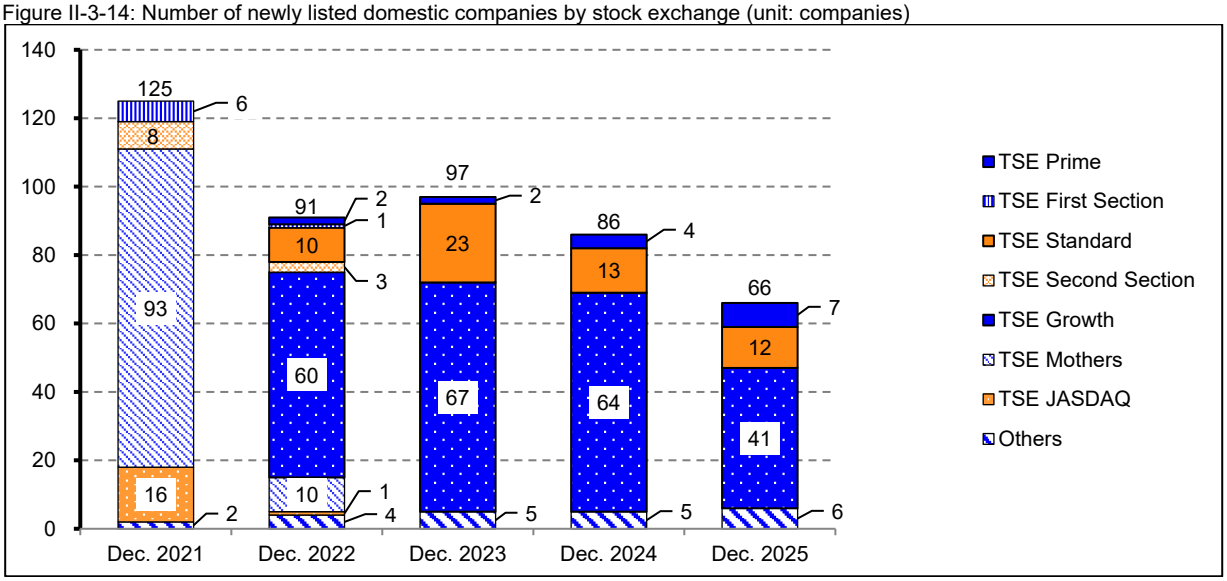
The number of IPOs (excluding listings on the TOKYO PRO Market and Fukuoka PRO Market) for the period from January 2025 to December 2025 (year through December 2025) came to 66, significantly below the 86 IPOs recorded in the previous year. By market segment, the number of newly listed companies on the Tokyo Stock Exchange Growth Market declined sharply from 64 to 41. This decrease followed the decision to tighten the market capitalization requirement under the continued listing criteria from “a market capitalization of at least JPY 4 billion after ten years from listing” to “a market capitalization of at least JPY 10 billion after five years from listing,” effective on and after March 1, 2030 (Figure II-3-14).

Looking at market share by size of audit firms, large-sized audit firms continued to hold a substantial share of the IPO audit market (Figure II-3-15). However, the share held by each individual large-sized audit firm fluctuated, likely reflecting changes in the firms’ respective business operation policies and

the status of their IPO-related services. For information regarding audit firms' policies on accepting IPO audit engagements and their organizational structures, see "III. Operation of Audit Firms, A. Operations Management System, 4. Organizational Structure for Providing Audit Services".

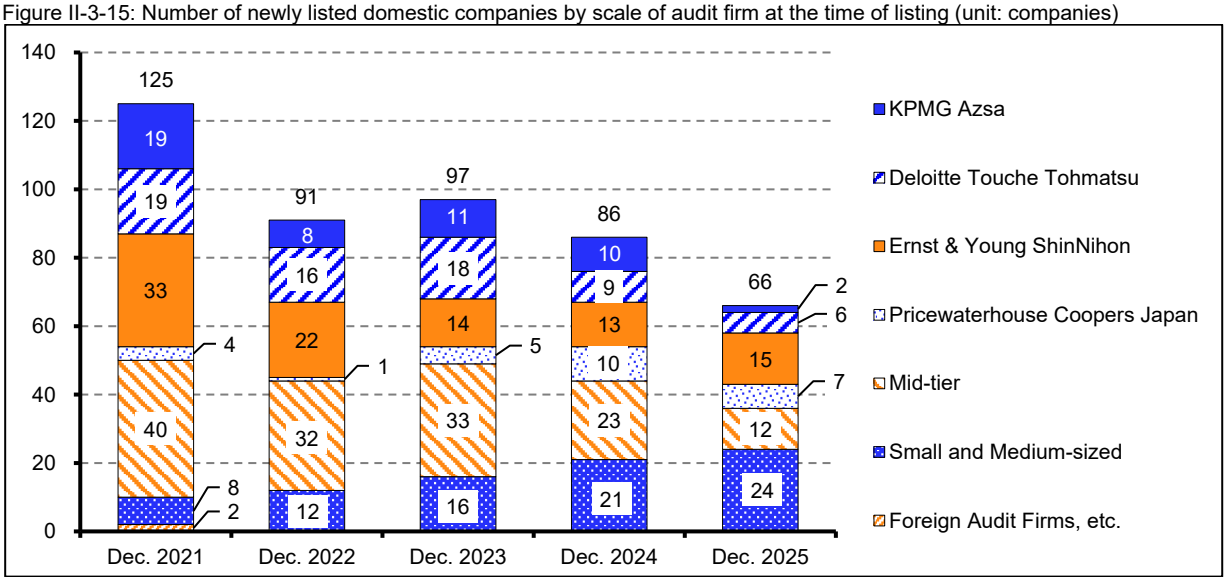
As of December 31, 2025, the share of large-sized audit firms decreased from 49% to 46%, while the share of mid-tier audit firms declined from 27% to 18%. In contrast, the share of small and medium-sized audit firms increased from 24% to 36%.

Figure II-3-14: Number of newly listed domestic companies by stock exchange (unit: companies)



(Source) Prepared by the CPAAOB based on data from exchanges

Figure II-3-15: Number of newly listed domestic companies by scale of audit firm at the time of listing (unit: companies)



(Note) As of December 1, 2023, PricewaterhouseCoopers Aarata and PwC Kyoto were merged to form PwC Japan. For companies whose IPO audits were involved by PwC Kyoto before the merger, PwC Kyoto is classified as a mid-tier audit firm.

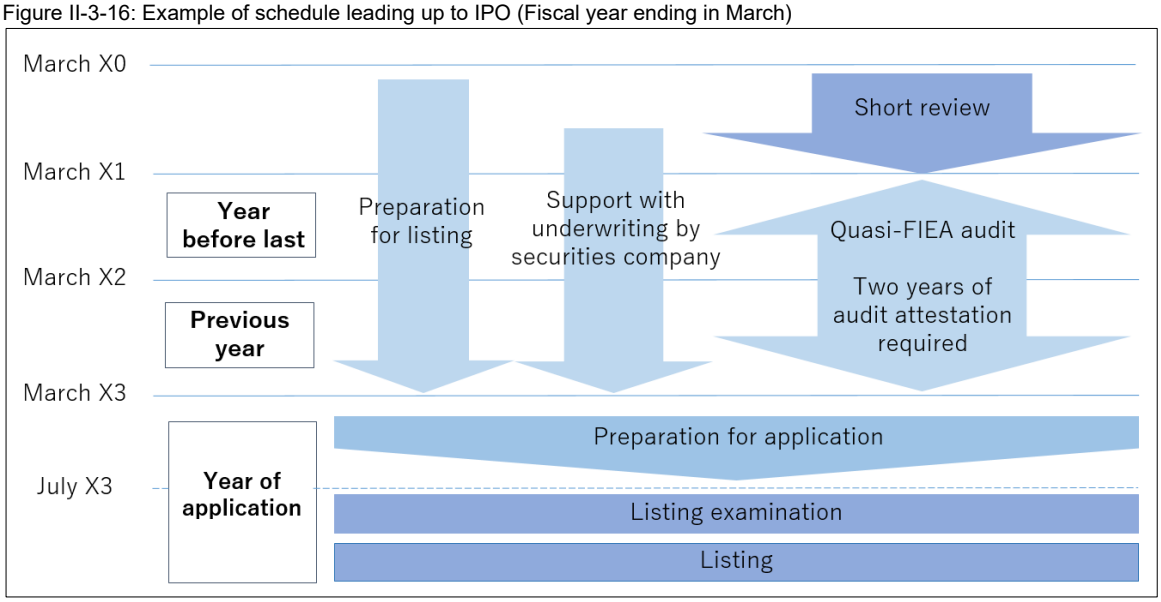
(Source) Prepared by the CPAAOB based on data from exchanges

Most audit firms regard the acceptance of IPO audit engagements as a part of the mission of audit firms since assisting with IPOs contributes not only to companies' growth but also to socioeconomic development.

However, IPO audits often entail relatively high audit risk because audited companies may have weaknesses in their internal control structures, and improper accounting may already be occurring by the time of the IPO. Accordingly, many audit firms have a policy of more carefully considering engagement risks than usual when accepting IPO audit engagements.

The increase in the market share of small and medium-sized audit firms may be attributable to several factors, including resource constraints at large-sized and mid-tier audit firms and the tendency of those firms to seek higher audit fees commensurate with the level of audit effort required in light of the risks associated with IPO audits. As a result, audited companies may have viewed the audit fees charged by small and medium-sized audit firms as being more commensurate with the scale of their businesses.

Figure II-3-16: Example of schedule leading up to IPO (Fiscal year ending in March)



(Source) Prepared by the CPAAOB

■ IPO Support Services ■

Article 192-2, paragraph 1 of the FIEA stipulates that to obtain a listing, a company needs to have its financial statements audited for the two years prior to the year in which it will be listed (application year). (This type of audit is described as “quasi-FIEA audit”). Furthermore, before concluding a quasi-FIEA audit contract, a short review is conducted to identify and resolve issues ahead of listing. This is the typical workflow when preparing for listing. Companies often ask CPAs and audit firms for support with conducting the short review and resolving issues, and CPAs and audit firms accept these engagements as non-audit work. The IPO-related support services that CPAs and audit firms provide as non-audit work include the following:

- Short reviews
- Support with establishing management structures
- Support with establishing internal control structures
- Support with speeding up book-closing procedures
- Support with preparing listing application documentation

According to the collection of reports from small and medium-sized audit firms (covering 44 small and medium-sized audit firms in PY2025), 59% of respondents reported that they either "provide audit services" or "provide non-audit services" to companies preparing for an IPO. As indicated by the aforementioned market shares by audit firm size at the time of listing, small and medium-sized audit firms have continued to achieve growth by adopting management strategies that focus on providing services to companies preparing for an IPO.

The CPAAOB will continue to examine, through inspections and the collection of reports from small and medium-sized audit firms, whether there are any issues relating to the provision of audit and other professional services to companies preparing for an IPO.

■ Responses to Accounting Fraud Cases Identified at the Time of IPO ■

In response to cases in which accounting fraud was discovered shortly after the listing of newly listed companies, the IPO Liaison Meeting[35] (Secretariat: Tokyo Stock Exchange, Inc. and Japan Exchange Regulation (hereinafter collectively referred to as the "TSE and JPX-R")) published "*The Exchange's Measures in Response to Accounting Fraud Cases at the Time of IPO*" ("TSE and JPX-R Liaison Meeting Paper") on December 12, 2025.

This paper states that the following measures will be implemented to enhance the quality of the listing examination process and to prevent recurrence through cooperation and collaboration among IPO stakeholders:

- Listing examination based on fraud risk;
- Review of the proper establishment of whistleblowing systems and enhancement of collection and sharing of fraud-related information;
- Awareness activities and other initiatives for executives;
- Partnership with IPO stakeholders; and
- Initiatives to enhance the listing examination capabilities related to fraud risk at JPX-R.

Following the publication of the TSE and JPX-R Liaison Meeting Paper, various IPO stakeholders announced their respective response measures. On January 26, 2026, JICPA published *Audit Responses to Accounting Fraud Cases at Newly Listed Companies and Other Entities (Notice)* ("JICPA Notice") and *Initiatives to Enhance the Reliability of Audits Conducted by Auditors of Registered Listed Companies and Other Entities*. In addition, on March 18, 2026, the Japan Securities Dealers Association (JSDA) published the *Guidelines for Underwriting Examinations in Light of Accounting Fraud Cases Identified at the Time of Initial Public Offerings*. Subsequently, on March 27, 2026, the TSE and JPX-R, the JICPA, and the JSDA jointly published *Responses by IPO Stakeholders to Accounting Fraud Cases Identified at the Time of Initial Public Offerings*, which consolidated the measures adopted by IPO stakeholders.

As one of these measures, where an audit firm has been replaced during the IPO preparation period, the TSE and JPX-R and the lead managing securities company will verify the circumstances surrounding the auditor change, including discussions with the predecessor auditor, as part of the listing examination process. In addition, to enhance auditors' capabilities to address fraud risks, the JICPA has announced measures such as considering stricter eligibility requirements for registered auditors of listed companies and strengthening the monitoring of auditors. These measures reflect the growing participation of small and medium-sized audit firms in the IPO market and are expected to affect audit firms involved in IPO engagements.

The JICPA Notice also summarizes six areas requiring particular attention when complying with auditing standards and other professional requirements, based on the results of investigations and reviews of member firms' audit practices in actual accounting fraud cases. Its objective is to maintain and enhance public confidence in auditing. In particular, the Notice highlights that small and medium-sized audit firms with relatively few listed company audit clients often have limited human resources and practical experience in dealing with accounting fraud cases. Accordingly, such firms are encouraged to refer to the JICPA Notice and to re-emphasize the proper application of the risk-based approach, including the identification, assessment, and response to risks of material misstatement.

For further details regarding each of these publications, see "IV. Responses to Changes in the Global Environment Surrounding Audits, A. Trends Surrounding Small and Medium-Sized Audit Firms".

[35] The IPO Liaison Meeting is a forum established in January 2025 by the Japan Exchange Group, Inc. for the purpose of conducting regular exchanges of views with securities companies, audit firms, and other stakeholders regarding issues relating to IPOs.

D. Foreign Audit Firms

1. System for Foreign Audit Firms

Financial statements submitted by domestic listed companies under the FIEA generally require audit attestation by Japanese CPAs or audit firms. For foreign companies, however, audit attestations of financial statements to be submitted pursuant to the FIEA are generally provided by CPAs or audit firms in their home jurisdictions. To avoid duplicate audits, an exemption is granted where the issuer has obtained audit attestation deemed equivalent to that required under the FIEA.

To further enhance the soundness of Japan's capital markets, the CPA Act was amended in 2007 to require foreign CPAs and audit firms auditing foreign companies, etc. subject to the FIEA disclosure requirements to file a notification with the FSA Commissioner. Upon filing the notification, they are recognized as foreign audit firms (Article 1-3(7) and 34-35 (1) of the CPA Act) and become subject to inspection and supervision by the CPAAOB and the FSA.

Under "Approach to Inspections and Supervision of Foreign Audit Firms" (September 14, 2009), the CPAAOB generally collects reports from foreign audit firms once every three years. Most recently, in PY2024, the CPAAOB collected reports from 28 foreign firms in 12 countries and regions as the most recent case. The CPAAOB has published the *"Basic Guidelines on Information Requirements and Inspection on Foreign Audit Firms etc. by the CPAAOB"* [37], which sets out the procedures for report collections and inspections.

2. Foreign Audit Firms

Most foreign audit firms registered with the FSA are based in Europe, followed by the Asia-Pacific region (Figure II-4-1). France and the Cayman Islands have the largest number of registered firms (eight each), followed by the U.S. and Hong Kong (seven each). Registered foreign audit firms are listed and updated on the FSA website.

Figure II-4-1: Number of registered foreign audit firms (as of March 31, 2026)

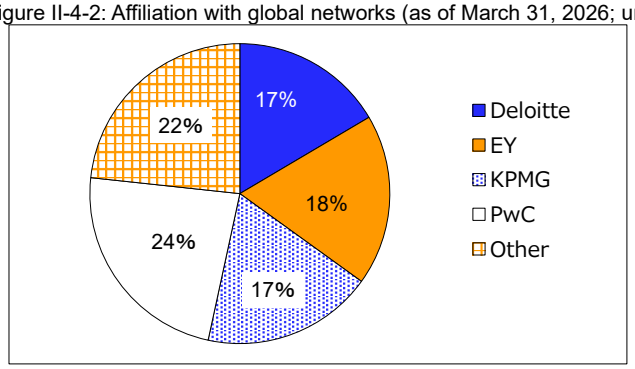
	Number of countries/regions	Number of foreign audit firms
Europe	16	61
Asia-Pacific	10	30
North America	2	10
Middle East	1	2
Total	29	103

(Source) Prepared by the CPAAOB based on information from the FSA website

[36] This document sets out specific implementation procedures and matters requiring attention regarding policies for the supervision and inspection of foreign audit firms (published in September 2009)
[37] The guideline prescribes specific procedures, points requiring attention, and other matters relating to the collection of reports from and inspections of foreign audit firms, etc. (Most recently revised in June 2024.)

Around 80% of foreign audit firms are affiliated with Big Four global accounting firms (Figure II-4-2).

Figure II-4-2: Affiliation with global networks (as of March 31, 2026; unit in right-hand table: Firms)



Big Four global accounting firms	80
Other	23
Total	103

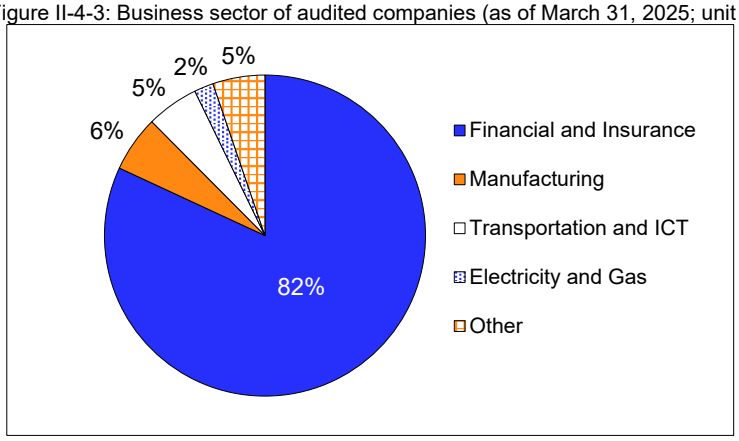
(Note) The figures cover foreign audit firms registered with the FSA and whose audit firm names include the names of one of the Big Four global networks.
(Source) Prepared by the CPAAOB based on information from the FSA website

3. Audited Companies

Securities issued by foreign companies that are subject to the FIEA disclosure regulations include not only shares issued by a foreign company that are offered for public offering or secondary distribution, or listed on exchanges in Japan, but also bonds issued by foreign companies, beneficiary certificates issued by foreign investment trusts, and foreign investment securities. Among foreign companies currently subject to disclosure rules, most are unlisted funds (foreign investment trusts and foreign investment securities).

Regarding the business sectors of companies audited by foreign audit firms, 82% are classified as finance and insurance, and around 65% of these are unlisted funds (Figure II-4-3).

Figure II-4-3: Business sector of audited companies (as of March 31, 2025; unit in right-hand table: companies)



Finance and Insurance		421(3)
	Unlisted Funds	273
	Fund issuer	69
Manufacturing		29(-)
Transportation and ICT		27(-)
Electricity and Gas		10(-)
Other		27(4)
Total		514(7)

(Note) Figures in parentheses are the number of companies (including funds) listed on exchanges in Japan
(Source) Prepared by the CPAAOB based on information on the FSA website

III. Operation of Audit Firms

III. Operation of Audit Firms

A. Operations Management System

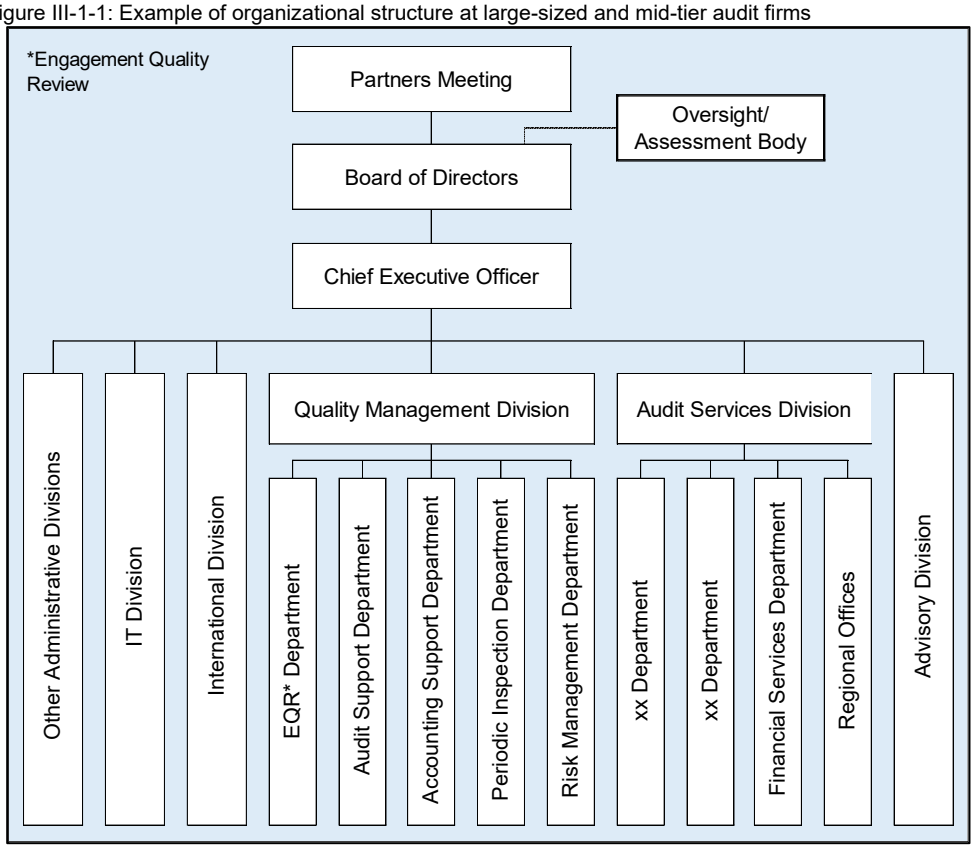
1. Organizational Structure of Audit Firms

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

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

Large-sized audit firms have established industry-specific divisions within their audit practice, including divisions such as the financial services division, which is responsible for auditing listed financial institutions.

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

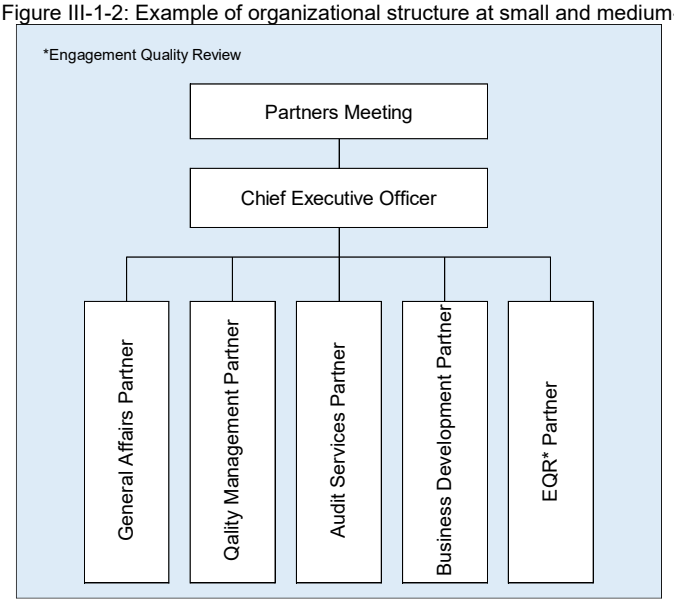


(Note) The organizational structure of mid-tier audit firms is often simpler than the structure shown in the above figure.
(Source) Prepared by the CPAAOB

In contrast, small and medium-sized audit firms often make organizational decisions directly through

partners' meetings without establishing boards of directors or oversight/assessment bodies, due to their limited personnel resources. In many cases, their audit functions are also not divided into specialized units. Furthermore, most small and medium-sized audit firms do not maintain dedicated quality management departments and instead address quality management matters by appointing individuals responsible for such functions. As a result, the effectiveness of quality management tends to depend on the capabilities of, and the time devoted by, those individuals. In addition, knowledge and experience are less likely to be accumulated and shared throughout the organization. Compared with large-sized audit firms; therefore, small and medium-sized audit firms generally operate under a more personnel-dependent framework (Figure III-1-2).

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



(Source) Prepared by the CPAAOB

Characteristics of organizational structure based on audit firm size are shown in Figure III-1-3 and summarized below.

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

At mid-tier audit firms, head-office functions are being strengthened through measures such as increasing head-office personnel; however, challenges remain in fostering organizational culture that promotes awareness of audit quality among engagement teams and in establishing frameworks to

support audit engagements involving heightened audit risk.

At small and medium-sized audit firms, quality management responsibilities are generally assigned to partners and full-time staff who also perform audit engagement work. In many cases, partners are permitted to engage in a side business such as operating their own accounting office. In addition, the proportion of part-time staff tends to be relatively high. As a result, partners and full-time staff may not be able to devote sufficient time to quality management activities.

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

	Large-sized audit firm	Mid-tier audit firm	Small and medium-sized audit firms
No.of partners	Approx. 250 to 550	Approx. 40 to 100	Up to approx. 50 (Note)
No.of full-time personnel	Approx. 3,400 to 6,800	Approx. 230 to 950	Up to approx. 120 (Note)
Decision-making bodies	・The partners' meeting is the highest decision-making body. ・A board of directors and an executive committee are established under the partners' meeting.	・The partners' meeting is the highest decision-making body. ・A board of directors is established under the partners' meeting.	・Most decisions are made by the partners' meeting. ・Larger firms have a board of directors beneath the partners' meeting.
Oversight/ assessment bodies	・A body is established to oversee/assess business execution bodies, such as the board of directors and management committee. ・Subcommittees are established for "nomination" (appointment of the Chief Operating Officers and other executives), "compensation" (evaluation of executives/partners, compensation decisions, etc.), and "audit" (oversight of accounting and auditing matters). A public interest subcommittee is also established to monitor business execution from a public-interest perspective. ・Third parties with independence ("independent third parties") serve as members of oversight/ assessment bodies and subcommittees.	・Oversight/assessment bodies are established, but their authority is more limited than that of large-sized audit firms. ・Many firms do not establish nomination, compensation, and audit subcommittees. ・Independent third parties serve as members of oversight/assessment bodies.	・Due to their small scale, many firms rely on checks and balances among partners rather than establishing oversight/assessment bodies. ・Many firms appoint independent third parties to participate in management meetings and serve on management councils, management oversight committees, supervisory boards, etc.
Design of business operation departments	・Multiple audit services divisions are established, and firm-wide operations, including regional offices, are centrally managed. ・A division specializing in financial services has been established. ・Quality management and risk management divisions are established.	・Multiple audit services divisions are established, and firm-wide operations, including regional offices, are centrally managed. ・A quality management division is established.	・Many firms assign partners to specific functions without establishing dedicated divisions. ・Larger firms have established organizational structures similar to those of mid-tier audit firms
Number of offices	・In addition to offices in the three major metropolitan areas (Tokyo, Osaka, and Nagoya), many firms maintain offices throughout Japan.	・In addition to the head office, firms often maintain offices in major metropolitan areas such as Tokyo, Osaka, and Nagoya.	・Many firms operate only a head office.
Design of quality control divisions	・The quality management division comprises departments responsible for functions such as maintaining and distributing audit manuals, providing accounting and auditing consultations, supporting IFRS and U.S. GAAP matters, conducting engagement quality reviews, and performing periodic inspections. ・A risk management division has been established to oversee audit engagements, auditor independence, and audit risks. ・Audit service divisions often also perform quality management functions.	・Within the quality management division, departments responsible for risk management, accounting consultations, engagement quality reviews, and periodic inspections are generally established.	・Many firms assign partners to both quality management and audit engagements without establishing a dedicated quality management division. ・In some smaller firms, the representative partner is also responsible for quality management.

(Note) Excluding one audit firm with exceptionally large numbers of partners and full-time staff.
(Source) Prepared by the CPAAOB from CPAAOB inspections, collected reports and business reports

2. Efforts in Response to Audit Firm Governance Code

The Audit Firm Governance Code was formulated in March 2017. Subsequently, amendments to the CPA Act in May 2022, together with the related government ordinances issued in January 2023 and brought into effect in April 2023, required audit firms auditing listed companies to establish governance arrangements consistent with the Code and enhance their public disclosures. In response, the Code was revised in March 2023 to make it more readily applicable to small and medium-sized audit firms. These requirements apply to audits of companies with accounting periods commencing on or after July 1, 2024 (July 1, 2023 for large-sized audit firms).

The Audit Firm Governance Code provides principles for the organizational management of audit firms auditing listed companies. It is applied on a “comply or explain” basis, requiring firms either to implement the principles or explain why they have not done so. Audit firms are expected to apply the five principles in a manner suited to their individual circumstances to promote effective governance.

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

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

Principle 2: Organizational structure (management functions)

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

Principle 3: Organizational structure (oversight/assessment functions)

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

Principle 4: Operation

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

Principle 5: Ensuring transparency

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

From the perspective of firm size, large-sized and mid-tier audit firms have adopted all principles of the Code. In contrast, some small and medium-sized audit firms have not adopted all principles, particularly those relating to organizational structure and oversight/assessment functions (Principle 3) and ensuring transparency (Principle 5).

In light of these differences by firm size, the following section reviews audit firms’ initiatives with respect to these two principles.

a. Oversight/assessment functions within organizational structure (Principle 3)

i. Strengthening oversight/assessment functions through the use of independent third parties

(i) Large-sized audit firms

Large-sized audit firms strengthen their oversight and evaluation functions by incorporating the public interest perspective and the expertise of independent third parties. Two approaches have been observed (Figure III-1-4): (1) including independent third parties as outside committee members in existing oversight/assessment bodies, and (2) establishing separate and independent bodies such as a public interest committee.

Pattern 1: Independent third parties participate directly in nomination, compensation, and audit processes through their membership on the relevant subcommittees as outside members.

Pattern 2: Independent third parties participate through separate bodies, such as public-interest committees, rather than being directly involved in nomination, compensation, and audit processes.

All large-sized audit firms disclose in their annual audit quality reports whether independent third parties are involved in the nomination, compensation and audit processes.

(ii) Mid-tier audit firms

Following the introduction of the Code, many mid-tier audit firms have established oversight/assessment bodies, such as public-interest committees, that include independent third parties. However, except for some firms, nomination, compensation and audit subcommittees have not been established. As a result, the involvement of independent third parties in the process remains more limited than at large-sized audit firms.

(iii) Small and medium-sized audit firms

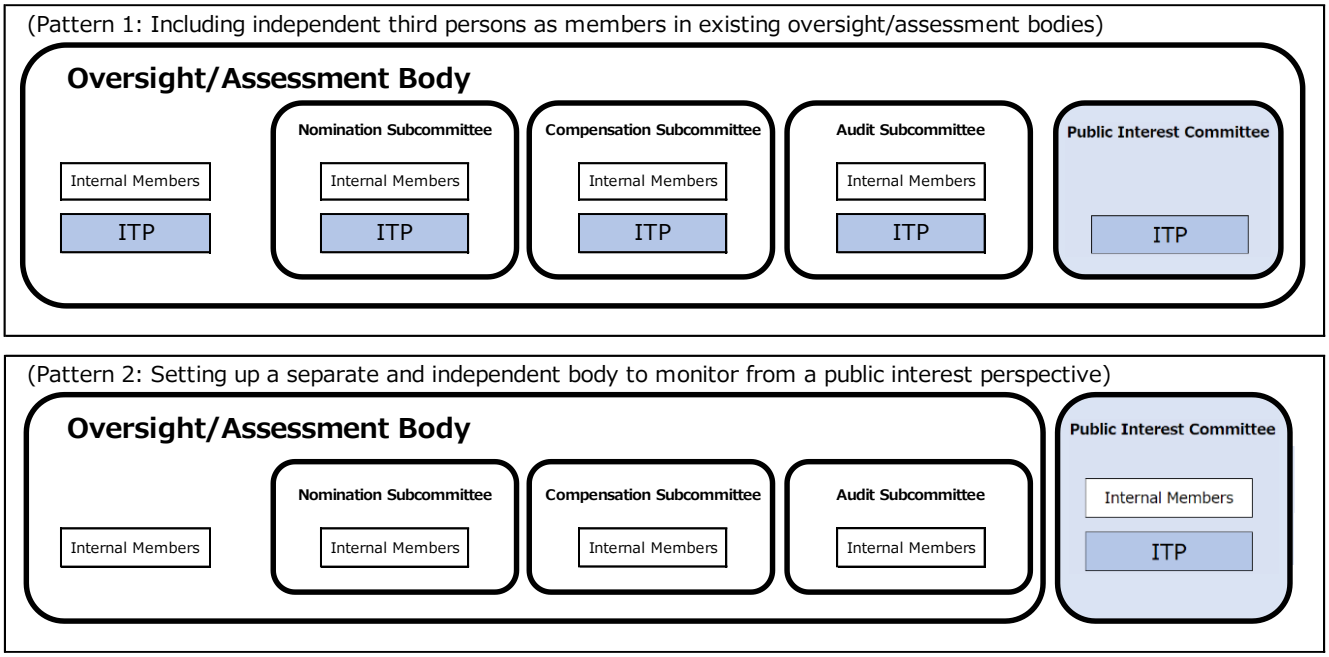
Of the 44 small and medium-sized audit firms subject to collection of reports, 23 have not established oversight/assessment bodies, citing their relatively small size and the effectiveness of mutual checks and balances among partners.

Nonetheless, some of these firms reported involving independent third parties in management-related meetings and obtaining advice and recommendations aimed at strengthening management functions and organizational governance.

Firms that have established oversight/assessment bodies utilize independent third parties as members of bodies such as management councils, management oversight committees, and supervisory boards.

Many firms also do not clearly define procedures relating to nomination, compensation, and audit processes.

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



(Source) Prepared by the CPAAOB

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

(i) Large-sized audit firms

To benefit from the public interest perspective and expertise of independent third parties as described in Section a. i., audit firms need to provide them with sufficient information on matters such as governance, executive appointments and dismissals, and compensation and to obtain their views in a timely manner.

Under Pattern 1 (Figure III-1-4), where independent third parties serve as members of existing oversight/assessment bodies, information is shared and views are obtained through participation in meetings. Some firms have also increased the proportion of independent third parties on the oversight/assessment bodies and their subcommittees to enhance their effectiveness.

Under Pattern 2, where separate bodies are established, firms provide information and receive views through these bodies, while also holding regular discussions between independent third parties and the CEO.

Because independent third parties are not directly involved in existing oversight and evaluation bodies, timely access to relevant information is particularly important. To facilitate this, some firms grant independent third parties the right to attend executive body meetings, including those of group firms, and to request information. Others have established secretariats to support outside members.

(ii) Mid-tier audit firms

Many mid-tier audit firms have established independent bodies, such as public-interest committees, composed of independent third parties. However, unless these individuals are

provided with adequate information on a timely basis, oversight/assessment functions may not operate effectively. To address this, some firms grant independent third parties the right to attend executive body meetings and request information. Nevertheless, some firms have not clearly defined the authority of independent third parties to obtain information proactively.

(iii) Small and medium-sized audit firms

Oversight/assessment bodies at small and medium-sized audit firms often consist primarily of internal partners, with limited participation by independent third parties. In many cases, information is shared with independent third parties through these bodies, and views are exchanged at meetings of executive bodies. The scope of information provided, the meetings attended by independent third parties, and the extent to which external expertise is utilized vary considerably across firms.

iii. Experience and expertise of independent third parties

Independent third parties serving on oversight/assessment bodies should possess knowledge and experience appropriate to the size, governance structure, and organizational challenges of the audit firm. Consideration should be given not only to their independence from the audit firm but also to their independence from the firm's audit clients.

Large-sized and mid-tier audit firms tend to appoint individuals with corporate management experience at general business companies, often complemented by professionals with legal backgrounds, such as attorneys, or former government officials. Small and medium-sized audit firms more frequently appoint individuals with legal and/or academic backgrounds.

The number of independent third parties typically range from three to four at large-sized audit firms, one to three at mid-tier audit firms, and generally one at small and medium-sized audit firms. Some large-sized and mid-tier audit firms appoint independent third parties as chairs of oversight/assessment bodies as well as nomination, compensation and audit subcommittees to enhance their effectiveness.

b. Ensuring transparency (Principle 5)

i. Disclosure of the application of the Code and efforts to improve audit quality

(i) Large-sized audit firms

Large-sized audit firms publish annual audit quality reports on their websites. These reports explain how each principle of the Code is applied and describe initiatives to enhance audit quality. The reports provide detailed information on organizational structures, the system of quality management, human resource development, and global network arrangements. Recently, they have devoted considerable attention to compliance with the revised Quality Control Standards, Audit Quality Indicators (AQIs), the use of technology in auditing, and responses to sustainability and other non-financial disclosures. Another notable feature is the provision of specific explanations of priority initiatives aimed at achieving each firm's long-term vision.

(ii) Mid-tier audit firms

Mid-tier audit firms publish audit quality reports, primarily describing their organizational structures and the system of quality management, and make them available on their websites. As with large-sized audit firms, some reports include explanations of the effective use of technology in auditing, responses to non-financial disclosure, and evaluations under the new quality management standards. However, in many cases, the content is less detailed than that provided by large-sized audit firms. Some firms do not include explanations of AQIs linked to their medium- to long-term vision or descriptions of the initiatives they intend to prioritize. As a notable initiative, some firms disclose the results of internal surveys and other assessments conducted by their personnel to evaluate the current state of audit quality and support its improvement.

(iii) Small and medium-sized audit firms

Of the 44 small and medium-sized audit firms subject to the collection of reports, 43 firms had issued audit quality reports and made them available on their websites. In addition, these firms explain their application of the Code within such reports. The one firm that had not yet issued an audit quality report indicated that it plans to publish one on its website in the future.

In many cases, audit quality reports and similar publications issued by small and medium-sized audit firms are prepared in accordance with the structure illustrated in the JICPA's *Guidance on Preparing Annual Reports on Audit Quality Management*. Compared with those issued by mid-tier audit firms, the content is generally less detailed, with some reports lacking specific information on organizational structures.

Compared with those issued by mid-tier audit firms, the content is generally less detailed, and some reports provide explanations of specific organizational structures.

ii. Disclosure of AQIs

Audit quality does not have an established definition and is inherently difficult to measure directly. For this reason, large-sized audit firms, mid-tier audit firms, and some small and medium-sized audit firms have established AQIs, which quantify initiatives aimed at improving audit quality and the results of those initiatives, taking into account the circumstances of each firm. By continuously monitoring these indicators, firms seek to assess the state of their audit quality. It should be noted that AQIs are selected by each audit firm so as to provide a balanced representation of its efforts and progress in improving audit quality, reflecting its specific circumstances. Accordingly, the fact that one audit firm discloses a particular AQI that is not disclosed by another audit firm should not, in itself, be regarded as evidence that the latter has established an insufficient set of AQIs.

(i) Large-sized audit firms

Among the large-sized audit firms, all firms disclose AQIs relating to information technology (such as investment amounts and the rate of adoption of audit tools), reflecting their efforts to promote the use of IT and delivery centers in the audit process. Other AQIs commonly

disclosed include indicators relating to internal reviews of the system of quality management (such as the number of significant deficiencies identified through periodic inspections), the average number of training hours per partner and employee, globalization-related indicators (such as the proportion of personnel with overseas work experience), and diversity-related indicators (such as the proportion of female partners and employees).

In addition, AQIs disclosed by many firms include indicators relating to the quality management framework (such as the number of personnel engaged in quality management activities), independence (such as the results of internal reviews relating to independence), sustainability (such as the number of personnel dedicated to sustainability-related reporting and assurance matters), and the results of inspections and reviews conducted by external oversight bodies.

(ii) Mid-tier audit firms

Among mid-tier audit firms, AQIs commonly disclosed include the results of employee surveys relating to audit quality, workforce composition, indicators relating to the quality management framework (such as the number of personnel engaged in quality management activities), independence (such as response rates to independence confirmations and the number of identified violations), and indicators relating to internal reviews of the system of quality management (such as the number of significant deficiencies identified through periodic inspections).

In addition, some firms disclose IT-related indicators, such as IT investment amounts and the number of personnel engaged in digital initiatives.

(iii) Small and medium-sized audit firms

Among small and medium-sized audit firms, the extent of AQI disclosure varies depending on the size of the firm, and some firms do not disclose any AQIs at all. Among the firms with the highest audit service revenues, common disclosures include workforce composition, training participation, and the degree of fee dependence on specific clients. In addition, many firms disclose AQIs relating to independence, the quality management framework, and internal reviews of the system of quality management.

Even for audit firms that do not currently disclose AQIs, they are expected to actively identify and disclose appropriate AQIs that reflect their own initiatives relating to quality management, governance, and other relevant areas, taking into account their size and characteristics, so that capital market participants and other stakeholders can make informed assessments of such firms.

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

(i) Large-sized audit firms

Large-sized audit firms have conducted surveys and dialogues with Chief Financial Officers (CFOs) and audit and supervisory board members of audited companies regarding audit

quality. In recent years, large-sized audit firms have also taken initiatives to provide opportunities for dialogue with a broader range of capital market participants by holding meetings with institutional investors and analysts, with the participation of independent third parties.

(ii) Mid-tier audit firms

Some mid-tier audit firms reported conducting surveys among CFOs and audit and supervisory board members of audited companies regarding audit quality. In addition, some firms make use of the meetings for investors organized by the JICPA or exchanges instead of hosting their own dialogue sessions.

(iii) Small and medium-sized audit firms

In many of the small and medium-sized audit firms that have disclosed the application status of the Code, stakeholder dialogue is often limited to exchange of views between engagement teams and the CFOs and audit and supervisory board members of audited companies.

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

3. Human Resources of Audit Firms

a. Partners and full-time personnel

Most CPA exam passers joining large-sized audit firms are recruited immediately after passing the essay exam, while mid-career hires account for only a small proportion of CPAs and CPA exam passers. Many of those recruited obtain CPA qualification within the firm, progress to managerial positions, and some are ultimately promoted to partner (See “II. Overview of the Audit Sector, B. Audit Firms, 1. Organizational Structure of Audit Firms”).

In contrast, mid-tier and small and medium-sized audit firms often face difficulties in recruiting sufficient numbers of CPA exam passers and therefore rely more heavily on mid-career hires. Many of these recruits are CPAs who previously worked at large-sized audit firms, helping such firms secure the personnel required for audit engagements and other services.

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

The number of partners and full-time staff members, analyzed by size of audit firms, had been on an upward trend at large-sized audit firms since FY2021. However, it declined in FY2025. This decline was mainly attributable to a reduction in personnel at a particular large-sized audit

firm resulting from the transfer of part of its non-assurance services to another entity within the audit firm group. At mid-tier audit firms, the number of personnel had also been increasing since FY2021, but temporarily decreased in FY2024 due to the merger of PwC Kyoto with PwC Aarata in FY2023, before returning to an upward trend in FY2025. Small and medium-sized audit firms have likewise continued to experience growth since FY2020, supported by factors such as the establishment of new audit firms and business expansion.

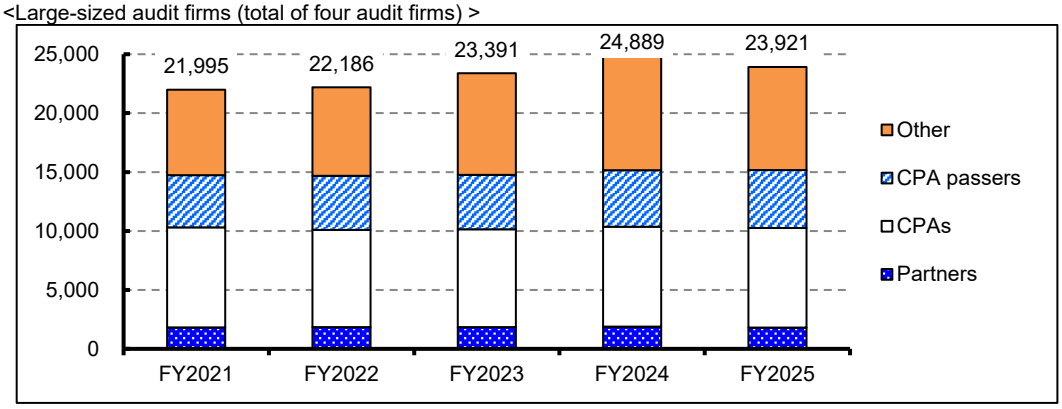
Taking into account the effects of the above-mentioned business transfer and merger, trends by personnel category indicate that the number of CPA exam passers, etc. has been increasing across audit firms of all sizes. The number of personnel other than partners and CPAs (including CPA exam passers) has also shown an upward trend regardless of the firm size. According to the latest data, personnel other than partners and CPAs (including CPA examination passers and equivalent personnel) account for 37% of the total workforce at large-sized audit firms, 26% at mid-tier audit firms, and 25% at small and medium-sized audit firms. Compared to FY2021 (FY2020 for small and medium-sized audit firms), when the corresponding ratios were 33%, 30%, and 27%, respectively, the proportion increased only at large-sized audit firms (see Figure III-1-5).

Audit firms have increased the number of personnel other than partners and CPAs (including CPA exam passers) in order to respond to the growing digitalization of audited companies, improve operational efficiency, address personnel shortages, and enable CPAs to focus more on tasks requiring judgement. This trend is particularly pronounced among large-sized audit firms. These personnel include IT specialists who conduct IT audits using technologies and support engagement teams in carrying out audit procedures using IT, and audit assistants who support engagement teams by sending/receiving balance confirmation letters, preparing various reports, and organizing data.

Some large-sized audit firms have further enhanced operational efficiency by establishing specialized organizations to centrally manage the work and procedures of audit assistants, their skill development, and work assignments.

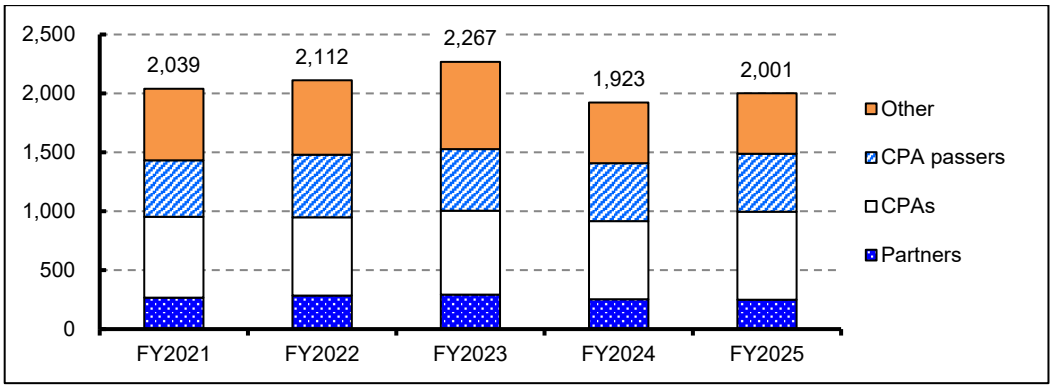
Figure III-1-5: Change in the number of partners and full-time personnel (unit: persons)

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



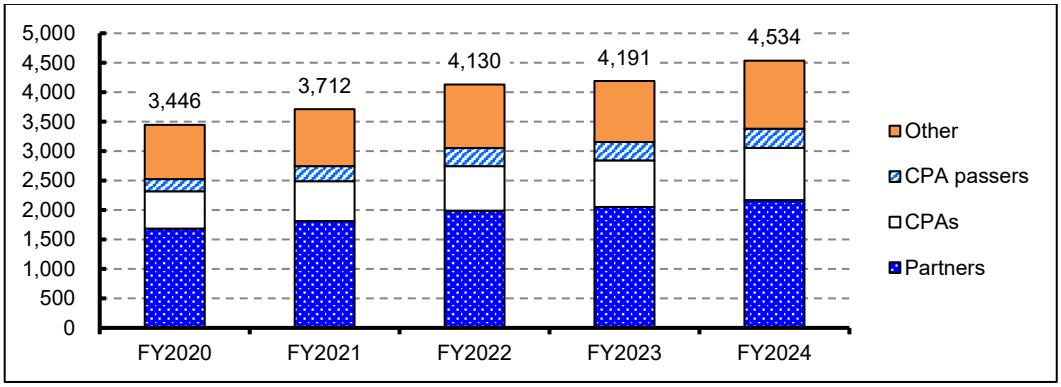
(Note) The number of PwC Kyoto in FY2023 is included in the mid-tier audit firms.
(Source) Prepared by the CPAAOB based on business reports submitted by audit firms.

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



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

<Small and medium-sized audit firms>



(Note1) The book-closing months of small and medium-sized audit firms vary widely, so figures for FY2025 have not yet been compiled. As a result, the figures for small and medium-sized audit firms only cover the period up to FY2024.
(Note2) The number of small and medium-sized audit firms varies from year to year, but 281 such firms are included in the figures for FY2024.
(Source) Prepared by the CPAAOB based on business reports submitted by audit firms.

b. Side businesses of partners

Large-sized audit firms generally do not permit partners to engage in a side business with tax accountant offices or solo practitioner offices.

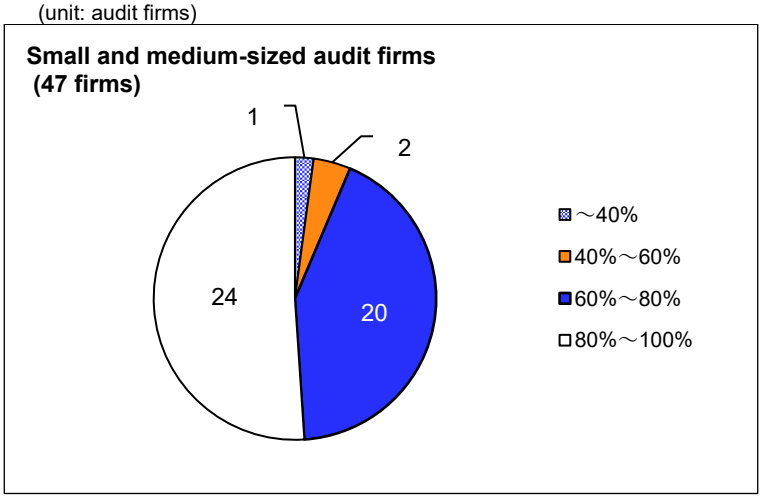
As with large-sized audit firms, some mid-tier audit firms do not permit a side business of

partners. However, at some mid-tier audit firms, the number of partners having a side business accounts for around 50% of the total number of partners. Those partners work for the JICPA and provide tax services at their own offices as a side business. Furthermore, calculations of the proportion of each partner's total working hours spent to the audit firm show that, at mid-tier audit firms that permit side business activities, partners spend more than 90% of their working hours to the audit firm, including those engaged in such activities.

Most small and medium-sized audit firms permit a side business, as many partners are already operating their own tax accountant offices at the time they join the firm.

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

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



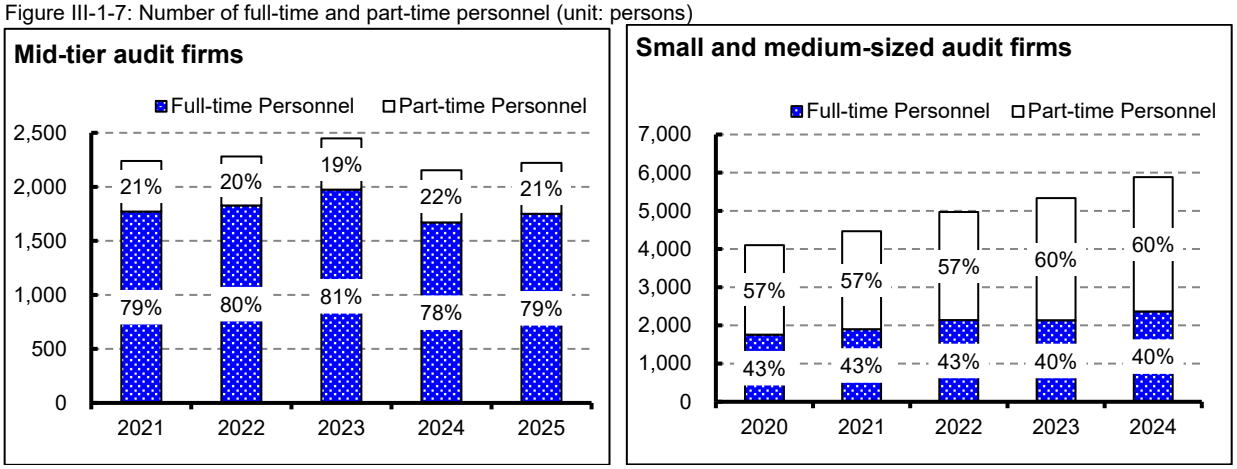
(Source) Prepared by the CPAAOB based on partners' declarations collected through the inspections and collection of reports in PY2024.

c. Part-time personnel

Part-time personnel account for a very small proportion of total personnel at large-sized audit firms, at around 2%. The ratio of part-time personnel to total staff at mid-tier audit firms remained at around 20%.

The ratio of part-time personnel was around 60% at small and medium-sized audit firms, indicating a reliance on part-time audit assistants to support firm operations (see Figure III-1-7). In particular, at audit firms with four or fewer full-time personnel, which account for around 70% of small and medium-sized firms, the ratio of part-time personnel to total personnel is approximately 90% (see Figure III-1-8).

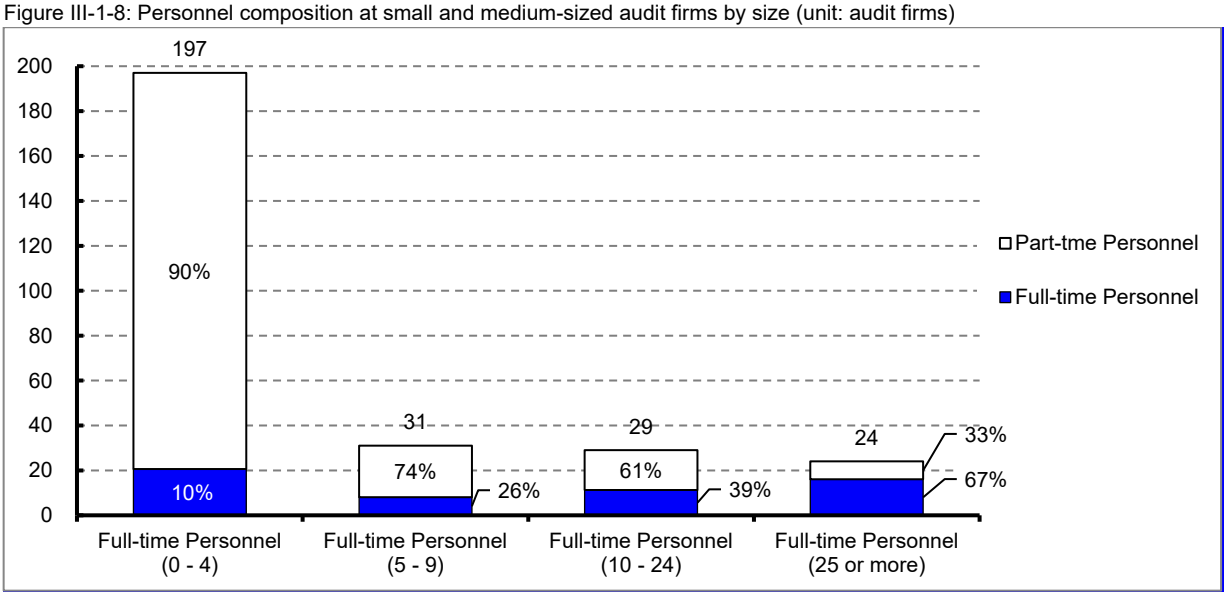
Figure III-1-7: Number of full-time and part-time personnel (unit: persons)



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

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

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



(Note) The 281 audit firms were classified by the number of full-time personnel based on the business reports submitted by small and medium-sized audit firms in FY2024, after which the number of employees was totaled and the composition ratios of full-time and part-time personnel calculated.

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

4. Organizational Structure for Providing Audit Services

An audit engagement team, as an audit service provider, is required to exercise professional skepticism[38], carry out appropriate risk assessments and risk-response procedures and perform appropriate audit procedures to improve audit quality. The CPAAOB endeavors to understand the engagement team's status through its inspections of audit engagements, and to ascertain the status of the conduct of audit services through other monitoring activities. This section elaborates on the status of engagement teams.

An engagement team consists of an executive partner who takes primary responsibility, CPAs serving as audit assistants and other audit assistants. Other audit assistants include CPA exam passers and

[38] An attitude with a questioning mind, alertness to conditions that may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence.

other audit assistants (staff members who are not qualified to be involved in the audit of financial statements by CPAs, etc.). If the business activities of an audited company are complicated and extensive in scale, IT, tax and other in-house experts join the team. As occasion demands, experts in business valuation and fraud response from affiliated entities within the group may also be involved in the team. The general job classification-based formation of an engagement team (Note 1), formed by a large-sized audit firm to audit a large domestic listed company, is shown in Figure III-1-9.

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

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

		Position	Principal roles
Three engagement partners		Partner	Control of audit services, communication with the senior management of the audited company
Assistants to the engagement partners	One senior manager/ Manager	Senior manager/Manager	Management of engagement team, management of audits
	One senior manager/ Manager	Senior manager/Manager	Management of audits of foreign components
	14 CPAs	Manager/Senior staff	Performance of audit procedures in significant audit areas
	12 qualified assistants (CPA exam passers, etc.	Staff	Performance of audit procedures other than important audit procedures
	Four unqualified assistants	Assistant	Data processing, reconciliation of administrative vouchers, other tasks not requiring significant judgements, administration of the dispatch and collection of balance confirmation letters, administration of engagement documentation
	23 in-house experts (Note 2)	Partner, manager, senior staff, etc.	Audit procedures, including assessment of IT control, verification of accounting treatments for corporate tax, etc., assessment of appropriateness of retirement benefit obligations, and verification of real estate and business valuations.

(Note1) An example of an engagement team auditing a company having consolidated sales of approximately 1.8 trillion JPY that requires approximately 13,000 hours for audit engagements.
(Note2) In-house experts are assigned to engagement teams as needed.
(Note3) In addition to the assistants shown in the above table, personnel belonging to a delivery center also serve as audit assistants.
(Source) Prepared by the CPAAOB based on information obtained through the CPAAOB inspections

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

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

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

Small and medium-sized audit firms often have audit assistants on a part-time basis due to limited human resources for audit teams, although in some firms it is difficult to assign enough audit assistants to their teams. Compared with large-sized audit firms, therefore, the members with primary responsibility for auditing tend to play larger roles. For example, audit managers may need to perform audit procedures themselves (Figure III-1-10).

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

To audit listed financial institutions subject to accounting and auditing procedures that significantly differ from those applicable to ordinary business enterprises, large-sized audit firms have set up mechanisms capable of performing an audit based on professional knowledge and experience, such as the establishment of a financial audit services division dedicated to auditing the financial institutions. An engagement team to audit a listed financial institution includes members with knowledge and experience in auditing financial institutions through measures such as forming a team mainly from a financial audit services division or deploying a member from a financial audit services division with primary responsibility for the audit.

<Structure of the engagement team in an IPO audit>

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

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

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

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

(Note) CPAs at small and medium-sized audit firms are often part-time.
(Source) Prepared by the CPAAOB based on the CPAAOB inspections

5. Organizational Structure for Supporting Audit Services

As audited companies grow in size and their operations become increasingly sophisticated and globalized, audit firms are required not only to provide specialized expertise and develop IT-enabled tools and systems, but also to support engagement teams through operational environments that promote efficient and effective audits.

Accordingly, the CPAAOB's monitoring focuses not only on audit engagements themselves but also on whether audit firms have established arrangements, appropriate to their size and characteristics, to support the delivery of high-quality audit services. This section outlines such support structures and highlights examples, primarily from large-sized audit firms, including frameworks for identifying audit risk, the development of IT-enabled tools and systems, and initiatives to streamline administrative tasks.

a. Overview of support systems

To ensure the appropriateness of audit services, large-sized audit firms have assigned over 100 personnel to their quality management divisions and have established various departments, including contract management, monitoring, accounting support, audit support, engagement quality reviews, IT, international services, and risk management (Figure III-1-11). See "B. Engagement Quality Reviews" and "C. Monitoring of the System of Quality Management" for

information on engagement quality reviews and periodic reviews. A number of large-sized audit firms are strengthening quality management functions within their audit business divisions and are taking steps to gather information on the firm's quality management in a timely manner and to provide support to engagement teams. Audit firms, especially large ones, have digitized audit working papers and introduced analytical tools for identifying unusual journal-entry data, tools for identifying fraud risks, and communications tools to facilitate the online exchange of information and reference material between audited companies and engagement teams, etc. (For progress in the digitization of audit services, see "6. Use of Technology in Audit and Cybersecurity Initiatives, a. Progress with the Adoption of IT in Audit Engagements").

In addition, some large-sized audit firms have established dedicated organizations to perform not only administrative tasks, such as sending and collecting audit confirmations, reviewing securities reports, and processing audit-related data, but also certain audit procedures, including work related to management's assessment of internal controls. These arrangements enable CPAs and other audit professionals to concentrate on tasks requiring professional judgment. Such organizations may be located within existing offices or at newly established sites near Tokyo and other regional cities. While audit assistants perform much of the work, firms maintain quality through training programs and review procedures conducted by CPAs. With respect to audit confirmations, large-sized audit firms jointly established Audit Confirmation Center GK in November 2018. The center has developed a shared receivables and payables confirmation system, provides an online confirmation platform, and performs related administrative services, including the dispatch of confirmation requests.

Through these initiatives, large-sized audit firms, supported by relatively stable financial resources and substantial personnel, have further strengthened operational support in recent years by expanding the use of IT-enabled tools and increasing the specialization of administrative functions.

Although mid-tier audit firms are smaller in scale than large-sized audit firms, they have established quality management divisions similar to those of large-sized audit firms. Furthermore, the use of electronic audit documentation has become widespread, including through the adoption of audit documentation management systems used by overseas member firms and the introduction of commercially available electronic audit documentation systems.

It is common for small and medium-sized audit firms not to establish a dedicated quality management division and instead appoint a partner responsible for quality management, or for the CEO to concurrently serve in that role. At many small and medium-sized audit firms, the digitalization of audit documentation has not progressed significantly. Accordingly, paper-based audit documentation is often prepared using commercially available software and then stored electronically on cloud-based platforms or servers. In October 2024, the Audit Confirmation Center LLC established the "Audit Firm Council for Expanding the Digitalization of Balance Confirmations," aiming to promote system development and expand usage among mid-tier and

small and medium-sized audit firms.

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

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

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

b. Management of risk information

Audit firms develop and maintain firm-wide systems for managing risk information to handle high-risk audit engagements and to respond to the risk of fraud. Specifically, large-sized audit firms handle this as follows (Figure III-1-12).

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

[Actions taken by risk management department]

- Developing a database of past fraud cases and sharing that information within the audit firm
- Selecting high-risk audit engagements by gathering current and historical information and implementing continuous monitoring and support to engagement teams
- Establishing procedures to obtain internal or external expert advice when circumstances indicating a material misstatement due to fraud are identified, or when such a misstatement is suspected, and directing the performance of a higher-level review
- Establishing specialized fraud investigation teams within the audit firm or its group firms to support fraud investigations at audited companies.
- Establishing and operating a desk for receiving reports from whistleblowers inside or outside the audit firm
- Conducting effective fraud case study training based on actual fraud cases identified within the firm

[Actions taken by engagement teams]

- Addressing the risk of fraud through the use of data analysis tools
- Seeking expertise from the quality management division and undergoing high-level engagement quality reviews when fraud risks or high-risk matters are identified
- Securing resources necessary to perform audits responsive to identified risks

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

■ Initiatives at Large-Sized Audit Firms to Strengthen the Exercise of Professional Skepticism ■

The Auditing Standards (revised in November 2020) state that "auditors shall exercise due professional care as professionals and conduct audits with professional skepticism." In addition, Audit and Assurance Standard Report 240, Fraud in an Audit of Financial Statements (last revised in September 2024), requires auditors to exercise professional skepticism when assessing the risks of material misstatement due to fraud, performing audit procedures responsive to those risks, and evaluating audit evidence obtained, so as not to overlook circumstances indicating a material misstatement due to fraud.

Professional skepticism refers to "an attitude that includes a questioning mind, alertness to conditions that may indicate possible misstatements due to error or fraud, and a critical assessment of audit evidence rather than accepting it uncritically." Internationally, it is generally understood to comprise two elements: a questioning mind and a critical assessment of audit evidence. In addition to these elements, an attitude that does not overlook inconsistencies or warning signs is considered particularly important in practice.

According to *Trends in Accounting Fraud at Listed Companies and Other Entities (2025 Edition)*, published by the JICPA on July 23, 2025, the number of listed companies and other entities that disclosed accounting fraud during the fiscal year ended March 31, 2025, increased to 56, exceeding the 45 companies reported in the previous fiscal year. The number has increased continuously since the fiscal year ended March 31, 2021.

Against a backdrop of growing public concern regarding the reliability of financial information, it is important for auditors to reaffirm the significance of conducting audits with appropriate professional skepticism.

This column introduces initiatives undertaken by large-sized audit firms to promote the exercise of appropriate professional skepticism. Major initiatives include the following:

- Continuous communication from firm leadership and quality management divisions to partners and staff regarding the importance of audit quality, including the exercise of professional skepticism.
- Implementation of comprehensive training programs based on fraud cases.
- Introduction of fraud detection tools utilizing AI and other technologies to support fraud risk assessment.

From the perspective of the operation of an audit firm, the exercise of professional skepticism has been described as an activity that may entail additional costs, as it may result in increased audit effort due to more extensive verification procedures or the performance of additional audit procedures, as well as delays in audit engagements arising from disagreements with the audited entity or within the audit team. As a result, personnel may sometimes perceive psychological barriers to exercising professional skepticism.

Among the initiatives undertaken by large-sized audit firms, communications from firm leadership include clearly demonstrating the commitment of the CEO to audit quality as the highest priority (Tone at the Top), recognizing and rewarding good behavior that contributes to audit quality, and encouraging individuals to raise concerns proactively (Speak-Up). These initiatives are also intended to foster psychological safety among personnel.

In addition, to cultivate professional skepticism among personnel, firms have adopted various approaches, including discussion-based training, lectures based on actual fraud cases identified in the course of the firm's audit clients, and sessions in which partners share lessons learned from audit engagements that resulted in restatements due to fraud or other issues. These approaches provide practical, realistic training.

Furthermore, to support fraud risk assessment, firms are making practical improvements to enable personnel to exercise sufficient and appropriate professional skepticism. Such efforts include providing audit teams with fraud risk scoring results based on data and digital technologies, encouraging the use of AI and other technologies to identify indicators of fraud, and strengthening collaboration with fraud specialists.

Against the backdrop of an increasing number of accounting fraud cases, audit firms are expected to continue promoting awareness among personnel of the importance of exercising appropriate professional skepticism in order to maintain and enhance audit quality.

6. Use of Technology in Audit and Cybersecurity Initiatives

a. Progress with the adoption of IT in audit engagements

In recent years, audit firms, particularly large-sized audit firms and mid-tier audit firms, have significantly increased their use of IT, including AI, in audit engagements. This is partly because audited companies are rapidly digitizing their accounting and transaction records as society becomes increasingly digitalized, coupled with the need for audit firms to perform audit engagements more efficiently and effectively in response to broader workstyle reforms. This is affecting the nature of audits, and large-sized and mid-tier audit firms are moving proactively, either jointly with their global networks or independently, to deploy or develop IT-driven audits.

This section elaborates on audit firms' current strategies and the ways in which they are transforming their audit practices.

i. Unification of audit tools

Audit firms that are members of global networks use audit tools provided by the global networks (for more details, see "7. Responses to Overseas Expansion of Companies, b. Status of affiliations with global networks"). These audit tools not only enable the preparation and storage of audit documentation but also provide functions that support audit activities, such as those for secure transfer of data and materials to and from audited companies, and timely monitoring of audit progress, including work performed by teams auditing subsidiaries.

Unified R&D and IT operations across the global networks promote more efficient IT investment. Member firms can also provide feedback on defects in audit tools and requests for enhancements, enabling global networks to strengthen security and continuously improve the functionality of those tools.

At the same time, some Japanese audit firms have also independently developed and deployed analytical tools, including tools that seek to predict the risk of accounting fraud.

ii. Task automation (RPA[39])

CPAs have conventionally performed standardized tasks in audit procedures, such as data collection and aggregation. In recent years, the adoption of audit support tools has accelerated. Some of these tools provide integrated capabilities that enable a one-stop process covering data extraction, processing, and analysis. These capabilities have promoted the automation of tasks such as data processing and the preparation of draft working papers. For example, data can be obtained in bulk from an audited company's core operational systems, information required for analysis can be extracted within the audit support tool, and analytical results can then be generated automatically.

iii. Sophistication and expansion of data analytics

[39] RPA is short for robotic processing automation and represents efforts to streamline and automatize office work by means of AI and other technologies. It is realized by software robotics that operates software and other programs like humans. It is also called "digital labor" and "virtual knowledge worker."

Amid the increasing introduction of audit support tools, the improvement of their functions has made it possible to analyze all accounting data of an audited company from multiple perspectives. Findings generated through broad-based analysis, many of which are currently used to assess risks when developing an audit plan, are expected to be used in the entire auditing process, through to the formation of the audit opinions.

Traditionally, risk analyses to identify indications of fraudulent accounting and other irregularities have been conducted primarily using audited companies' financial information. However, advances in AI have led to the development and adoption of tools that use non-financial information to predict fraud risks and identify abnormal transactions from large volumes of accounting records. These technologies enable more sophisticated analysis and audit judgments. Consequently, the use of analytical results based on non-financial information, including information on audited company's governance, is expected to support broader risk assessments.

iv. Use of AI in audit engagement

Currently, particularly among large-sized audit firms, there is a growing trend toward the adoption of AI in audit engagements. By training AI on the expertise and know-how of audit practitioners and leveraging generative AI, firms are seeking to enhance both the efficiency and sophistication of audit services, particularly in areas such as financial data analysis and document review.

Specifically, some firms use chatbots to respond to inquiries regarding accounting and auditing standards, as well as internal audit manuals and guidance. In addition, AI is being used to analyze audited companies' financial statements and journal entries based on data from annual securities reports and past cases of improper accounting, and to identify accounts that may indicate signs of fraud and unusual journal entries for audit teams' attention. Some firms have also introduced tools that combine LLMs with the expertise of CPAs to comprehensively and efficiently extract audit-relevant information from specialized documents, such as contracts.

On the other hand, the following challenges have been identified with respect to the use of AI:

- Accuracy, timeliness, and completeness of data: Inaccurate, untimely, or limitations in the scope of available data, may result in erroneous outputs.
- Black-box nature of decision-making processes: In the case of deep learning, decision-making processes comprise multiple layers and numerous parallel processes, making it difficult to explain the reasoning underlying the outputs.
- Algorithmic bias: Biases in algorithms or training data may result in biased outputs.
- Data confidentiality: When using AI systems provided by external parties or training AI with data obtained from external internet sources, there is a risk that confidential information of the firm may be leaked or that confidential external information may be inadvertently misappropriated.

- Hallucinations: Because AI generates information based on statistical language patterns without truly understanding meaning or context, outputs that appear plausible may contain inaccurate information or flawed reasoning.

Audit firms that increase their use of AI are required to establish internal controls to address the challenges described above. In addition, CPAs employed by such firms need to possess a certain level of knowledge of data science and machine learning in order to avoid relying uncritically on AI-generated outputs.

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

Currently, much of the audit work is concentrated in the period following an audited company's fiscal year-end. However, with the use of the IT tools described above, audit firms are exploring the introduction of audit techniques that enable the day-to-day analysis of an audited company's transactions and other activities (real-time auditing). Such techniques are expected to help distribute audit work more evenly throughout the year, create a more favorable working environment, and enhance auditors' ability to identify risks and detect fraud at an early stage.

Items i through iv above are areas in which adoption is already progressing among large-sized audit firms, while item v is an area where future adoption is expected. The implementation of these advanced audit techniques requires that transaction records and other relevant data maintained by audited companies be available in electronic form. In addition, audit firms need the consent of audited companies to obtain such data. As a result, the understanding and cooperation of audited companies are essential. Furthermore, considerable time may be required for data cleansing before the data can be utilized for RPA, data analytics, and AI applications. Given these and other challenges, the adoption of these techniques remains gradual. Regarding item iii, although the accuracy of fraud detection tools has improved over time, audit firms are continuing to develop tools capable of identifying abnormal transactions associated with higher fraud risks, as well as fraud schemes that employ increasingly sophisticated methods.

Figure III-1-13 summarizes the status of the audit tools and technologies discussed above by audit firm size. It shows that large-sized audit firms, which audit many large companies possessing vast amounts of data, are leading the use of IT-enabled audit tools and techniques.

Among responses from 44 small and medium-sized audit firms obtained through reports collected, 20 reported that they had already implemented electronic audit documentation systems, while 13 responded that they were considering their implementation. In addition, 10 reported that they had introduced journal analysis tools for analyzing transaction details (journal entries) and identifying unusual journal entries. These responses suggest that, although not to the same extent as large-sized and mid-tier audit firms, small and medium-sized audit firms are also increasingly utilizing IT in their audit engagements.

The advancement of the digitalization of audit services depends on improving the IT skills of the professional personnel who actually use audit tools. In response, particularly among large-sized audit firms, efforts are being made to develop IT talent through the introduction of audit tools, training on data analytics techniques, and training on the use of AI and related considerations. At the same time, these firms are recruiting experienced IT engineers from outside the firm with the aim of establishing a framework at an early stage under which the use of IT in audit services becomes standard practice.

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

Status	Large-sized audit firms	Mid-tier audit firms
Implemented / In use	・Electronic audit documentation system (audit working paper preparation and audit procedure management) ・Journal analysis tools (analysis of transaction details (journal entries) and detection of unusual transactions) ・Evidence reconciliation tools (tools for reconciling external data with the complete population of sales data of audited companies) ・File exchange system (used for exchanging data with audited companies) ・RPA (automation of data input and manipulation) ・Debit/credit balance confirmation system (automation of the external confirmation of the existence/accuracy of transactions) ・AI (for forecasting potential fraudulent transactions using historical financial information, generative AI for internal information (rules and audit manuals etc.) to respond to internal inquiries) ・Use of blockchain technology ・Audit databases (storing and sharing know-how and other information through an internal database)	・Electronic audit documentation system (audit working paper preparation and audit procedure management) ・Journal analysis tools (analysis of transaction details (journal entries) and detection of unusual transactions)
Being installed/ introduced at some firms	・Text analysis (digitalization and analysis of documents) ・Disclosure review tool ・AI (including AI agents[40] that support the drafting of audit documentation using generative AI)	・Evidence reconciliation tools ・File sharing systems ・RPA (automation of data input and manipulation ・Debit/credit balance confirmation system (automation of the external confirmation of the existence/accuracy of transactions) ・Text analysis (digitalization and analysis of documents) ・Disclosure review tool
Under development	・AI (fraud forecasting using non-financial information) ・Drones (improved efficiency in physical inventory count)	

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

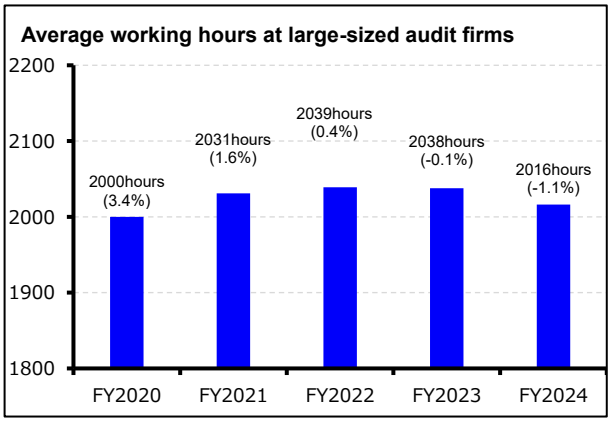
[40] “AI Discussion Paper - Preliminary Discussion Points for Promoting the Sound Utilization of AI in the Financial Sector” https://www.fsa.go.jp/en/news/2025/20250304/aidp_en.pdf

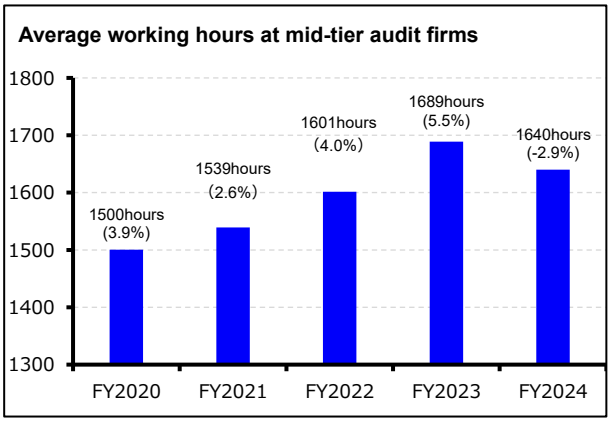
■ IT Tool Adoption and Its Impact on Average Working Hours at Large-sized and Mid-tier Audit Firms ■

Some audit firms state the average annual working hours of partners, staff, etc. in their audit quality reports. The following table represents average annual working hours and average year-on-year rates of change based on information that could be confirmed in the audit quality reports of large-sized and mid-tier audit firms over the last five years.

The annual average working hours at large-sized audit firms have generally remained at around 2,000 hours and, as indicated by the year-on-year rate of change, have shown a gradual downward trend in recent years. Although the annual average working hours at mid-tier audit firms have remained at a lower level than those at large-sized audit firms, since 2021 their year-on-year rate of change tended to exceed that of large-sized audit firms. In FY2024, however, both the annual average working hours and the year-on-year rate of change at mid-tier audit firms declined, as was also the case at large-sized audit firms.

These trends may reflect not only the transfer of audit engagements from large-sized and mid-tier audit firms to small and medium-sized audit firms during FY2024, but also the effects of efficiency-enhancing measures, such as the introduction of IT tools, including AI, and the transfer of work to delivery centers. In particular, at large-sized audit firms, these initiatives appear to have continued to generate positive effects, contributing to a sustained decline in annual average working hours.





(Note) Figures in parentheses in the graph indicate the year-on-year rate of change.
(Source) Prepared by the CPAAOB based on audit quality reports published by the respective audit firms.

Going forward, the use of IT tools and delivery centers by audit teams may become more widespread at mid-tier audit firms. As a result, annual average working hours at such firms may, as is the case at large-sized audit firms, continue to exhibit a downward trend. In addition, the wider adoption of AI-enabled audit tools is expected to further enhance the efficiency of audit services.

b. Cybersecurity efforts

As mentioned earlier, particularly among large-sized audit firms, audit tools are being utilized and data are exchanged with audited companies through e-mail and file-sharing systems. These practices have become increasingly widespread as data volume has grown and transactions have become more digitized.

At the same time, the risk of information leakage resulting from cyberattacks and other threats has increased, as demonstrated by cyberattacks targeting audit firms overseas. In particular, the leakage of confidential information related to audited companies can seriously undermine confidence in an audit firm. It is therefore essential for audit firms to continuously strengthen their cybersecurity measures. Given these circumstances, the CPAAOB has been focusing on the following areas.

[Monitoring of audit firms]

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

- Establishing basic information security policies and promoting information protection including cybersecurity across the global network as a whole
- Setting up organizations responsible for cybersecurity (CSIRT[41]) and, as necessary, recruiting experts from within or outside the audit firm
- Identifying the data held by the audit firm, rating the materiality, and developing policies for data use as well as contingency plans for information security incidents and cyberattacks
- Undergoing reviews by the global network to confirm the effectiveness of the audit firm's information security system, making improvements in the system, collecting information on cyberattacks and information security countermeasures, and utilizing this information to develop and improve the information security system.

In general, cyberattacks are widely regarded as targeting vulnerabilities in security systems. At some small and medium-sized audit firms, information security policies and procedures are not fully aligned with actual operational practices. Furthermore, according to responses regarding cybersecurity initiatives from 52 small and medium-sized audit firms that were subject to the collection of reports, more than half of the firms had implemented measures such as acquiring and analyzing communication logs and establishing incident reporting procedures and response protocols. However, some firms had neither established basic cybersecurity policies nor implemented anti-virus software.

Under the Registration System for Auditors of Listed Companies, the confirmation of whether an audit firm has an adequate framework to conduct audit and attestation services for listed

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

companies fairly and appropriately (“confirmation of eligibility”) is based on the Guideline for the Confirmation of Eligibility. In the revision of the Guideline in August 2024, audit firms conducting audits of listed companies were required to strengthen their information security frameworks, including the protection of confidential information handled in audit services, centralized data management, and the security of external access. As a result, the development of information security systems at audit firms became an urgent priority[42]. Small and medium-sized audit firms have conducted self-assessments using the Guideline for the Confirmation of Eligibility, evaluating whether their circumstances correspond to those described in the Guideline and, where applicable, voluntarily implementing improvements. Consequently, progress has been made in strengthening their information security frameworks. Nevertheless, responding to the risk of information leakage and other threats arising from increasingly sophisticated cyberattacks remains a continuing challenge for many small and medium-sized audit firms.

7. Responses to Overseas Expansion of Companies

a. Group audits

Many domestic listed companies have established subsidiaries or other entities overseas and conduct business operations locally. In recent years, there has also been an increasing number of cases in which companies have acquired foreign entities through M&A rather than establishing new subsidiaries. As a result, parent companies face a wide range of challenges, such as establishing frameworks to manage overseas subsidiaries, evaluating complex business transactions, and addressing differences in local accounting standards. Furthermore, serious accounting fraud incidents have often occurred at overseas subsidiaries. Consequently, the importance of group audits has continued to increase, and audit firms are strengthening their capabilities and measures to respond to these challenges.

i. Overview of group audits

When the auditor of a parent company (the “group auditor”) performs an audit of group financial statements, the scope of the audit includes the parent company, consolidated subsidiaries, and head offices, branches, and other entities (a company or other entity whose financial information is included in the group financial statements is referred as a “component”). For example, an internationally operating manufacturer may have many components (subsidiaries) both in Japan and overseas, including manufacturing subsidiaries located in countries with relatively low labor costs and sales subsidiaries established in foreign markets.

Group auditors identify and assess the risks of material misstatement in the group financial statements, and design and perform audit procedures responsive to the assessed risks (ASCS 600 para 13. (b)). They also evaluate whether sufficient and appropriate audit evidence has been obtained through the audit procedures performed, including work performed by

[42] As part of efforts to strengthen information security frameworks, the June 2025 revision of the eligibility guidelines introduced a requirement for audit firms to implement measures to prevent the tampering of audit documentation within electronic audit documentation systems during the final assembly period of the audit file.

component auditors, as a basis for forming an opinion on the group financial statements (ASCS 600 para 13. (d)).

ii. Risk assessment of the group financial statements

Based on the understanding of the group and its environment, the applicable financial reporting framework and the group's system of internal control, the group auditor takes responsibility for the identification and assessment of the risks of material misstatement in the group financial statements (ASCS 600 para 30 and 33). Key members of the audit team are required to discuss where and how the group financial statements may be susceptible to material misstatement due to fraud or error, with particular emphasis on where and how material misstatements due to fraud could occur in the group financial statements (ASCS 240 para 14, ASCS 315 para 16, and ASCS 600 para 30, A91 and A92).

In recent years, there have been numerous cases in which fraud and other irregularities at overseas subsidiaries that could have a significant effect on group financial statements were identified only after the fact. As a result, it has become increasingly important to conduct risk assessments based on a thorough understanding of the entity's environment, including the group's governance arrangements and the internal controls of overseas subsidiaries. Such an understanding includes, for example, whether the head office has established a department responsible for overseeing overseas subsidiaries and whether internal audits are conducted over their operations.

iii. Responding to the assessed risks of material misstatement

Group auditor shall take responsibility for the nature, timing and extent of further audit procedures to be performed, including determining the components at which to perform further audit procedures and the nature, timing and extent of the work to be performed at those components. (ASCS 600 para 37).

In response to the assessed risks of material misstatement, the group auditor may determine the following scope of work to be appropriate at a component. Component auditors can be, and often are, involved in all phases of the group audit, including in the design and performance of further audit procedures (ASCS 600 para A131 and A132).

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

The approaches to group audit procedures adopted by audit firms of different sizes are as follows (Figure III-1-14).

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

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

(Note1) Documentation used by the group auditors to communicate their requirements to the component auditors.
(Note2) Regarding "Other" in the figure, of the 44 firms from which reports were collected in PY2025, information is presented for 21 firms conducting audit engagements for which group audit is required in cases where there is any component overseas. Among these, only five firms are affiliated with a global network and using the group audit manual or audit instructions provided by the global network.
(Source) Prepared by the CPAAOB based on information obtained through the CPAAOB inspections or the collection of reports

iv. Communication with component auditors

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

The group auditors therefore not only send and receive audit instructions and reports on the audit results and obtain an understanding of the status of component audit by phone or e-mail, etc., but also communicate through visits to component auditors and online meetings. Large-sized audit firms and some mid-tier audit firms have established support systems for their group auditors by establishing international business support sections within the firm and dispatching Japanese expatriates to key overseas offices. These measures help facilitate communication between group auditors and component auditors and provide group auditors with local information.

b. Status of affiliations with global networks

Large-sized audit firms, mid-tier audit firms, and some small and medium-sized audit firms, partnerships, and solo practitioners have entered into member firm agreements with and become members of global networks in order to facilitate audits of audited companies with overseas operations by leveraging the global network's know-how such as audit manuals.

i. Membership of global networks

All large-sized and mid-tier audit firms as well as some small and medium-sized audit firms that need to audit the overseas operations of audited companies belong to a global network, and are developing frameworks of conducting group audit (Figures III-1-15 and III-1-16). It should be noted that not all small and medium-sized audit firms that conduct group audits involving overseas components belong to a global network (For details, see "a. Group audits, iii. Responding to the assessed risks of material misstatement").

Figure III-1-15: Number of audit firms belonging to global networks[43] (unit: audit firms)

Large-sized audit firms	4
Mid-tier audit firms	4
Small and medium-sized audit firms	20
Total	28

(Source) Prepared by the CPAAOB based on business reports

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

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

(Source) Prepared by the CPAAOB based on data from publicly disclosed materials from each audit firm (as of July 1, 2025)

The operating revenues of global networks comprise revenues from audit services, tax related services and advisory services, and a breakdown of the top-ranking global networks in terms of operating revenues is shown below (Figure III-1-17). The scale of the Big Four global networks is particularly prominent.

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

	DTT	PwC	EY	KPMG	BDO	GT
Operating revenues	70.5	56.9	53.2	39.8	16.0	8.5
Audit services (Share of operating revenues)	13.3 (19%)	19.8 (35%)	17.9 (34%)	14.1 (36%)	6.4 (40%)	3.8 (45%)
Tax-related services (Share of operating revenues)	11.9 (17%)	12.7 (22%)	12.7 (24%)	9.3 (23%)	3.6 (22%)	1.7 (20%)
Advisory services (Share of operating revenues)	45.3 (64%)	24.4 (43%)	22.6 (42%)	16.4 (41%)	6.0 (38%)	3.0 (35%)

(Source) Prepared by the CPAAOB based on data from publicly disclosed materials of each global network (2025 accounting year).

In Japan, the Big Four global networks'[44] account for 97% of the audit engagements of the 225 companies comprising the Nikkei Stock Average (Nikkei 225). The audit market is also highly

[43] Among small and medium-sized audit firms, some have concluded cooperative relations (alliances) with overseas audit firms.
[44] Large-sized audit firms

concentrated overseas. As shown in Figure III-1-18, the Big Four global networks account for a substantial share of audit engagements among the 500 companies comprising the S&P 500 Index in the United States and the 350 companies with the largest market capitalizations listed on the London Stock Exchange (FTSE 350). As in Japan, the audit markets in these jurisdictions are characterized by a high degree of concentration.

Figure III-1-18: Market share of Big Four Global Networks in audit engagements for major listed companies in Japan, the U.S., and the U.K.

	Japan	US	UK
Market share of Big Four Global Networks (based on number of companies)	97%	99%	87%

(Sources) Japan: Compiled by the CPAAOB from QUICK and exchange data (as of March 31, 2026)
U.S.: Compiled by the CPAAOB from Bloomberg data (as of March 31, 2026)
U.K.: "Key Facts and Trends in the Accountancy Profession, October 2025," Financial Reporting Council

ii. Relationships with global networks

Member firms of a global network may benefit from the right to use the network's name and logo, as well as from mutual referrals of engagements and the sharing of expertise and know-how. In return, they may be subject to various obligations, including those relating to quality management. The nature and extent of these obligations vary depending on the size and structure of the global network. In general, the larger the global network, the greater the influence it exerts over its member firms.

(i) Large-sized audit firms

Each of the large-sized audit firms belongs to one of the Big Four global networks (Deloitte Touche Tohmatsu, Ernst & Young, KPMG, and PricewaterhouseCoopers) and has established close relationships with them. Specifically, they not only have the right to use the networks' logos and brand, but are also involved in the operation performed by the networks. For example, their CEOs and the persons responsible for quality management participate in important meetings of the global network and express Japan's views as members of high-level committees. In addition, members of oversight/assessment bodies attend meetings organized by the relevant global network.

Large-sized audit firms receive audit manuals and audit tools from their global networks and conduct audit engagements using audit methodologies that comply with the standards established by those networks. They have also adopted the standards, policies, and procedures developed by their global networks for quality management matters, including engagement quality reviews and independence requirements.

Some large-sized audit firms not only receive audit manuals, tools and other resources from their global networks, but also second personnel to their global networks, including quality management personnel, to participate in global network initiatives such as the revision of audit manuals and the development of electronic audit tools. Through such involvement, these firms are able to directly contribute Japanese perspectives to the initiatives undertaken

by their global networks.

In addition, to confirm that the level of audit quality required by their global networks is being maintained, the firms undergo periodic global reviews conducted by the networks, with a particular focus on individual audit engagements (For details, see "C. Monitoring of the System of Quality Management, 2. Utilization of Global Reviews").

Furthermore, in recent years, there has been a trend toward managing and overseeing member firms on a regional basis. In the Asia-Pacific region, members of Japanese large-sized audit firms have increasingly assumed leading roles, including serving as board members in regional organizations.

(ii) Mid-tier audit firms

All mid-tier audit firms are affiliated with global audit networks. However, the extent of their ties differs depending on factors such as the size of the global networks. While some firms maintain affiliations comparable to those of large-sized audit firms, others do not use audit manuals and audit tools provided by their global networks and instead rely on audit manuals and audit tools developed internally. In addition, all mid-tier firms are subject to periodic global reviews conducted by their respective global networks.

(iii) Small and medium-sized audit firms

Among small and medium-sized audit firms, while some have partnerships with global networks at a level comparable to large-sized audit firms, others have loose affiliations. In such cases, their involvement is limited to using the global networks' names, logos and brands, and receiving referrals for audit engagements. These firms are not provided with audit manuals and are not subject to global reviews.

8. Treatment of Key Audit Matters

From the perspective of enhancing transparency and the provision of information pertaining to audits conducted under the FIEA, auditors are required to include Key Audit Matters (KAMs) in audit reports.

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

i. Auditors consider the following matters from among those communicated with audit and supervisory board members and others in the process of auditing, and determine which matters require special attention:

- Matters involving identified risks requiring special consideration or assessed risks of material misstatement that are considered higher
- The degree of auditor judgment related to areas involving significant management judgment, including accounting estimates with high estimation uncertainty
- The effect on the audit of significant events or transactions occurring during the current year

ii. From among the matters that required significant auditor attention, the auditor identifies those

matters that, in the auditor's professional judgment, were of most significance in the audit of the current year's financial statements and determines them to be KAMs. The auditor then includes a dedicated section in the auditor's report and describes the following:

- Content of KAMs;
- A reference to the related disclosures in the financial statements, where applicable;
- The reasons why the auditor considered the matter especially important in the audit of the current year’s financial statements and determined it to be a KAM; and
- How the matter was addressed in the audit.

b. Responses by audit firms

Recent monitoring has identified the following measures taken by large-sized and mid-tier audit firms. In addition to these efforts, these firms established frameworks related to KAMs, including arrangements for communications with audited companies (Figure III-1-20). Recognizing the need to avoid boilerplate disclosures, these initiatives have continued beyond the the second year of implementation.

i. Development of guidance for drafting KAMs

- Developing and disseminating guidance and illustrative examples for audit teams to follow when drafting KAMs

ii. Provision of training

- Training based on analyses of actual application cases, including explanation of good practices in KAM reporting
- Training on key considerations of drafting KAMs
- Training on findings and observations relating to KAMs identified through periodic internal reviews, CPAAOB inspections, and JICPA Quality Control Reviews.

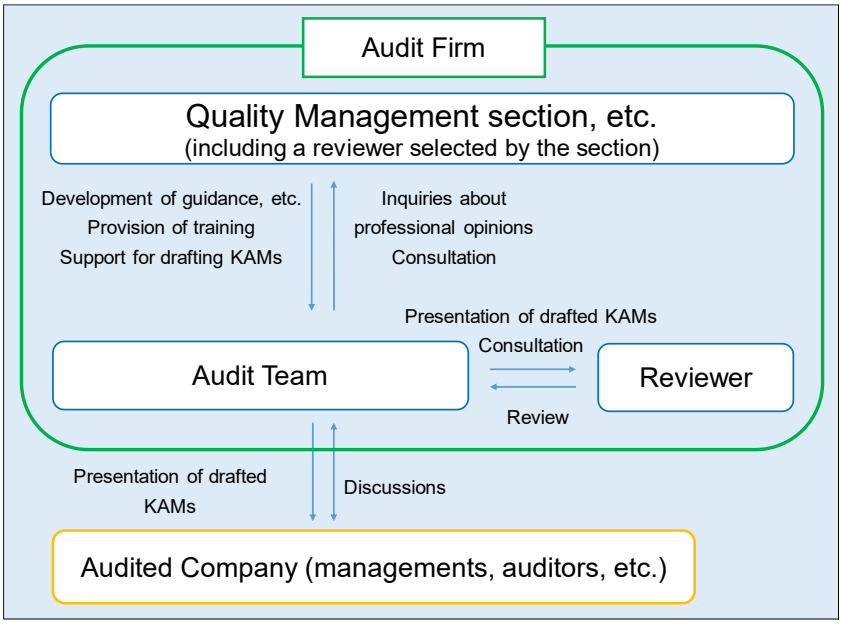
iii. Support for audit teams by the quality management function

- Providing guidance on the content and timing of communication to facilitate meaningful and ongoing dialogue throughout the year with management, audit and supervisory board members and other relevant personnel of audited companies
- Monitoring and following up on audit teams' implementation of KAM-related procedures
- Reviewing draft KAM disclosures by reviewers designated by the quality management function when audit teams propose new KAMs or make significant changes to KAMs reported in prior years

iv. Reviews and technical consultations

- Requiring committee-based reviews by the firm's headquarters or consultations with technical specialists in specified circumstances, such as when no KAM is disclosed or when a matter relating to the going concern assumption is identified as a KAM

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



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

While KAMs have become well established in practice, concerns about boilerplate disclosures remain. For example, there continue to be cases where KAM disclosures closely resembles those of peer companies or those reported in prior years. In addition, in some jurisdictions outside Japan, auditing standards have been revised to enhance transparency regarding auditors' responses to fraud risks, including requirements of disclosure fraud-related KAMs. The CPAAOB will continue to examine, through its inspections, the process for determining KAMs, as well as the content and implementation of the related audit responses.

9. Domestic Audit Firm Groups

a. Structure of domestic audit firm groups

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

Regarding the structure of a domestic group to which large-sized audit firms belong, there are many examples of firms establishing a holding company to manage the global brand and placing each group company including the audit firm on an equal footing. However, some audit firms directly invest in other group entities (excluding entities of licensed professionals such as tax accountant firms or attorney firms, etc.), making them subsidiaries.

Domestic groups to which large-sized audit firms belong often establish councils comprising representatives from the major group entities. This structure facilitates coordination of interests

among group entities and discussions of joint business operations within the domestic group.

b. Group operating revenues

The ratio of non-audit and attestation revenue to operating revenue at groups consisting of audit firms and their subsidiaries, etc. ("audit firm groups")[45] had once decreased to 39% as certain large-sized audit firms spun off non-audit and attestation services and subsidiaries from their group. However, it has been on an upward trend in recent years due to revenue growth at group companies other than audit firms (Figure III-1-20). For audit firms' operating revenue, see "II. Overview of the Audit Sector, B. Audit Firms, 5. Financial Condition (Operating Revenue, Proportion of Audit and Attestation Services and Non-audit and Attestation Services)".

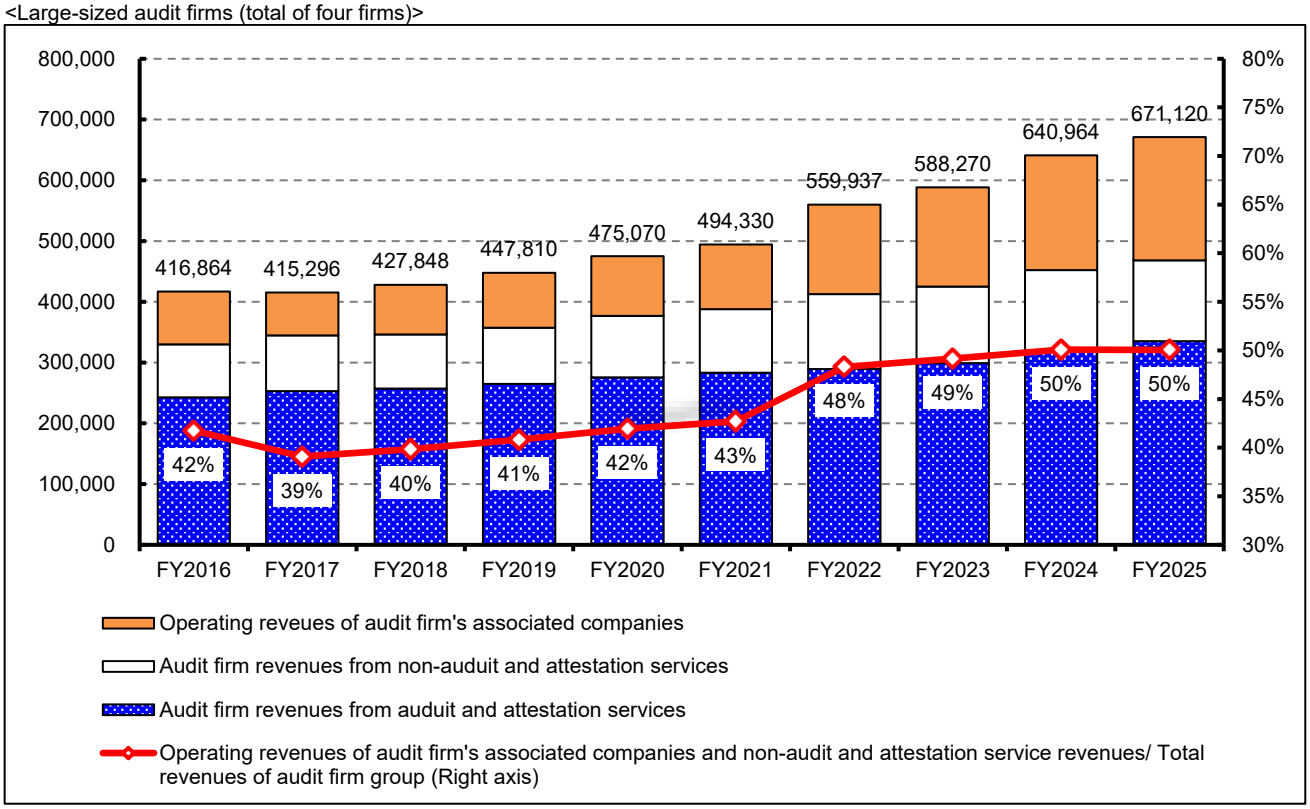
Among mid-tier audit firm groups, the ratio of non-audit and attestation revenue to total group revenue has remained lower than that of large-sized audit firm groups, staying roughly in a range between 10% and 14% from FY2016 through FY2025. The revenue structure of mid-tier audit firm groups differs significantly from that of large-sized audit firm groups. This is partly attributable to the smaller number of group entities other than the audit firm itself. As a result, audit and attestation revenue accounts for a significant portion of total group revenue in mid-tier audit firm groups (Figure III-1-21).

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

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

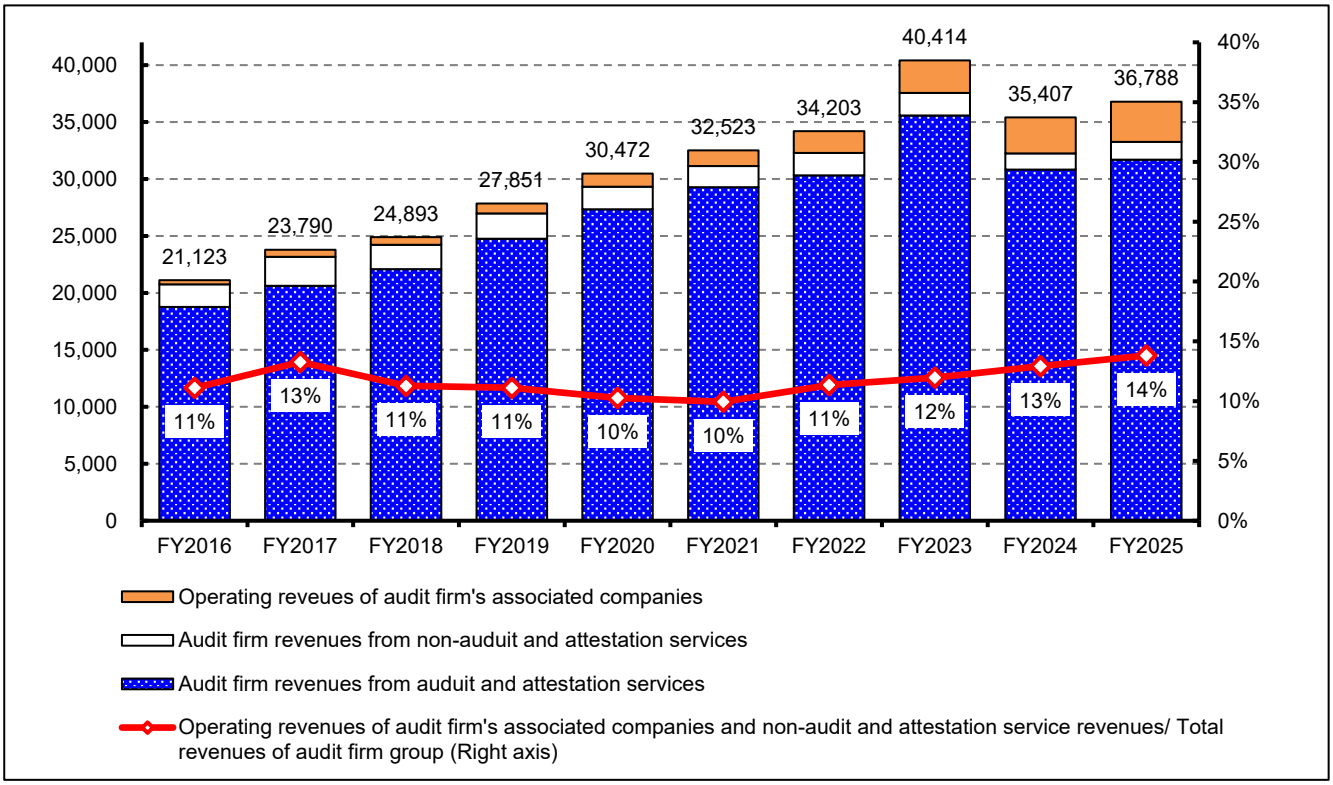
Figure III-1-21: Changes in the share of non-audit and attestation service revenues in audit firm group revenues (unit: million JPY (left axis))

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



(Note1) Operating revenues of audit firm groups include revenues of the audit firm itself and, in principle, those of its of group entities that fall under subsidiaries of the audit firm. This also includes the revenues of subsidiaries that provide intra-group services.
(Note2) Non-audit and attestation service revenues are the total of the non-audit and attestation revenue of the audit firm and the revenues of the subsidiaries etc. of the audit firm.
(Note3) One audit firm group changed its fiscal year-end in FY2017, so the FY2017 operating revenues for that audit firm group cover an eight-month period. As a result, FY2017 operating revenues are calculated by extrapolating eight-month operating revenues to one-year periods (by multiplying figures by 12 months/8 months) for the audit firm group that changed its fiscal year-end.
(Note4) In FY2017, certain large-sized audit firms spun off businesses or subsidiaries that perform non-audit and attestation services
(Note5) Data for FY2016 through FY2023 were compiled based on the fiscal year prior to the establishment of PwC Japan, and no adjustment has been made for the effects of the merger of PwC Arata and PwC Kyoto.
(Source) Prepared by the CPAAOB based on business reports submitted by audit firm

<Mid-tier audit firms (Total of five firms from FY2016 to FY2023, total of four firms from FY2024 to FY2025)>



(Note1) Operating revenues of audit firm groups include revenues of the audit firm itself and, in principle, those of its group entities that fall under subsidiaries of an audit firm within the group, in principle.
(Note2) Non-audit and attestation service revenues are the total of audit firm revenues from non-audit services and domestic network firm revenues
(Note3) One audit firm group changed its fiscal year-end in FY2016, and it did not submit its report within the program year, so the FY2016 operating revenues for that audit firm group cover 15-month period. As a result, when aggregating the figure, FY2015 data was used for the FY2016 operating revenues for the audit firm group. Operating revenues for FY2017 represent 15-months' worth of operating revenues.
(Note4) Data for FY2016 through FY2023 represent the combined totals of Gyosei, Sanyu, Taiyo, Toyo, and PwC Kyoto. Following the merger of PwC Aarata and PwC Kyoto in December 2023, data for FY2024 onward represent the combined totals of Gyosei, Sanyu, Taiyo, and Toyo. Accordingly, the total amount of revenue and its breakdown decreased.
(Source) Prepared by the CPAAOB based on business reports submitted by audit firms

B. Engagement Quality Reviews

The “IV. Reporting Standards 1. General Principles” in Auditing Standards require auditors to undergo a review prior to the expression of an audit opinion in order to confirm that their opinion has been appropriately formed in accordance with generally accepted audit standards. In addition, audit firms are required to address engagement quality reviews in accordance with QCSCS 2, *Engagement Quality Reviews*, and to establish policies or procedures requiring engagement quality reviews for audits of the financial statements of entities (QCSCS 1, para 34(6)). Accordingly, engagement quality reviews serve as the final safeguard for ensuring the appropriateness of the audit opinion. Therefore, whether the engagement quality reviews provide an objective evaluation of the audit procedures performed by the audit team, significant audit judgements, and the audit opinion can have a significant impact on audit quality.

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

a. Concurring review partner approach

   An engagement quality review normally involves the engagement quality (EQ) reviewer, who is appointed for each audit engagement, performing the entire review from the audit planning stage to the expression of the audit opinion. This means that a more in-depth review is possible. For example, the EQ reviewer accumulates information about the audited company and engagement team, and throughout the audit, assesses whether the engagement team is responding appropriately to changes in the circumstances of the audited company.

   On the other hand, under the concurring review partner approach, revies quality is highly dependent on the competence of individual EQ reviewers. Some small and medium-sized audit firms assign all audit engagements to a specific EQ reviewer. In such cases, the competence of that reviewer can have significant impact on the overall quality of reviews within the audit firm.

b. Council approach

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

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

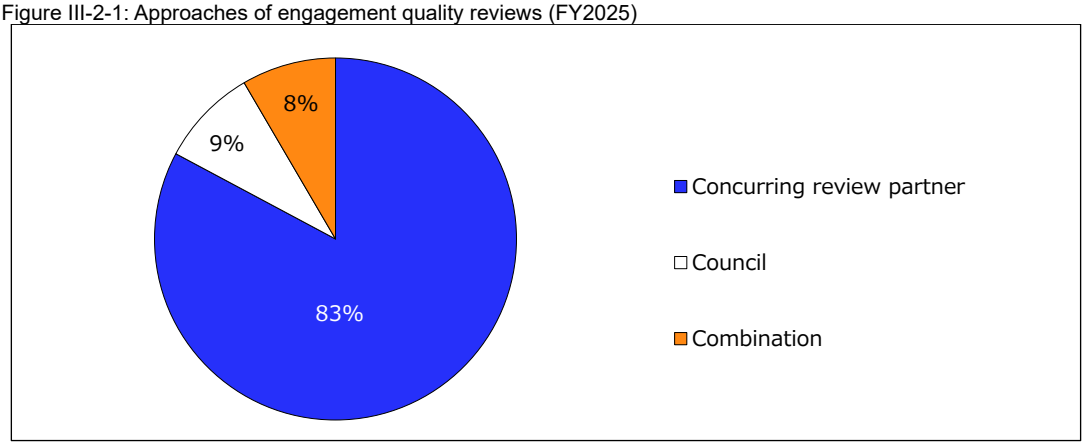
c. Combination approach

   Under the combination approach, the concurring review partner approach is used in some cases, while the council approach is used when the matter involved in expressing the audit opinion falls under predetermined criteria. In another case, either the concurring review partner approach or

the council approach is used, depending on the risk of each audit engagement.

The approaches of engagement quality reviews are shown below (Figure III-2-1).

Figure III-2-1: Approaches of engagement quality reviews (FY2025)



(Note1) Aggregated the status of 285 audit firms based on business reports submitted by the audit firms
(Note2) As fiscal year-end dates vary widely among small and medium-sized audit firms, their results in FY2025 have yet to be tallied. This report therefore covers their results through FY2024.
(Source) Prepared by the CPAAOB based on business reports submitted by audit firms

Large-sized audit firms adopt a concurring review partner approach, under which an EQ reviewer appointed for each audit engagement performs all reviews from the audit planning stage through the expression of the audit opinion. In addition, matters that are significant to the expression of the audit opinion or involve significant audit judgments are identified in advance, and consultations are conducted on such matters to obtain professional views.

Mid-tier audit firms adopt both the concurring review partner approach and the council approach. For example, a reviewer conducts reviews of risk assessments performed by the audit team, the appropriateness of risk-response procedures, etc., while material matters requiring further consideration are brought up at a review committee at headquarters.

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

Regarding the appointment of reviewers, many firms establish eligibility requirements based on factors such as knowledge, experience, competence, position, and appoint reviewers from among personnel who satisfy those requirements. In making such appointments, the review function or quality management function generally takes into account factors such as the circumstances of the audited company. Some firms, however, have arrangements under which the audit operations division identifies candidates for appointment, subject to approval by the review function, the board of directors of the firm, or a similar governing body.

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

There are also audit firms implementing programs to further improve review functions, such as reinforcing

the information shared among reviewers, carrying out review-related compulsory training programs and conducting engagement quality reviews by reviewers belonging to quality management divisions at headquarters in higher-risk audit engagements compared to ordinary engagements.

C. Monitoring of the System of Quality Management

Given that audit firms are responsible for ensuring and improving audit quality, it is important that they proactively undertake initiatives aimed at enhancing audit quality.

For this, it is important for audit firms to understand the levels of quality management in audit engagements in a timely manner and continuously implement appropriate remedial actions. The CPAAOB examines the monitoring of audit firms' system of quality management.

Furthermore, where an audit firm is a member of a global network, a global network may require its member firms in each jurisdiction to perform audit engagements in accordance with its global policies to ensure high-quality and consistent audit practices across member firms. The global network also conducts reviews to verify whether member firms comply with those policies ("global review"). Given that large-sized and mid-tier audit firms incorporate global reviews as part of their systems of quality management, information on the implementation of such reviews is also presented below.

1. Periodic Inspections of Audit Engagements

Once an audit has been completed, the audit firm is required to conduct procedures to ascertain whether an engagement team performed the audit in accordance with the system of quality management prescribed by the audit firm ("periodic inspections"). A periodic inspection must cover at least one audit conducted by each engagement partner during a certain period (e.g. three years) (QCSCS 1 para 38, A151 to A154).

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

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

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

Large-sized and mid-tier audit firms have established a division responsible for monitoring audit services to enhance the objectivity and effectiveness of monitoring in their system of quality

management. They conduct periodic inspections mainly by members of the section.

Figure III-3-1: Overview of the periodic inspections conducted in FY2025

	Large-sized audit firms	Mid-tier audit firms	Small and medium-sized audit firms
Number and method of selection of audit engagements to be inspected	Each engagement partner is subject to inspection at least once every three to four years. Additional selections are made taking into account the size and complexity of the audited company.	Each engagement partner is subject to inspection at least once every three years. Additional selections are made taking into account the size and complexity of the audited company.	Each engagement partner is subject to inspection at least once every three years.
Inspectors	Under the supervision of partners in charge of quality management, partners and assistants who are not involved in inspected audit engagements (Inspection team is mainly composed of staff belonging to the monitoring division.)	Under the supervision of partners in charge of quality management, partners and assistants who are not involved in inspected audit engagements	Persons not involved in inspected audit engagements, under the supervision of a partner responsible for quality management (including those outside the audit firm)
Number of inspectors	Approximately 50 to 170	Approximately 15 to 40	Between one and around 20
Inspection framework (procedures, assessment policy), tools to be used	Conducted inspection under the framework and tools provided by the global network. In response to requirements specific to Japanese auditing standards, many firms have partially tailored the global network's tools, such as adding items.	Some firms conduct inspection under the framework provided by the global network, while others conduct based on each firm's own inspection framework and tools.	Conducted inspection based on each firm's own framework. Many firms use "Checklist for Periodic Inspections" and "Audit Service Review Procedures" provided by the JICPA as inspection tools.
Use of inspection results	Inspection results are shared within the firm and reflected in evaluations of partners and staff.	Inspection results are shared within the firm and reflected in evaluations of partners and staff.	Inspection results are shared within the firm. Some firms reflected in evaluations of partners and staff.

(Note) As fiscal year-end varies widely among small and medium-sized audit firms, their results in FY2025 have yet to be tallied. This report therefore covers their results through FY2024 (from April 2024 through March 2025).
(Source) Prepared by the CPAAOB based on information obtained through the CPAAOB inspections or the collection of reports

2. Utilization of Global Reviews

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

Among global networks other than the Big Four, some require their member firms to comply with the audit manuals developed by the global network to a similar degree to the Big Four. However, in most cases, the compliance requirements are less stringent than those of the Big Four.

Where member firms are not required to comply with audit manuals developed by the global network,

global reviews are conducted primarily to assess compliance with local auditing standards or International Auditing Standards. Accordingly, the scope, content, and frequency of such reviews vary considerably among global networks. For information on affiliations with global networks, see "III. Operation of Audit Firms, A. Operations Management System, 7. Responses to Overseas Expansion of Companies, b. Status of affiliation with global networks, ii. Relationships with global networks".

While all large-sized and mid-tier audit firms undergo global reviews, only some small and medium-sized audit firms that belong to global networks are subject to such reviews (Figure III-3-2).

Figure III-3-2: Overview of global reviews

	Large-sized audit firms	Mid-tier audit firms	Small and medium-sized audit firms
Whether global reviews are performed	All firms are reviewed	All firms are reviewed	Some firms are reviewed
Frequency of global reviews	Every year	Once every three to four years	Typically, once every three years
Global reviewers	In most cases, the global review is performed by global network reviewers.	In most cases, the global review is performed by global network reviewers.	In most cases, the global review is performed by global/domestic reviewers appointed by the global network.

(Note) Few small and medium-sized audit firms are members of global networks.
(Source) Prepared by the CPAAOB based on information obtained through the CPAAOB inspections or the collection of reports

3. Monitoring Before Issuance of Audit Opinions

Among the responses designed to address quality risks within the audit firm's system of quality management, some firms have implemented monitoring activities targeting ongoing audit engagements prior to the issuance of the auditor's report, as illustrated in the application guidance to QCSCS 1, para 37 and A140.

Monitoring before the expression of audit opinions is conducted with respect to ongoing audit engagements. It is performed by reviewers designated by the quality management function or the audit operations division, with the objective of identifying quality management issues at an early stage and encouraging the audit team to take timely corrective actions.

Such monitoring is often focused on audit areas involving high risks, such as fraud risks or going concern, as well as audit areas in which deficiencies have been repeatedly identified through external inspections or periodic internal reviews, such as accounting estimates.

D. Development and Retention, Education and Training, and Evaluation of Professional Personnel

In order to maintain and improve audit quality, audit firms need to provide their professional personnel (including audit partners) with opportunities to acquire necessary expertise and also need to evaluate them appropriately. It is particularly important to train and properly evaluate the personnel who can exercise professional skepticism needed to detect accounting fraud. The CPAAOB examines, through its monitoring activities, including inspections, how audit firms recruit, develop, and assign personnel, as well as how they evaluate and determine the remuneration of partners and other personnel.

The following section describes initiatives undertaken for the development and retention of professional personnel, as well as the status of education and training, and performance evaluation.

1. Development and Retention of Professional Personnel

To deal with changes in the audit environment and the increasing sophistication and complexity of audit methodologies, large-sized and mid-tier audit firms have established medium- to long-term development strategies for personnel. They implement education and training programs and promote various development initiatives for personnel, including providing diverse professional opportunities that contribute to the growth and development of personnel as CPAs. (Figure III-4-1).

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

- Job rotations and interdepartmental transfers (including transfers to regional offices)
- Participation in quality management activities and provision of tax, advisory, and other non-attestation services
- Secondments to overseas member firms and overseas posting
- Secondments to organizations outside the audit firm (e.g., group firms, the JICPA and other professional organizations, commercial companies)

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

In addition, audit firms have implemented various initiatives aimed at improving staff retention, including the introduction of flexible working arrangements, such are remote work and flextime; the leveling of workloads (responsibilities of professional personnel) through the centralized management of assignments; the review of personnel evaluation systems, including compensation; and the presentation of diverse career paths through counseling, together with the provisions of work opportunities aligned with those career paths. Some audit firms also provide on-to-one on-the-job training for young staff members. Furthermore, some firms have introduced initiatives aimed at reducing turnover and leave-of-absence rates, including group counseling sessions involving peers to support employee motivation and mentor programs through which personnel can seek advice on personal concerns. In addition, some firms monitor turnover rates as an AQI while working to create an environment that enhances the attractiveness of audit work.

2. Education and Training of Professional Personnel

Audit firms are required to establish quality objectives related to ensuring that professional personnel are recruited, developed and retained, and that they possess the competence and capabilities to consistently perform high-quality engagements, including appropriate knowledge and experience relating to the engagements undertaken by the firm (QCSCS 1, para 31 (1)). To meet this requirement, audit firms have established education and training frameworks for professional personnel in proportion to their size (Figure III-4-2).

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

Large-sized and mid-tier audit firms	・ Establishing a training section within the human resources department to design and operate training programs for each job classification and level of experience ・ Implementing a series of training programs covering updates to accounting and auditing standards, the use of audit tools including data analytics tools, responses to fraud risks, key considerations and emerging issues relating to specific industries/sectors and IPO audits, the results of periodic internal inspections, CPAAOB inspections and JICPA Quality Control Review, professional ethics and independence, and information security. ・ Providing training on sustainability-related disclosures and assurance engagements ・ Conducting examinations to measure understanding of training ・ Providing support for acquiring language-related qualifications and implementing language training programs at home and abroad (including online training) ・ Holding information-sharing meetings to provide updates on the latest industry trends and developments by industry and sector
Small and medium-sized audit firms	・ Providing opportunities to attend training sessions organized by the JICPA headquarters or regional offices as well as to access JICPA e-learning courses ・ Sharing the results of periodic inspections within the firm, CPAAOB inspections and JICPA Quality Control Review (including communication at firm-wide training sessions of improvement measures in response to the findings of periodic inspections and other internal reviews).

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

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

Even among small and medium-sized audit firms, some of the comparatively larger ones have introduced level-based training systems and e-learning systems, while others are providing opportunities for education and training by covering tuition fees for external training programs. On the other hand, many small and medium-sized audit firms face difficulties in providing tailored training programs that reflect the experience and competence of their professional personnel and the industry sectors of their audited companies. As a result, some firms are limited to confirming whether their partners and staff have satisfied the training requirements under the Continuing Professional

Development (CPD) system administered by the JICPA, including the completion of the required number of CPD credits.

<Education and training needed for IFRS adoption>

As the number of companies that applying or have decided to adopt IFRS in Japan has now exceeded 310, large-sized audit firms in particular are working to develop professional personnel involved in audits of companies applying IFRS. For that reason, the CPAAOB monitors the training structures relating to IFRS, with key examples shown below (Figure III-4-3). In some small and medium-sized audit firms, all professional personnel are required to take training provided by the JICPA on IFRS. However, in many cases, those involved in audits of companies applying IFRS are expected to rely on self-study.

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

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

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

3. Evaluation of Professional Personnel

The appropriate performance evaluation of professional personnel demonstrates that the audit firm is committed to audit quality, and ongoing efforts are particularly important for fostering the organizational culture that forms the foundation of audit quality. Audit firms must establish quality objectives that ensure professional personnel demonstrate a commitment to quality through their conduct and attitude, develop and maintain the appropriate competencies to fulfill their roles, and are held accountable and evaluated through timely assessments, compensation, promotions, and other incentives (QCSCS 1, para 32 (2)).

Furthermore, when conducting audits of listed companies, audit firms are expected under the Audit Firm Governance Code to establish and implement policies concerning human resource management, performance evaluation, and remuneration (Principle 4, Guidance 4-2).

a. Evaluation of partners

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

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

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

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

Evaluation results are generally fed back to the individuals concerned and are often used as a basis for setting objectives and developing specific action plans for the following year to address identified issues. In addition, some audit firms reflect evaluation results in partners’ remuneration, determine audited companies to be assigned based on such results, and where evaluations are extremely poor, impose restrictions on engagement responsibilities or take other remedial measures.

On the other hand, some small and medium-sized audit firms do not conduct periodic evaluations of partners, while others that do conduct such evaluations have not clearly established evaluation policies and procedures.

b. Evaluation of professional personnel

Audit firms evaluate professional personnel in accordance with established evaluation criteria and have policies under which promotions and other personnel decisions are determined based on the evaluation results.

Many large-sized and mid-tier audit firms include audit quality-related criteria in their evaluations of professional personnel, such as understanding of auditing standards and other professional requirements, communication within engagement teams, and management capabilities (including the ability to address international matters). In addition, large-sized and mid-tier audit firms generally establish policies and requirements for admission to partnership and promotion to manager and other positions, with such appointments and promotions determined through a selection process.

Although small and medium-sized audit firms evaluate professional personnel in a manner similar to that of large-sized and mid-tier audit firms, some have not established policies regarding admission to partnership, promotions, and related personnel decisions based on evaluation results. This is partly because they rarely recruit newly qualified CPAs and, in some cases, hire experienced professional personnel with the expectation that they will become partners. Furthermore, in some small and medium-sized audit firms, evaluation criteria have been established for part-time professional personnel but evaluations are not conducted in accordance with those criteria. In other cases, even where evaluations are conducted, the

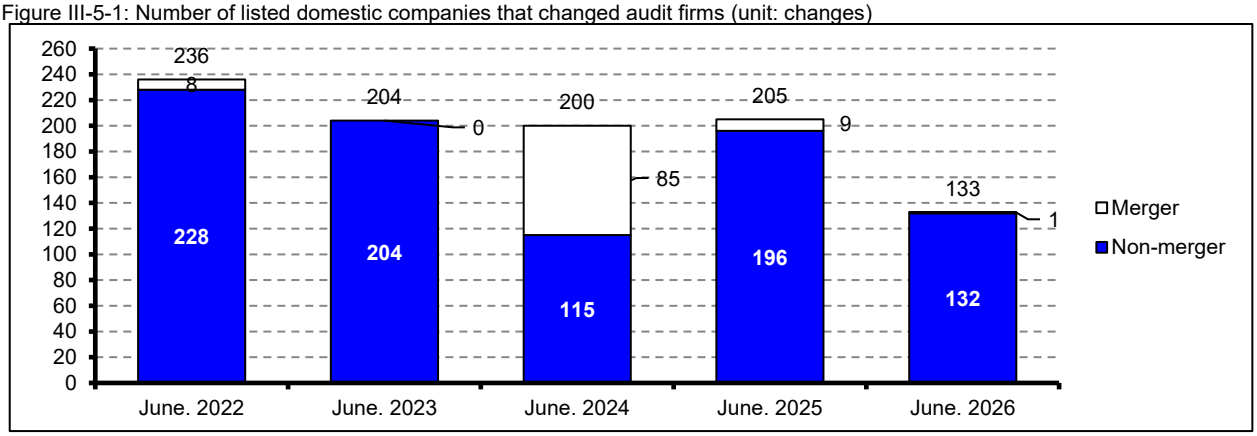
results are not reflected in decisions regarding revisions to employment terms and conditions or the renewal of employment contracts.

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

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

Looking at changes in accounting auditors of domestic listed companies, there were 133 cases in the twelve months ended June 2026, the lowest number recorded in the most recent five-year period. Compared to the twelve months ended June 2025, the number of changes attributable to reasons other than mergers[46] declined significantly (Figure III-5-1). These developments suggest that the number of changes in accounting auditors, which had remained at a high level and peaked in the twelve months ended June 2022, has been returning to the levels observed before that period, indicating that the trend of frequent changes in accounting auditors appears to have temporarily stabilized. For information on mergers, see "II. Overview of the Audit Sector, B. Audit Firms, 4. Mergers of Audit Firms".

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



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

As can be seen from the changes in audit firms by firm size for reasons other than mergers, the number of changes in the twelve months ended June 2026 decreased compared with the twelve months ended June 2025. Nevertheless, the trend of companies changing their auditors from large-sized audit firms to mid-tier audit firms or small and medium-sized audit firms has continued (Figures III-5-2 and III-5-3). This trend is considered to reflect the fact that large-sized audit firms continue to place importance on

[46] In the twelve months ended June 2026, there were no mergers between audit firms. However, transfers to audit firms established through business integration of regional offices of an accounting auditors are categorized as "mergers."

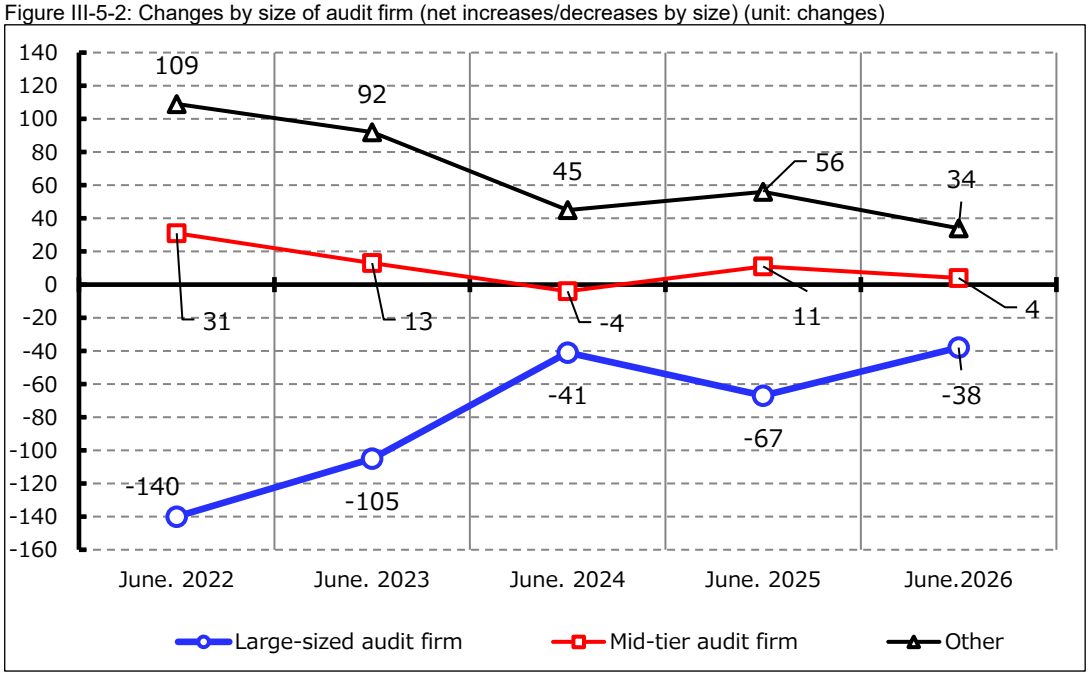
operational management by taking into account factors such as audit fees, audit risk, and the personnel required to perform the audit engagement when deciding whether to continue audit contracts. At the same time, audited companies are also considering the need to change auditors by taking into account factors such as the length of continuous audit engagements, the appropriateness of audit services in light of their business scale, and the reasonableness of audit fees.

For information about business operations concerning continuance of audit contracts at large-sized audit firms, see "3. Reasons for Changes in Accounting Auditors as Identified Through CPAAOB Monitoring".

In addition, although the number of changes from one small and medium-sized audit firm to another decreased in the twelve months ended June 2026 compared with the twelve months ended June 2025, the tendency for companies to switch from one small and medium-sized audit firm to another has continued (Figure III-5-3). Large-sized audit firms and mid-tier audit firms have maintained a cautious stance toward entering into new audit engagements with listed domestic companies previously audited by small and medium-sized audit firms, particularly from the perspective of audit fees and related considerations. At the same time, these listed domestic companies appear to be selecting successor auditors based on factors such as the appropriateness of audit services for their business scale and the reasonableness of audit fees, which has resulted in a greater tendency to appoint other small and medium-sized audit firms. In addition, among cases involving a change from one small and medium-sized audit firm to another, there were 35 cases in the twelve months ended June 2025 in which the predecessor auditor was not registered in the Register of Auditors for Listed Companies and Other Entities, compared with only seven cases in the twelve months ended June 2026. This suggests that the introduction of the auditor registration system for listed companies also affected the trends observed in the twelve months ended June 2025.

The above-mentioned shift from large-sized audit firms to mid-tier audit firms or small and medium-sized audit firms suggests that the role of small and medium-sized audit firms in auditing listed companies is expanding. However, the CPAAOB’s recent inspection of small and medium-sized audit firms has identified cases where the firms did not have adequate systems in place to properly perform audit engagements, making it an urgent priority for such firms to maintain and enhance audit quality. In light of these circumstances, the CPAAOB intends to place greater emphasis on inspections of small and medium-sized audit firms.

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



(Note1) Net increases/decreases in the number of changes
(Note2) Aggregate numbers of companies that had decided on an incoming auditor by the end of June of each period, based on timely disclosures by listed domestic companies
(Note3) Figures in the above table do not include changes due to mergers of audit firms.
(Source) Prepared by the CPAAOB

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

From/To			June 2024	June 2025	June 2026	Increase/Decrease
Large-sized	→	Large-sized	12	14	14	-
	→	Mid-tier	10	25	18	▲7
	→	Other	40	49	27	▲22
Mid-tier	→	Large-sized	5	3	5	2
	→	Mid-tier	-	2	1	▲1
	→	Other	11	14	13	▲1
Other	→	Large-sized	4	4	2	▲2
	→	Mid-tier	2	3	4	1
	→	Other	31	82	48	▲34
Total			115	196	132	▲64

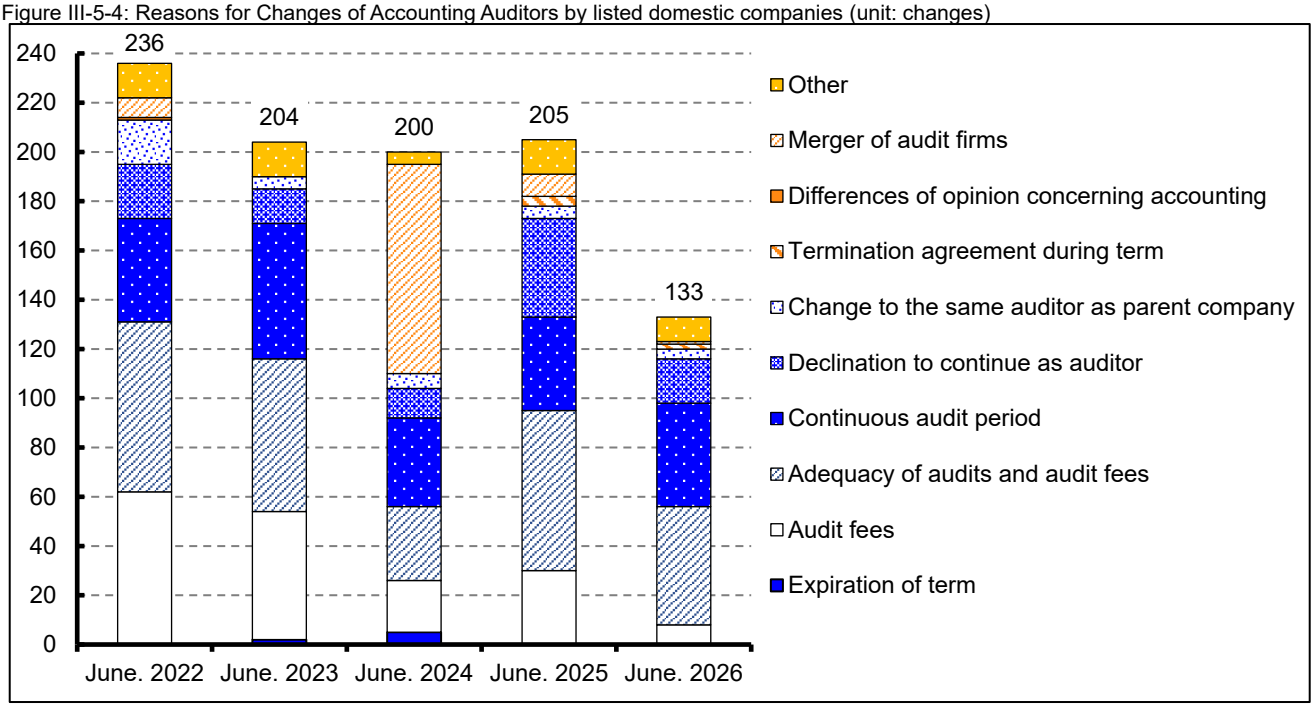
(Note1) Aggregate numbers of companies that had decided on a successor accounting auditor by the end of June of each period, based on timely disclosures by listed domestic companies
(Note2) "Other" in the figure refers to small and medium-sized audit firms, partnerships and solo practitioners.
(Note3) Figures in the above table do not include changes due to mergers of audit firms.
(Source) Prepared by the CPAAOB

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

When a listed domestic company changes its accounting auditor, the company shall disclose the change immediately (Article 402 of the Securities Listing Regulations, Tokyo Stock Exchange). In such cases, the company must specifically disclose the substantial reasons for the change and the background leading to the decision.

An examination of the reasons for the changes in accounting auditors disclosed pursuant to these regulations shows that many companies stated the proposed increases in audit fees, as well as the appropriateness of the audit services in light of their business scale and the reasonableness of audit fees, as reasons for the change. In addition, many companies stated that, after comparing alternative audit firms while taking into consideration the prolonged audit period of their incumbent auditor, they decided to change accounting auditors (Figure III-5-4). In the twelve months ended June 2026, many companies continued to state these factors as reasons for changing accounting auditors. In addition, there was a notable increase in cases categorized as “declination to continue as auditor,” where the incumbent accounting auditor declined to continue the audit engagement. In such cases, reasons cited included the expectation of increased audit workload arising from changes in the audit environment, coupled with difficulties in securing sufficient personnel to perform the engagement.

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



(Note1) Compiled based on timely disclosures by listed domestic companies choosing new auditors by the end of June each year.
(Note2) In the case of two or more reasons disclosed, the classification was made based on the principal reason.
(Source) Prepared by the CPAAOB

2. Reasons for Changes of Accounting Auditors during Fiscal Term

In the twelve months ended June 2026, there were two cases of changes in accounting auditors in the middle of the fiscal year out of a total of 133. The changes were primarily due to terminations or resignations initiated by the audit firms, following the discovery of inappropriate accounting practices at the audited companies.

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

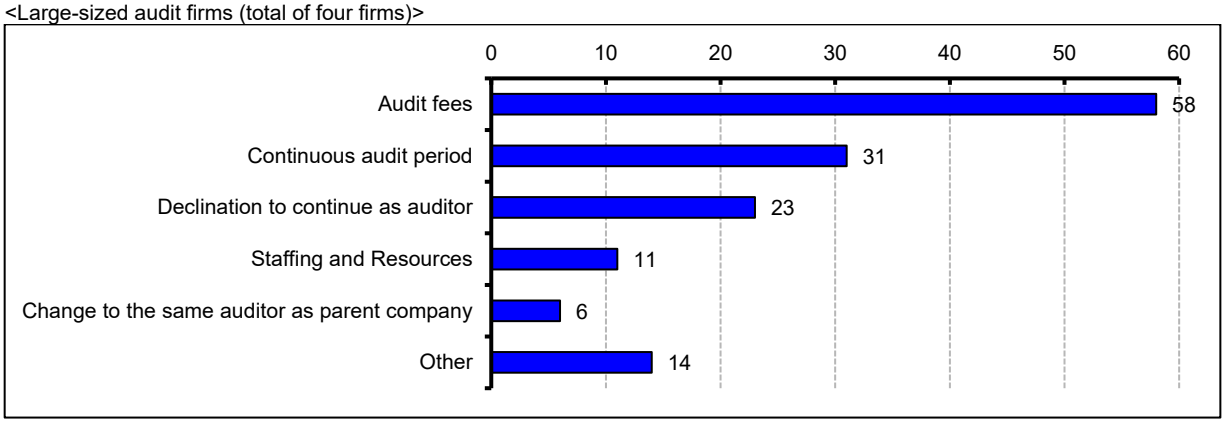
This section lays out the reasons for changes in accounting auditors identified through CPAAOB monitoring conducted in PY2025, in addition to the timely disclosures released by audited companies. It should be noted that inspections and the collection of reports were not conducted for all audit firms during PY2025. Furthermore, due to the timing of inspections and information collection, the cases reviewed may include reasons for changes that occurred in previous years. Accordingly, the number of changes identified through the monitoring does not necessarily correspond to the number of changes disclosed for each fiscal year.

a. Large-sized audit firms

Among the 94 cases of changes in accounting auditors reported by large-sized audit firms as predecessor accounting auditors through inspections and information collection, the most frequently cited reason for the change was “audit fees” (58 cases), followed by "continuous audit period" (31 cases). In addition, a number of cases cited both “audit fees” and “continuous audit period” as reasons for the change. On the other hand, from the perspective of the manner in which the change occurred, 23 cases involved the accounting auditor declining to continue the audit engagement. In a number of these cases, it appeared that the audit firm had concluded that continuation of the engagement was difficult after comprehensively considering factors such as audit risk, audit workload, and fee levels in the course of allocating audit resources and reviewing its client portfolio (Figure III-5-5).

Compared with the previous year, both the number of changes in accounting auditors (57 cases in the previous year) and the number of cases in which the accounting auditor declined to continue the engagement (4 cases in the previous year) increased significantly. This trend can be attributed in part to the growing tendency of audited entities to consider changing their auditors based on factors such as continuous audit period and audit fees. In addition, when determining whether to continue audit engagements, large audit firms analyze individual audit engagements and their audit portfolios as a whole, taking into account factors such as whether audit fees are commensurate with audit risk, whether audit risk remains within an manageable range, and whether sufficient personnel can be secured to perform the audit. Audit engagements are then managed in accordance with the results of such analyses.

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

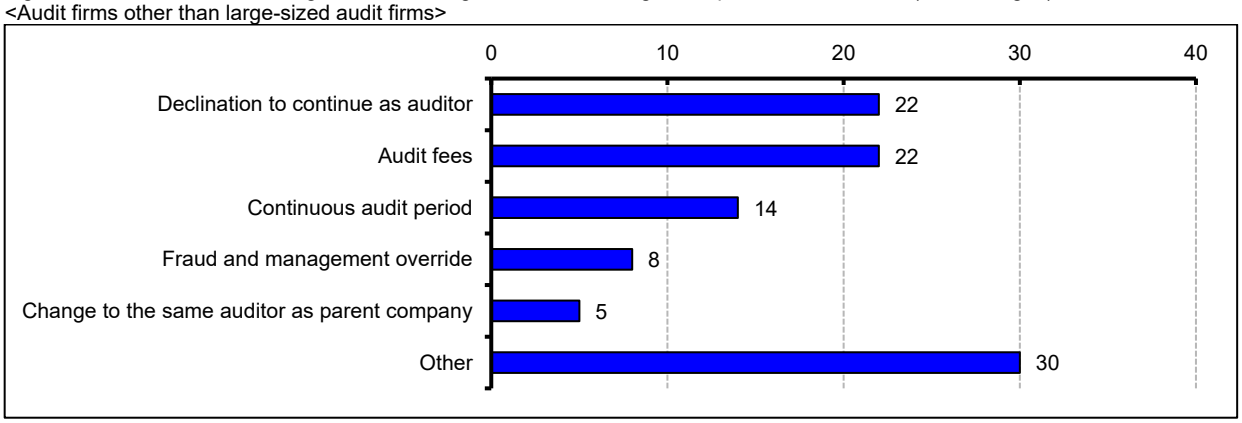


(Note1) Based on data from 94 changes identified through inspections and report collection during PY2025.
(Note2) If there was more than one reason, that change is included in the figure for each reason (a cumulative total of 143).
(Source) Prepared by the CPAAOB

b. Mid-tier audit firms and small and medium-sized audit firms

Among the 66 cases of changes in accounting auditors reported by mid-tier audit firms and small and medium-sized audit firms through inspections and information collection, the most frequently cited reasons reported by predecessor accounting auditors excluding “other,” were “declination to continue as auditors” and “audit fees”, followed by “continuous audit period” (Figure III-5-6). The underlying reasons for “declination to continue as auditor” included cases in which audit risk had increased due to factors such as deteriorating business performance or weaknesses in the audited company’s accounting systems, making it difficult to secure sufficient audit resources for the audit effort required. In a number of cases, audit firms also concluded that continuation of the engagement was not feasible in light of the level of audit fees. In addition, some cases cited constraints on the audit firm’s own audit resources as the primary reason for declining to continue the engagement. With respect to “other” reasons, there were cases in which the audited company reviewed its accounting auditor in order to obtain audit services more suited to its business activities or scale, or to respond to the requirements of a global audit framework.

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



(Note1) Based on data from 66 changes for which the reason was identified through the inspections by the CPAAOB in PY2025 and reports collected from four mid-tier audit firms and 49 small and medium-sized audit firms.
(Note2) If there was more than one reason, that change is included in the figure for each reason (a cumulative total of 101).
(Source) Prepared by the CPAAOB

F. Audit Fees

1. Rules on Audit Fees

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

On the other hand, the JICPA Code of Ethics, as most recently amended June 2025, states that an audit firm may quote whatever fee it deems appropriate based on the content and value of services provided. It also states that quoting an unduly low fee without proper justification may make it difficult to perform professional services in accordance with applicable technical and professional standards. As a result, such fee arrangements may give rise to a self-interest threat to compliance with the principles of professional competence and due care.

2. Methods for Calculating Audit Fees

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

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

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

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

According to the reports collected in PY2025, audit fee estimates are calculated as follows.

a. Large-sized audit firms

All large-sized audit firms state that they adopt the hourly rates approach for audit fee estimates. Hourly rates are established for each rank of audit personnel, and are calculated to include indirect costs associated with the firm's management and quality management activities, such as personnel expenses for administrative functions and IT system-related costs.

In some cases, firms also establish more granular charge rates not only by staff rank, but also by factors such as the complexity of the audit engagement and the specific service provided.

b. Mid-tier audit firms

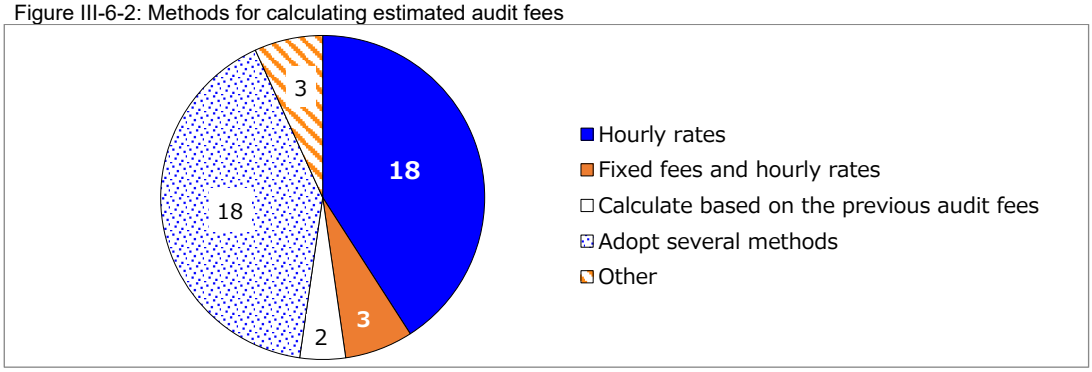
With respect to audit fee estimation, three mid-tier firms stated that they adopt the hourly rates approach, while one firm stated that it adopts the fixed fees and hourly rates approach. In addition, one of the firms using the hourly rates approach does not establish charge rates

according to the rank of audit personnel. The other three firms stated that they set charge rates according to the rank of audit personnel.

c. Small and medium-sized audit firms

Based on a compilation of responses from the small and medium-sized audit firms that were subject to collection of reports (44 firms, all of which were small and medium-sized audit firms), many firms stated that they adopt either the hourly rates approach or multiple fee-calculation methods, such as using the hourly rates approach as the principal method while combining it with other approaches (Figure III-6-2).

Figure III-6-2: Methods for calculating estimated audit fees



(Note) Aggregated from reports collected from small and medium sized audit firms in PY2025
(Source) Prepared by the CPAAOB

In addition, many small and medium-sized audit firms stated that they do not set charge rates according to the rank of audit personnel (Figure III-6-3).

Figure III-6-3: Setting of charge rates by rank of audit personnel

Setting	Number of audit firms	Percentage
Charge rates set	10	23%
Charge rates not set	34	77%
Total	44	100%

(Note) Aggregated from reports collected from small and medium-sized audit firms in PY2025
(Source) Prepared by the CPAAOB

3. Audit Fees Before and After Changes in Accounting Auditors

As audit fees are often reviewed following a change of accounting auditors, the CPAAOB analyzed pre- and post-transfer audit fees for 185 cases of changes in accounting auditors at listed domestic companies disclosed through timely disclosures between July 2024 and June 2025, excluding changes resulting from mergers of audit firms. In conducting the analysis, particular attention was paid to changes in the size of the successor accounting auditor, and the analysis revealed the following trends.

In cases where companies changed to larger audit firms (8 cases), audit fees increased in many instances, rising in approximately 70% of cases (6 cases), while they decreased in approximately 30% of cases (2 cases). In cases where companies changed to audit firms of the same size (91 cases),

audit fees increased in approximately 60% of cases (56 cases) and decreased in approximately 30% of cases (28 cases). Meanwhile, in cases where companies changed to smaller firms (86 cases), audit fees decreased in approximately 70% of cases (64 cases), while they increased in approximately 20% of cases (19 cases) (Figure III-6-4).

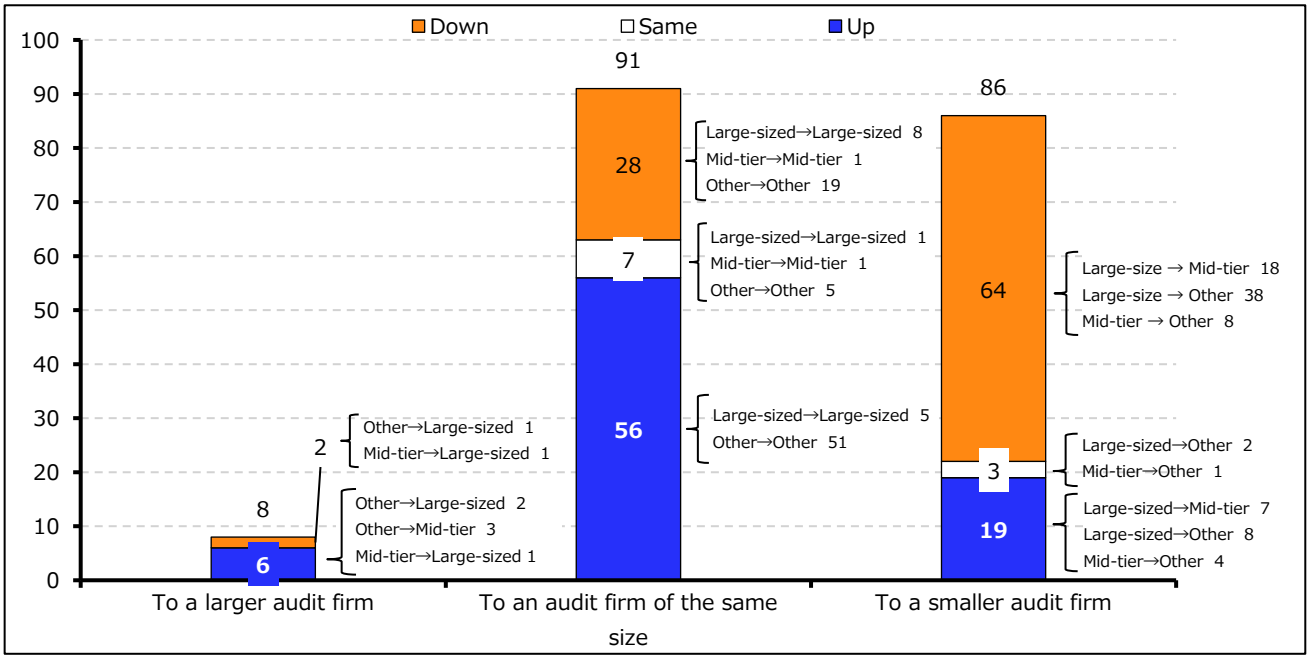
As noted earlier in 1. Reasons for Change of Accounting Auditors Given in Timely Disclosures by Audited Companies, many listed domestic companies cite the appropriateness of audit services and audit fees in relation to their business scale as reasons for changing accounting auditors. Based on the above findings, it appears that some listed domestic companies determine that the audit fees charged by their incumbent auditors were excessive relative to their business scale and other circumstances, and therefore tend to appoint primarily small and medium-sized audit firms as successor accounting auditors with the aim of reducing audit fees.

On the other hand, in PY2025, even in cases where companies changed to smaller audit firms, increases in audit fees were observed more frequently than in the previous program year. This is considered to reflect situations in which audited companies, while placing importance on the appropriateness of audit fees, prioritized obtaining audit services from accounting auditors whose scale was better suited to their business scale and therefore accepted increases in audit fees. In other words, the findings suggest an emerging trend in which a reduction in audit fees is no longer necessarily associated with a change to a smaller audit firm.

Cases in which audit fees increased following a change of auditors were also observed in substantial numbers when companies changed to audit firms of the same size, particularly in changes between small and medium-sized audit firms (51 cases). Given the increasing number of cases in which incumbent accounting auditors have declined to continue audit engagements, audited companies may have found it necessary to appoint a successor promptly and, may therefore have accepted higher fees proposed by prospective auditors.

The CPAAOB will continue to monitor trends in audit fees before and after changes of accounting auditors, while paying close attention to changes in the size of successor accounting auditors.

Figure III-6-4: Audit fees following changes of accounting auditors (unit: changes)



(Note1) Included are cases of changes in accounting auditors by listed domestic companies disclosed between July 2024 and June 2025, for which audit fees both before and after the change were publicly disclosed.
(Note2) Breakdowns of these changes are shown in the graph
(Note3) "Other" in the figure refers to small and medium-sized audit firms.
(Source) Prepared by the CPAAOB based on timely disclosures of changes in accounting auditors and securities reports submitted by June 2026

4. Fee Dependency (Safeguards)

When the proportion of audit fees received from a specific audited company becomes high relative to the total revenue[47] of the audit firm[48] (fee dependency), the resulting fee dependency and concerns over losing that source of income may increase the level of self-interest threats and create undue pressure on the audit firm, potentially impairing its independence.

The JICPA Code of Ethics includes provisions relating to fee dependency. Under these provisions, where the fee dependency of a particular audited company exceeds, or is likely to exceed, 15% for two consecutive years, the audit firm is required to implement a safeguard by obtaining a review equivalent to an engagement quality review conducted by a member who is not affiliated with the audit firm, prior to expressing its audit opinion. Furthermore, where the fee dependency of a particular audited company that is a public interest entity exceeds 15% for five consecutive years, the audit firm is required to resign from the engagement following the issuance of the audit opinion for the fifth year.

With regard to the application of safeguards related to fee dependency, no applicable cases were identified among large-sized audit firms or mid-tier audit firms. However, among small and medium-sized audit firms, safeguards relating to fee dependency were applied in 13 engagements across eight firms, out of 49 firms (all of which were small and medium-sized audit firms) subject to inspections and the collection of reports conducted in PY2025.

[47] Total audit and attestation revenue and non-audit service revenue (e.g. advisory and tax services)
[48] Audit firms and business entities that are linked through control relationships, including those established through contractual arrangements, personnel relationships, or other means.

■ Enhancing Audit Quality and Improving Profitability and Operational Efficiency ■

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

Although the number of registered CPAs has increased gradually in recent years, the number of CPAs employed by audit firms has not grown at the same pace. This is partly due to the increasing availability of career opportunities in other attractive fields, such as consulting firms and positions including CFOs at commercial companies, where compensation and remuneration levels may be more attractive. As a result, concerns have been raised regarding a shortage of professionals available to perform audits.

At the same time, large-sized audit firms in particular have been promoting initiatives to standardize and centralize audit processes. These initiatives include assigning less specialized audit tasks to audit assistants and processing certain audit procedures centrally through delivery centers, thereby enabling CPAs and other professionals to devote more time to higher-value and more complex areas of audit work. In addition, audit firms have continued to develop and deploy audit tools utilizing technologies such as AI, advancing efforts not only to address shortages in audit personnel but also to improve the efficiency and sophistication of audit engagements.

However, the environment surrounding audits is changing at a rapid pace. Factors such as the diversification and increasing complexity of audited companies' business activities, the continued globalization of business operations, the growing complexity of applicable accounting standards, and the need to respond to new auditing requirements are expected to require ongoing investment by audit firms in both human capital and technology. In particular, continued investment in securing and developing personnel, as well as in technologies such as AI, is likely to remain necessary across audit firms.

Under these circumstances, audit firms have been reviewing their audit fee levels by more precisely estimating the audit hours necessary to ensure sufficient and appropriate audit quality and by proposing revisions to audit fees to audited companies.

According to business reports submitted to the Local Finance Bureaus and other authorities, large-sized audit firms have experienced a decline in the number of audit clients subject to audits under the FIEA, while total audit fee revenue has increased. In addition, disclosures regarding audit fees in annual securities reports filed by listed domestic companies indicate that, among large-sized audit firms, audit fees increased from the previous fiscal year for more than half of their audit clients, suggesting that the review of audit fee levels has been progressing. However, an analysis of timely disclosures relating to changes of auditors by listed domestic companies shows that many companies cited proposed increases in audit fees, as well as the appropriateness of audit services and audit fees in relation to their business scale, as reasons for changing auditors. These findings suggest that, although progress has been made in revising audit fee levels, a gap still remains between the level of audit fees required to support the roles and responses expected of audit firms in enhancing audit quality and the level of audit services expected by audited companies. Accordingly, revisions to audit fee levels cannot yet be said to have become fully established.

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

Ensuring the reliability of capital markets requires strengthening market governance[49], and further enhancement of the audit function is essential. However, the importance of audits in capital markets and the public-interest role of

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

audit firms are sometimes overlooked. Therefore, in light of the recent emergence of several cases of accounting fraud at listed domestic companies, it is expected that, in addition to discussions on improving audit quality, more active dialogue will take place from the perspective of the capital market as a whole, including audited companies and market participants, regarding the importance of financial audits, the fair evaluation of audit work, and the future role that audit firms should play.

IV. Responses to Changes in the Global Environment Surrounding Audits

IV. Responses to Changes in the Global Environment Surrounding Audits

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, while the number of listed domestic companies in Japan has been declining, the trend of changing accounting auditors from large-sized audit firms to mid-tier and small and medium-sized audit firms has continued. In particular, small and medium-sized audit firms currently provide audit services to approximately 28% of listed domestic companies (around 1,050 companies on a company basis). Moreover, the number of newly listed domestic companies appointing such firms as their accounting auditors has increased year by year. Accordingly, the role expected of these firms in the capital markets has become increasingly important.

Against this backdrop, the Quality Control Standards became fully applicable to audits of fiscal years beginning on or after July 2024. In addition, the JICPA Code of Ethics, which was amended in July 2022 to strengthen regulations related to independence, was further revised in July 2024 with respect to the definition of engagement teams, provisions relating to group audit engagements, and other matters. As a result, small and medium-sized audit firms are required not only to establish systems to provide audit services to listed domestic companies but also to appropriately implement and operate the system of quality management and respond to strengthened independence requirements concerning audit fees, non-audit fees, fee dependency, and the concurrent provision of non-assurance services.

Furthermore, small and medium-sized audit firms face challenges in securing and developing human resources and maintaining financial resources, particularly in response to the digitalization of audit services, including the digitalization of audit documentation, the increasing complexity of audit procedures relating to areas such as crypto-assets, and the expansion of service areas, including assurance over sustainability-related information.

Moreover, 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 and introduced a statutory Registration System for Auditors of Listed Companies. Under the Revised Ordinance for Enforcement of the CPA Act, audit firms conducting audits of listed companies are required to establish systems for enhanced information disclosure and to conduct business operations in accordance with the Audit Firm Governance Code (revised in March 2023). These requirements became applicable to small and medium-sized audit firms registered as auditors of listed companies from the beginning of the first accounting period of audited companies commencing on or after July 1, 2024.

In addition, cases have emerged in which accounting fraud had been committed since the initial public offering application stage at listed domestic companies audited by small and medium-sized audit firms, raising concerns regarding the quality of audits performed by such 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 of audit firms conducting audits of listed domestic companies had previously been administered by the Quality Control Committee of the JICPA as part of its self-regulatory activities. However, following the introduction of the statutory Registration System for Auditors of Listed Companies on April 1, 2023, Review for Application Review, Review for Revocation of Registration, and deliberations on matters necessary for the operation of the system have been conducted by the Registration Review Committee for Auditors of Listed Companies (“Registration Review Committee”), which consists of seven members, including three JICPA members and four non-members.

The Registration System for Auditors of Listed Companies is designed to contribute to the reliability of financial audits by:

(i) Registering audit firms conducting audits of listed companies on 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) Requiring the JICPA to verify through confirmation of eligibility, whether Registered Auditors of Listed Companies are fulfilling such responsibilities, and
(iv) Revoking registrations when necessary.

The JICPA receives applications from audit firms seeking registration (“Applicant Firms”) and conducts a Review for Application Review to assess the status of their systems of quality management. The JICPA also conducts confirmations of eligibility through the Quality Control Review, including the Review for Application Review, to determine whether the Applicant Firms or Registered Auditors of Listed Companies have systems sufficient to fairly and appropriately perform audit attestation services relating to the financial statements of listed companies. Based on the results of these reviews and confirmations of eligibility, the Registration Review Committee decides whether the registration should be approved or revoked.

In June 2023, the JICPA published the Eligibility Confirmation Guideline, which outlines viewpoints and criteria for review teams to consider when confirming eligibility. At the same time, Applicant Firms and Registered Auditors of Listed Companies are expected to conduct self-assessments against the conditions set out in the Eligibility Confirmation Guideline, and if any deficiencies are identified, to promptly develop and implement voluntary improvement measures. This Guideline was subsequently revised in August 2024 and June 2025 to reflect, among other things, the application of the Revised Quality Control Standards, discussions within the Registration Review Committee, and experience gained through Quality Control Review. These revisions included the reorganization of items and the addition of new viewpoints and criteria.

Audit firms that were conducting audits of listed companies as of April 1, 2023 were designated as

Deemed Registered Auditors of Listed Companies (“Deemed Registered Auditors”) under transitional measures and were permitted to continue providing audit attestation services until September 30, 2024. The JICPA stated that, from October 1, 2024, such firms would be categorized either as “Firms to be examined by the Registration Review Committee” or as “Firms whose registration applications were denied but that continued to audit listed companies.” On July 3, 2025, the JICPA announced that it had completed the Reviews for Application Review of all Deemed Registered Auditors. Accordingly, after that date, the only remaining Deemed Registered Auditors were the “Firms whose registration applications were denied but that continued to audit listed companies.”

The Registration Review Committee held a total of 40 meetings between April 2023 and June 2026. During this period, 130 audit firms (including 10 firms that newly applied for registration and were not Deemed Registered Auditors) were registered on the List of Auditors of Listed Companies. As of the end of June 2026, one audit firm remained a Deemed Registered Auditor. On July 2, 2026, however, it was announced that a temporary accounting auditor would be appointed at the listed audited company for which the successor accounting auditor had not yet been determined, and it was confirmed that this Deemed Registered Auditor would no longer perform the audit engagement. As a result, the number of Deemed Registered Auditors has fallen to zero[50].

b. Framework for supporting small and medium-sized audit firms

(i) Small Medium Practices Policy Committee

The Small Medium Practices Policy Committee considers measures to facilitate the smooth performance of services provided by small and medium-sized audit firms and to promote continuous improvement. The following committees have been established under this Committee:

[Audit and Ethics Standards Subcommittee]

- Considers publications and guidance materials to support appropriate compliance with the JICPA Code of Ethics, auditing standards and guidelines, and other relevant requirements, with the aim of maintaining and enhancing audit quality.

[IT Support Subcommittee for Small and Medium-Sized Audit Firms]

- Assesses the status of IT infrastructure development and the use of IT-based audit methodologies.
- Provides support for the enhancement of IT infrastructure, including cybersecurity measures, and for the development of audit tools utilizing information technology.

[International Affairs Subcommittee]

- Monitors developments in international standards through discussions conducted by the International Ethics Standards Board for Accountants (IESBA) and the International Federation of Accountants (IFAC) and shares information with small and medium-sized audit firms at an early stage to facilitate the smooth implementation of international standards.
- Communicates views from the perspective of small and medium-sized audit firms on matters

[50] Although this event occurred shortly after the end of the FY2025 inspection year, it is reflected here because of its close relevance to the circumstances discussed above.

that may affect audit practice in Japan.

[Accounting Subcommittee]

- Supports the application of accounting standards, including IFRS, prepares disclosure and presentation checklists for annual securities reports, and develops training materials related to audit responses associated with enhanced corporate disclosure requirements.

[Sustainability Information Support Committee for Small and Medium-Sized Audit Firms]

- Collects and provides information necessary to help small and medium-sized audit firms appropriately address sustainability-related information and other emerging reporting matters.

(ii) Small and Medium-Sized Audit Firms Liaison Council

The Small and Medium-sized Audit Firms Liaison Council operates on a voluntary membership basis and, in principle, is open to small and medium-sized audit firms conducting audits of listed companies. As part of efforts to maintain and enhance the quality of audit firms and audit engagements, the Council provides information and support on an ongoing basis. The following subcommittee and two working groups have been established under the Council:

[Subcommittee on Strengthening the Foundations of Small and Medium-sized Audit Firms]

- Established to promote various initiatives undertaken by the JICPA, in a robust and organized manner, to strengthen the operational foundations of small and medium-sized audit firms.
- Determines overall policies for enhancing disclosures and strengthening firm foundations and monitors various support measures aimed at strengthening those foundations.

[Working Group on Auditor Recruitment and Development]

- Established to support the recruitment and development of personnel at small and medium-sized audit firms.
- Prepares recruitment brochures for small and medium-sized audit firms and distributes them to professional schools, universities, and accounting colleges, and organizes networking events for young CPAs working at small and medium-sized audit firms.

[Working Group on Audit Firm Support]

- Established to support improvements in audit quality and enhance consultation services for small and medium-sized audit firms.
- Operates a consultation desk for matters relating to compliance with the Guideline for the Confirmation of Eligibility, and plans and administers interactive training programs aimed at improving audit quality.

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

The JICPA, primarily through the Small Medium Practices Policy Committee and the Small and Medium-Sized Audit Firms Liaison Council, implements various initiatives to strengthen the operational foundations of small and medium-sized audit firms that audit listed companies and other public interest entities. These initiatives include: (i) support for enhanced transparency and disclosure; (ii) support for improving audit quality and enhancing consultation functions; (iii) support for

digitalization; (iv) support for implementation of the revised Quality Control Standards; (v) training programs relating to the revised JICPA Code of Ethics; (vi) support for recruitment and development of personnel; (vii) maintenance of directories of overseas firms; (viii) dialogue with capital market stakeholders; and (ix) regular opinion exchange meetings. The principal initiatives are outlined below.

(i) Support for enhanced transparency and disclosure

- Prepared and published the Guidance for Preparing Annual Reports on Audit Quality Management and conducted training sessions through regional chapters.
- Reviewed draft (dry-run) versions of annual reports on audit quality management and provided feedback on the results.
- Conducted reviews of the finalized annual reports on audit quality management and collected related data.
- Compiled common observations and good practices identified across multiple audit firms and shared them with member firms of the Small and Medium-Sized Audit Firms Liaison Council.
- Held study sessions with external experts on topics such as the Audit Firm Governance Code and published the related materials on the JICPA website.
- Established a consultation desk to respond to inquiries relating to disclosure matters.
- Supported the preparation of video messages from firm leadership to facilitate implementation of the Audit Firm Governance Code.
- Established the “Top Message Website for Small and Medium-sized Audit Firms Auditing Listed Companies”, which publishes firms’ annual reports on audit quality management, information on the application of the Audit Firm Governance Code, and explanatory documents together with leadership messages and related videos.

(ii) Support for improving audit quality and enhancing consultation functions

- Conducted interactive training programs designed to improve audit quality while also strengthening individual consultation functions. Topics covered in FY2025 included audit firm quality management, evaluation of systems of quality management, organization and retention of audit documentation, information security, audit execution (including IT audits), risk assessment and response procedures, audit of accounting estimates, and group audits.
- Conducted training programs tailored to small and medium-sized audit firms, including seminars on audit risk and accounting fraud, updates on auditing and quality management standards, IFRS, and sustainability-related matters.
- Established a consultation desk to provide advice on the development of appropriate audit firm governance and operational structures.

(iii) Support for digitalization

- Held regular IT Community meetings to facilitate information sharing on the introduction of IT infrastructure and audit tools, with participation typically ranging from 200 to 300 IT professionals and practitioners.

- Established a consultation desk to advise on audit firm infrastructure, including IT environments and the digitalization of electronic audit documentation.
- Conducted surveys on the status of IT infrastructure, digital transformation (DX), and the use of generative AI, and shared the results through the IT Community.

(iv) Support for recruitment and human resource development

- Prepared, published, and distributed the recruitment brochure Employment Guidebook for Small and Medium-sized Audit Firms.
- Organized networking events for young CPAs working at small and medium-sized audit firms.
- Beginning in FY2026, plans to provide training programs for audit assistants who have not passed the CPA Examination, in cooperation with the Accounting Education and Learning Foundation.

(v) Regular dialogue and exchange of views

- Held a number of roundtable meetings between the JICPA President, Vice Presidents and Executive Board Members responsible for supporting small and medium-sized audit firms, and representatives of such firms.
- Gathered views and feedback on challenges faced by individual firms and communicated the JICPA's expectations regarding firm scale and organizational capacity necessary to maintain an appropriate level of audit quality.

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 digitalization platform for balance confirmation procedures that focuses on standardizing and improving the efficiency of audit operations, accelerating confirmation procedures, and ensuring a high-level of 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 June 2026, the platform was being used by more than 160 audit firms, including approximately 80 small and medium-sized audit firms. One factor that may have contributed to the increased adoption of the platform among small and medium-sized audit firms is the regular dissemination of information on the platform through the IT Community organized by the JICPA.

The Audit Digital & Innovation Consortium LLC (ADIC), established through joint investment by one mid-tier audit firm, two small and medium-sized audit corporations, and one business corporation, provides small and medium-sized audit corporations with a shared IT infrastructure environment that enables the use of electronic audit working paper systems, as well as digital transformation tools designed to enhance the effectiveness and efficiency of audit engagements.

ADIC was established with the advice and cooperation of the JICPA, and 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, exchange of opinions, and other forms of assistance.

In addition, 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 quality of audit firms and supports their efforts to meet the requirements set forth in the Audit Firm Governance Code and other relevant standards. Its membership consists of audit firms engaging in audits of listed companies. Specifically, the AFSA provides services including independent third-party advice to members, responses by specialists in accounting, auditing and related fields to members' inquiries seeking professional opinions, and support for improvement measures in response to significant findings identified through external inspections. The AFSA also plans to provide support for training related to accounting, auditing, ethics, and other professional matters in the future. The JICPA works in cooperation with the AFSA in providing support to small and medium-sized audit firms aimed at enhancing audit quality.

3. Response by the CPAAOB

The 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 receive the necessary support on a medium- to long-term basis, and that the administrative authority should promote proactive quality management by audit firms through CPAAOB inspections, 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 for the managements of small and medium-sized audit firms in a program entitled *"Strengthening Organizational and On-site Capabilities of Audit Firms"* organized by the Accounting Education and Training Organization, a general incorporated foundation. During the lecture, the CPAAOB explained its expectations regarding sound organizational management.

In addition, the CPAAOB has published the Case Report from Audit Firm Inspection Results and has presented these case studies at training sessions organized by regional chapters 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 their efforts through lectures delivered at seminars and training programs organized by relevant organizations.

B. Recent Trends in Auditing

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

The International Auditing and Assurance Standards Board (IAASB) and the IESBA, both established within the International Foundation for Ethics and Audit (IFEA)[51], are engaged in the development of international audit standards, assurance standards, and ethics standards.

Recent major revisions to the International Standards on Auditing (ISA) issued by the IAASB include revised ISA240 (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 effective for audits of financial statements for fiscal years beginning on or after December 15, 2026. The revised ISA240 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-periods financial statements as Key Audit Matters.

The revised ISA570 (Going Concern), which was finalized at the IAASB Board meeting held in December 2024 and published in April 2025, is effective for audits of financial statements for fiscal years beginning on or after December 15, 2026. The revised ISA570 requires management's assessment of going concern to cover a period of at least 12 months from the date of approval of the financial statements and requires the auditor's report to include a statement setting out the auditor's conclusion regarding the appropriateness of the going concern basis of accounting.

In addition, in response to calls for integrated project addressing audit evidence and responses to assessed risks, the IAASB decided at its Board meeting in December 2024 to launch a project to revise ISA330 (The Auditor's Responses to Assessed Risks), ISA500 (Audit Evidence) and ISA520 (Analytical Procedures) simultaneously. The project is intended to (i) strengthen auditors' exercise of professional judgment and professional skepticism, (ii) promote greater consistency in audit practice and auditor behavior, and (iii) encourage the use of technology in obtaining audit evidence and assessing its sufficiency and appropriateness. The IAASB aims to finalize the revised standards by December 2026.

Recent developments in international assurance standards issued by the IAASB include the ISSA5000, *General Requirements for Sustainability Assurance Engagements*, which was approved for finalization at the IAASB's September 2024 Board meeting and formally issued in November 2024. ISSA5000 is effective for sustainability assurance engagements relating to periods beginning on or after December 15, 2026, and for engagements as at a specific date on or after December 15, 2026. The standard is designed to be profession-agnostic and applies to all sustainability assurance practitioners, whether professional accountants or otherwise, and to both limited and reasonable assurance engagements.

Recent developments in the IESBA Code of Ethics include the IESBA's approval of revisions to the IESBA Code at its December 2024 Board meeting. Following this approval, the IESBA published in

[51] An organization established in 2022 to replace the International Federation of Accountants (IFAC) as the parent body of the IAASB and IESBA, reflecting the view that standard-setting bodies should be independent from professional accountancy organizations. The transfer of the IAASB and the IESBA to the IFEA was implemented in January 2023.

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 the Work of an External Expert*. The first introduces, among other changes, a new Part 5 that establishes ethics and independence requirements for sustainability assurance engagements meeting specified criteria and applies to all assurance practitioners, including those who are not professional accountants. The second provides guidance on evaluating the competence, capabilities, and objectivity of external experts whose work is used in situations where expertise other than that possessed by professional accountants or sustainability assurance practitioners is required. The above revisions to the IESBA Code, other than those relating to value chain components, are effective for sustainability assurance engagements covering periods beginning on or after December 15, 2026, or for sustainability-related information reported as of a specific date on or after December 15, 2026. The provisions relating to value chain components are effective for sustainability assurance engagements covering periods beginning on or after July 1, 2028, or for sustainability-related information reported as of a specific date on or after July 1, 2028.

2. Revision of the JICPA Code of Ethics

The JICPA has revised its Code of Ethics in response to changes in the domestic regulatory framework, while also taking into account revisions to the IESBA Code.

In the July 2022 revision, the JICPA undertook a fundamental restructuring of the framework of the JICPA Code of Ethics by integrating the guidance on independence, conflicts of interest, and non-compliance with laws and regulations (NOCLAR) into the JICPA Code of Ethics.

In addition, the independence requirements were strengthened. With respect to fees, where the audit client is a PIE, audit firms are required to disclose fee-related information, including audit and non-audit fees. Furthermore, where fees from a PIE audit client exceed, or are likely to exceed, 15% of the audit firm’s total fees for two consecutive years, an engagement quality review prior to the issuance of the auditor’s report is required as a safeguard, and disclosures relating to fee dependency is also required. Moreover, where fee dependency on a PIE audit client exceeds, or is likely to exceed, 15% for five consecutive years, the auditor is required to resign from the engagement after issuing the auditor’s report for the fifth year.

With respect to non-assurance services, the revised JICPA Code of Ethics provides that, where the audit client is a PIE, the audit firm or network firm shall not provide non-assurance services that may create a self-review threat.

Reflecting the revisions to the JICPA Code of Ethics, the Cabinet Office Ordinance on Audit Certification of Financial Statements, etc. was also amended to require the disclosure, in the auditor’s report, of information relating to fees received by the CPAs or audit firm (including persons and entities within the same network) from the audited entity, including its consolidated and non-consolidated subsidiaries.

The July 2024 revisions primarily included: (i) provisions relating to the definitions of listed entities and PIEs; (ii) provisions relating to the definition of engagement teams and group audit engagements; and (iii) provisions relating to technology (including amendments replacing the term “confidentiality obligation” with “confidentiality”). In addition, the July 2025 revisions introduced, among other changes, new ethical requirements applicable when the JICPA members provide tax planning services, including services involving tax planning, strategy development, and advice.

Further proposed revisions to the JICPA Code of Ethics were published in April 2026. The principal proposals include: (i) the introduction of new ethical requirements for sustainability assurance engagements; and (ii) new provisions relating to the use of the work of external experts.

3. Other Trends in Financial Reporting Systems

a. Responses to individual cases

Shares of domestic company A (Company A), a Japanese company whose principal business was the development and provision of services utilizing generative AI technology, were listed on the Tokyo Stock Exchange Growth Market in October 2024. In April 2025, the Securities and Exchange Surveillance Commission commenced a compulsory investigation of Company A on suspicion of false statements in its annual securities reports. In response, Company A established a third-party committee to investigate the possibility that its sales revenue had been overstated. In July 2025, Company A disclosed the investigation report received from the third-party committee, which revealed, among other findings, that most of the reported sales revenue from the fiscal year ended December 31, 2021, through the fiscal year ended December 31, 2024 was fictitious and lacked underlying economic substance. Subsequently, in August 2025, the Tokyo Stock Exchange delisted Company A’s shares.

An accounting fraud case involving Company A significantly undermined confidence in the financial reporting system. Notable features of the case included the use of circular transactions through sales agents, a change of audit firm during the IPO preparation process, and the inclusion of false information in the financial statements and other documents submitted as part of the listing application, which ultimately resulted in the company obtaining approval for listing.

In light of these characteristics, it was recognized that close cooperation among the principal gatekeepers involved in the IPO process, namely the stock exchange, the lead underwriter, and the audit firm, was essential. These gatekeepers were therefore expected to strengthen their capabilities in reviewing and auditing fraud-related risks and to promote information dissemination and awareness-raising activities directed at companies preparing for listing.

In December 2025, the TSE and JPX-R issued a report entitled *“Exchange Responses in Light of Accounting Fraud Cases at the Time of Initial Public Offerings.”*[52] The report stated that the Exchange would:

[52] JPX-R, “Exchange Responses in Light of Accounting Fraud Cases at the Time of Initial Public Offerings” https://www.jpx.co.jp/news/1020/t13vrt000000ciom-att/t13vrt000000cirn.pdf

(i) strengthen listing examinations based on identified fraud risks, including verifying the identity ad substance of suppliers and customers in business models that rely heavily on agents in view of the risk of circular transactions, and confirming with predecessor auditors the circumstances surrounding any change of audit firm during the IPO preparation period;
(ii) strengthen reviews of whistleblowing systems and enhance the collection and sharing of fraud-related information, including confirming the establishment of internal whistleblowing systems at IPO applicant companies and, in cooperation with IPO-related stakeholders, promoting awareness of the Exchange's whistleblowing channels among officers and employees of companies preparing for listing;
(iii) enhance awareness-raising activities for management, including strengthening communications with senior executives of IPO applicant companies regarding the responsibilities associated with being a listed company, with emphasis on integrity and fraud prevention, and confirming the effectiveness of frameworks for preventing fraud through interviews with outside directors and corporate auditors conducted a part of the listing examination process;
(iv) strengthen cooperation with IPO-related stakeholders; and
(v) improve the capabilities of the self-regulatory organization to assess fraud risks in listing examinations.

In March 2026, the Japan Securities Dealers Association published the "Guidelines for Underwriting Examinations in Light of Accounting Fraud Cases at the Time of Initial Public Offerings."[53] The guidelines identify matters to which lead underwriters should pay particular attention when conducting underwriting examinations. These include (i) procedures responsive to fraud risks, such as reviewing the status of suppliers, customers, subcontractors, and advertising activities, confirming, through discussions with predecessor auditors, the circumstances surrounding any change of auditors, and conducting interviews where concerns arise regarding management integrity or the issuer's responses during the underwriting review process; (ii) confirming the adequacy of internal whistleblowing arrangements and responding to information relating to fraud or misconduct, including reviewing the establishment of internal whistleblowing systems and the extent to which whistleblowing channels have been communicated within the organization; and (iii) making inquiries of representative directors, corporate auditors, and independent officers.

In January 2026, the JICPA published *"Initiatives to Enhance the Reliability of Audits Conducted by Registered Auditors of Listed Companies and Other Entities,"*[54] in which it announced measures including the strengthening the monitoring of Registered Auditors of Listed Companies and the enhancement of members' competencies through training programs. On the same date, the JICPA also issued *"Audit Responses in Light of Accounting Fraud Cases at Newly Listed Companies and*

[53] Japan Securities Dealers Association, "Guidelines for Underwriting Examinations in Light of Accounting Fraud Cases at the Time of Initial Public Offerings" https://www.jsda.or.jp/shijyo/seido/jishukisei/web-handbook/105_kabushiki/files/20260318_shinkijoujouhikiukeshinsa.pdf
[54] JICPA, "Initiatives to Enhance the Reliability of Audits Conducted by Registered Auditors of Listed Companies and Other Entities" https://jicpa.or.jp/news/information/files/5-99-0-2-20260126.pdf

Other Entities (Notice),"[55] which sets out considerations for audit engagements relating to companies seeking an initial public offering. These considerations include the evaluation of risks arising from auditor changes and new client acceptance, understanding the entity's business model, identifying and assessing fraud risks, responding to assessed risks, maintaining professional skepticism regarding management integrity, consulting on technical matters, and communicating with corporate auditors and audit committees. In addition, in March 2026, the JICPA published *"Treatment of Confidentiality Obligations in Relation to Interviews Conducted by Stock Exchanges and Other Organizations in Connection with Initial Public Offerings."*[56] This publication explains confidentiality provisions that may be included in audit engagement letters to enable auditors to respond appropriately to interviews conducted by stock exchanges and other relevant organizations.

Furthermore, in response to a series of accounting fraud cases involving listed Japanese companies, including Company A, the JICPA has advocated enhancing the content of the management confirmation letter submitted together with annual securities reports and other disclosure documents in order to strengthen management's awareness of its responsibility for appropriate disclosure.

The CPAAOB is closely monitoring the impact of the implementation of the measures introduced in response to accounting fraud cases at the time of initial public offerings, including their implications for 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.

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 the fiscal year ended 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.

According to large-sized audit firms, among listed domestic companies with the fiscal year ended on March 2026, the number of companies planning to disclose their annual securities reports prior to their shareholders' meetings increased by approximately 40% compared with the previous year. While the majority of these companies plan to disclose their annual securities reports one or two days before their shareholders' meetings, an increasing number are expected to make such disclosures more than one week in advance.

[55] Same as footnote 52.
[56] JICPA, "Treatment of Confidentiality Obligations in Relation to Interviews Conducted by Stock Exchanges and Other Organizations in Connection with Initial Public Offerings" https://jicpa.or.jp/specialized_field/files/0-53-0-2-20260318.pdf

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

- There are concerns that, if annual securities reports are disclosed substantially earlier than the current practices of disclosure only a few days before shareholders' meetings, audit schedules would need to be significantly accelerated. This could cause audit work for listed audit clients to become concentrated within a limited period and raise concerns about securing sufficient audit resources and maintaining audit quality.
- As the audit period for annual securities reports may need to be shortened, it will be necessary not only to identify audit procedures that can be performed earlier, but also to advance discussions and resolve issues relating to new disclosure requirements and emerging topics earlier than in the past.
- Listed audit clients should consider the scheduling of shareholders' meetings and the preparation of annual securities reports from the perspective of overall optimization and establish an appropriate framework for cooperation with their auditors, based on an agreed reporting and audit timetable.
- Even where listed audit clients advance their reporting schedules, audit firms generally consider it feasible to accelerate the corresponding audit schedules.
- If annual securities reports are disclosed one or two days before shareholders' meetings, the impact is not expected to be significant. However, if disclosure is advanced to as early as three weeks before shareholders' meetings, changes in the preparation timetable for annual securities reports may affect the manner in which audit engagements are conducted.
- For audit teams responsible for listed audit clients planning to disclose annual securities reports more than one week before shareholders' meetings, firms have individually confirmed the status of their responses, including why disclosure was being accelerated, whether sufficient measures have been implemented in advance in cooperation with the companies to ensure adequate audit resources, and whether plans existed for further accelerating disclosure or moving toward integrated disclosure of annual securities reports and business reports for the following year.
- If filing dates are accelerated excessively, there is a concern that insufficient time may be available to perform year-end audit procedures. Although audit firms intend to respond through the earlier performance of audit procedures and greater digitalization, some consider that postponing the dates of shareholders' meetings may be necessary to ensure that sufficient audit time is available.

Some large-sized audit firms also expressed the view that, if annual securities reports are expected to be disclosed more than three weeks before shareholders' meetings, relevant government agencies and other stakeholders would need to make further efforts to create an environment conducive to the integrated disclosure and consolidation of annual securities reports and business reports, as well as to the postponement of shareholders' meeting dates.

Large-sized audit firms described their responses to, and views on, the integrated disclosure and consolidation of annual securities reports and business reports, and the related impact on audit engagements, as follows:

- Dedicated portal sites have been established to provide their personnel with the latest information and to make available materials for communication with listed audit clients.
- Cross-functional project teams comprising personnel responsible for contracts, accounting and disclosure, auditing, and engagement quality reviews have been established within the quality management divisions to support audit teams in responding to integrated disclosure initiatives.
- Support is being provided to listed audit clients that plan to implement integrated disclosure or postpone shareholders' meeting dates.
- Where listed audit clients seek advice on integrated disclosure and consolidation, audit firms determine an appropriate response on a case-by-case basis, taking into account each client's circumstances and the potential implications for the audit engagement, etc.
- As progress toward integrated disclosure and consolidation among listed audit clients remains limited, audit firms are continuing to address matters individually while also developing tools such as standard contractual documentation and disclosure checklists.
- During the first year of transition to integrated disclosure, additional efforts are expected to be required, including the reorganization of disclosure information and the adjustment of audit schedules. From the second year onward, however, efficiencies in the audit process and a more balanced distribution of audit hours are expected as a result of document consolidation.
- Consolidating disclosure documents into a single reporting package is expected not only to improve audit efficiency but also to reduce the burden on listed audit clients in preparing disclosure materials, thereby facilitating the disclosure of annual securities reports before shareholders' meetings.

The CPAAOB will continue to monitor the impact of the disclosure of annual securities reports prior to shareholders' meetings, as well as the integrated disclosure and consolidation of annual securities reports and business reports, on audit engagements and related 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 ("the 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 a leasing company purchases an asset on behalf of the lessee and leases it to the lessee, where cancellation during the lease term is not permitted and substantially all of the acquisition cost of the asset and related expenses are recovered through lease payments. An operating lease is a lease transaction that has characteristics similar to those of an ordinary rental agreement. Under the former standards, only finance leases were recognized as assets and liabilities on the balance sheet.

However, in January 2016, the 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 conducted extensive 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 the new lease accounting standards, entities are, in principle, required to recognize on the balance sheet all assets and liabilities arising from leases. The standards also replace the term "lease transactions" with "leases. The new lease accounting standards apply to companies subject to disclosure under the FIEA, including listed domestic 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 contract to determine whether it constitutes a lease. They are also required to maintain documentation of their assessments and conclusion regarding whether a contract is a lease. This requirement is expected to be particularly burdensome for companies operating multi-store business models, such as retailers and restaurant operators, as a large number of leasehold property contracts that have previously accounted for as rental transactions may need to be assessed and may be determined to constitute leases under the new standards.

Accordingly, companies subject to the new lease accounting standards are required to implement accounting systems and revise their business processes in order to identify transactions within the scope of the new standards and ensure appropriate accounting treatment in accordance with those standards. In particular, identifying transactions subject to the new standards is expected to impose a significant workload on affected companies. In light of these circumstances, although early adoption has been permitted for fiscal years beginning on or after April 2025, few companies have elected to adopt the standards early.

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 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. In addition, as the use of generative AI is expected in areas such as the identification and evaluation of transactions subject to the standards, developments relating to its utilization will also warrant close attention.

C. Trends in Sustainability Disclosure and Assurance

1. Trends in the Development of Disclosure and Assurance Frameworks for Sustainability-related Information

Until recently, sustainability-related information has been disclosed primarily on a voluntary basis through integrated reports and other corporate publications. However, in Japan, disclosure of sustainability-related information in annual securities reports became mandatory for fiscal years ending on or after March 31, 2023. As the specific content of such disclosures has largely been left to the judgment of individual companies, concerns have been raised regarding the comparability of disclosed information. Consequently, efforts to establish disclosure standards have progressed both domestically and internationally. At the international level, the ISSB issued the IFRS Sustainability Disclosure Standards (ISSB Standards)[57] in June 2023. In response, jurisdictions around the world have been developing regulatory frameworks aligned with these standards. In Japan, the Sustainability Standards Board of Japan (SSBJ) published sustainability disclosure standards in March 2025 that are functionally aligned with the ISSB standards (SSBJ Standards).

Third-party assurance is also considered beneficial for enhancing the reliability of sustainability-related information. Against the backdrop of growing demand for a global benchmark capable of supporting consistent, high-quality assurance of sustainability-related information, the IAASB issued ISSA 5000 in November 2024. Although ISSA5000 is designed to be applicable to all assurance practitioners and not limited to CPAs and audit firms, it requires compliance with quality management standards at least equivalent to ISQM1 and ethics and independence requirements at least equivalent to the IESBA Codes as fundamental prerequisites for the delivery of high-quality sustainability assurance engagements that serve the public interest.

Given these circumstances, the Financial System Council's Working Group on Disclosure and Assurance of Sustainability-related Financial Information (Sustainability WG) conducted discussions on the future framework for sustainability-related disclosure and assurance in Japan. The Sustainability WG published an Interim Discussion Paper in July 2025, followed by its Final Report in January 2026.

The Interim Discussion Paper proposed a phased approach requiring Prime Market-listed companies meeting specific market capitalization thresholds to prepare annual securities reports in accordance with the SSBJ Standards.[58] Reflecting this proposal, the Cabinet Office Ordinance on Disclosure of Corporate Affairs and related regulations were amended in February 2026.

The Final Report presented the broad direction of the assurance framework, including: (i) mandatory assurance beginning one year after the initial application of the SSBJ Standards; (ii) limitation of the scope of assurance during the first two years to specified sustainability-related information,[59] with

[57] IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* (IFRS S1) and IFRS S2 *Climate-related Disclosures* (IFRS S2)
[58] Taking into account the periods for preparation for companies, the implementation roadmap provides for mandatory application of the SSBJ Standards beginning with fiscal years ending on March 2027 for companies with a market capitalization of JPY 3 trillion or more, March 2028 for companies with a market capitalization of JPY 1 trillion or more, and March 2029 for companies with a market capitalization of JPY 500 billion or more.
[59] During the first two years, the scope of assurance is limited to disclosures relating to Scope 1 and Scope 2 greenhouse gas (GHG) emissions, governance, and risk management.

possible expansion after the third year in light of international developments and other factors; and (iii) adoption of limited assurance as the required assurance level, with no planed transition to reasonable assurance. The Report also proposed a registration system for assurance providers. Under this framework, both audit firms and non-audit firms would be eligible for registration, provided that they satisfy prescribed registration requirements and perform assurance engagements in accordance with international standards such as ISSA5000. In addition, the Report outlined key registration requirements, including the establishment of appropriate personnel and system of quality management, and indicated that the FSA would be responsible, at least initially, for the inspection and oversight of registered assurance providers.

Following these recommendations, legislative efforts have also progressed. In April 2026, a bill to amend the FIEA and related legislation was submitted to the 221st session of the National Diet as part of the process toward institutionalizing the new framework. Furthermore, with respect to third-party assurance, the Sustainability Assurance Subcommittee was established under the Business Accounting Council in April 2026 to deliberate on and examine the development of standards that are aligned with international standards. The Subcommittee has since been conducting broad-based discussions regarding the framework for assurance standards and related requirements that would be equivalent to internationally recognized standards.

While regulatory frameworks for the disclosure and assurance of sustainability-related information have continued to develop in other jurisdictions, there have also been moves to review and simplify such frameworks in response to concerns about increasing compliance costs for companies and potential impacts on international competitiveness.

For example, in the European Union, the Corporate Sustainability Reporting Directive (CSRD), which entered into force in January 2023, requires the disclosure of sustainability-related information and the provision of limited assurance by an independent third party. The requirements began to apply to certain companies from the 2024 financial year. Subsequently, in February 2025, the European Commission published the Omnibus Package, a set of legislative proposals aimed at simplifying sustainability-related regulations, and until February 2026, these proposals have been progressively approved and adopted by the European Parliament and the Council of the European Union. As a result, a number of measures were introduced, including the simplification of the European Sustainability Reporting Standards (ESRS), a reduction in the number of companies subject to the requirements through revisions to the applicable thresholds, and the postponement of the implementation timeline for companies that had not yet become subject to the reporting obligations. In addition, the European Union clarified that it would not proceed with a future transition from limited assurance to reasonable assurance.

In the United States, the SEC adopted its final rule on climate-related disclosure in March 2024. However, implementation of the rule was suspended following a series of legal challenges. Subsequently, under the current Republican administration, momentum grew for a reconsideration of

climate-related disclosure requirements, and in May 2026, a proposal was published to rescind the rule.

Meanwhile, in Australia, regulatory initiatives have continued to advance, including the introduction of mandatory climate-related disclosures and the development and implementation of third-party assurance standards.[60] As a result, approaches to sustainability-related disclosure and assurance are becoming increasingly diverse across jurisdictions. Developments among IFIAR member jurisdictions are discussed in "I. Monitoring by the CPAAOB, C. Cooperation with International Organizations Related to Auditing, 1. Participation in International Discussions through IFIAR, d. Responses to the Institutionalization of Sustainability-related Disclosure and Assurance".

2. Response by Audit Firms

Given their experience in providing assurance through financial statement audits, audit firms are expected by investors and other stakeholders to play an important role in the reliability of sustainability-related information. The following section outlines developments in sustainability assurance practices among audit firms, categorized by firm size.

a. Large-sized Audit Firms

Large-sized audit firms, either directly or through their group entities, provide advisory services relating to sustainability-related disclosures as well as voluntary assurance engagements on sustainability-related information. To support these activities, they have established dedicated functions responsible for promoting sustainability assurance engagements, facilitating collaboration between audit practices and specialists in non-financial reporting, and providing opportunities for audit professionals to participate in sustainability assurance engagements in order to gain practical experience in this area.

With respect to assurance procedures under ISSA5000, audit firms have been developing methodologies and guidance in collaboration with their global networks. In some cases, Japanese professionals have been assigned to global development teams responsible for designing assurance methodologies. Many firms have also begun using global platforms and tools developed within their networks to improve the efficiency and standardization of sustainability assurance engagements. In addition, firms have been progressively enhancing their quality management frameworks for sustainability assurance engagements, including the establishment of dedicated functions responsible for oversight and quality management.

Large-sized audit firms generally have more advanced human resource development programs than mid-tier and small and medium-sized audit firms. Many have established structured training programs that combine formal learning with practical experience and require audit professionals to complete these programs as part of the firms' mandatory training requirements. Some firms have also introduced internal certification programs for sustainability disclosure and assurance professionals.

[60] In Australia, mandatory disclosure requirements currently apply only to climate-related information. The assurance standards have been developed based on ISSA5000, which covers assurance engagements for all types of sustainability-related information. The framework requires limited assurance initially and provides for a future transition to reasonable assurance.

b. Mid-tier Audit Firms

Mid-tier audit firms generally intend to perform sustainability assurance engagements directly, rather than through group entities, and have established dedicated departments, committees, or other organizational structures to promote such services. Many firms are considering the systems, internal policies, and procedures necessary to undertake sustainability assurance engagements. Approximately half of the firms have undertaken voluntary assurance engagements relating to sustainability-related information. In addition, some firms utilize advisory entities within their groups to provide support services for sustainability-related disclosures, enabling them to accumulate practical experience and expertise through such engagements. To strengthen human resources, firms are fostering personnel with specialized sustainability-related knowledge through internal training programs and support personnel in obtaining external sustainability-related qualifications.

Mid-tier audit firms also actively collaborate with global networks, including the collection of information on international developments and the provision of training materials. Some firms receive support from their global networks or from member firms in other jurisdictions with established expertise in sustainability assurance, including assistance in developing methodologies and conducting engagements. Others, however, report that they do not receive such support from their global networks.

c. Small and Medium-sized Audit Firms

Through the collection of reports conducted in PY2025, the CPAAOB examined the status of initiatives relating to assurance engagements for non-financial information.[61] Reports collected from the firms showed that a substantial majority of firms responded that they were either “interested in assurance engagements relating to non-financial information but have not yet undertaken specific consideration” or “not interested in such engagements and do not intend to provide them even if approached by clients.” Many firms explained that they had not commenced detailed consideration because none of their audit clients were currently subject to mandatory third-party assurance requirements. Other firms cited resources constraints as a challenge to undertaking such work.

On the other hand, firms that responded that they were “interested in assurance engagements relating to non-financial information and were conducting specific internal assessments, including information gathering,” tended to be undertaking initiatives similar to those of mid-tier audit firms, although they had not yet accepted any such assurance engagements. For example, most of these firms reported collecting information on domestic and international developments and developing personnel with specialized expertise. Specific initiatives included participation in training programs organized by the JICPA or global networks, in-house training sessions involving external experts, and support for personnel seeking external sustainability-related qualifications. Some firms also participate in committees established by the JICPA, such as the Sustainability Information Support Committee for Small and Medium-sized Audit Firms. From an organizational perspective, several firms have established project teams or committees to examine issues associated with providing sustainability

[61] The collection of reports covered 44 small and medium-sized audit firms.

assurance engagements and to consider the development of the necessary internal infrastructure.

In July 2025, the JICPA established the Sustainability Capacity Building Council as the body responsible for promoting competency development relating to sustainability-related disclosure and assurance engagements among CPAs. The Council is currently considering measures to develop the knowledge, skills, and competencies necessary for CPAs to perform sustainability assurance engagements and related services appropriately.

In April 2026, the Council launched the JICPA Professional Program in Sustainability, a structured training framework designed to enable CPAs to systematically acquire the sustainability-related expertise expected of the profession. The JICPA develops and offers training courses aligned with the Program for its members. In addition, the JICPA makes such training courses available to audit firms that have established systematic training frameworks, including firms that already conduct training under comprehensive programs for the development of sustainability-related competencies in collaboration with member firms within their global networks. Participants who complete all courses required under the Program are eligible to receive a certificate of completion upon application. Large-sized audit firms have been steadily aligning their existing internal training programs with the JICPA Professional Program in Sustainability. Active utilization of the Program is also expected among mid-tier and small and medium-sized audit firms.

(Reference materials)

1. Links to monitoring-related documents

Basic Policy for Monitoring Audit Firms
https://www.fsa.go.jp/cpaaob/english/oversight/20261030/20261030.html

Basic Plan for Monitoring of Audit Firms (PY 2026)
https://www.fsa.go.jp/cpaaob/shinsakensa/kihonkeikaku/20260717/20260717.html

Basic Guidelines for Inspections
https://www.fsa.go.jp/cpaaob/shinsakensa/kihonkeikaku/20260630/20260630.html

List of Recommendations
https://www.fsa.go.jp/cpaaob/shinsakensa/kankoku/index.html

Framework for Inspection/Supervision of Foreign Audit Firms, etc.
https://www.fsa.go.jp/cpaaob/english/shinsakensa/kouhyou/20090914.html

Basic Guidelines on Information Requirements and Inspection on Foreign Audit Firms etc.
https://www.fsa.go.jp/cpaaob/english/oversight/20240626/20240626.html

Annual Report of the CPAAOB (FY 2025)
https://www.fsa.go.jp/cpaaob/shinsakai/reports/r07/gaiyou/gaiyou.html

Case Report of Audit Firm Inspection Results (PY 2026)
https://www.fsa.go.jp/cpaaob/shinsakensa/kouhyou/20260717/20260717-2.html

Disclosure of inspection results, etc. to third parties
https://www.fsa.go.jp/cpaaob/shinsakensa/kouhyou/20260630/20260630.html

Self-Regulation Report -Quality Control Review System- (JICPA)
https://jicpa.or.jp/english/what-we-do/qc/#qualityControl3

2. Links to related organizations

Certified Public Accountants and Auditing Oversight Board (CPAAOB) website
https://www.fsa.go.jp/cpaaob/english/index.html

Financial Services Agency (FSA) website
https://www.fsa.go.jp/en/index.html

The Japanese Institute of Certified Public Accountants website
https://jicpa.or.jp/english/

Japan Exchange Group website
https://www.jpx.co.jp/english/

Sustainability Standards Board of Japan (SSBJ) website
https://www.ssb-j.jp/en/

US Public Company Accounting Oversight Board (PCAOB) website
https://pcaobus.org/

UK Financial Reporting Council (FRC) website

https://www.frc.org.uk/

International Forum of Audit Regulators (IFIAR) website

https://www.ifiar.org

International Federation of Accountants (IFAC) website

https://www.ifac.org

International Auditing and Assurance Standards Board (IAASB) website

https://www.iaasb.org

International Ethics Standards Board for Accountants (IESBA) website

https://www.ethicsboard.org

International Sustainability Standards Board (ISSB) website

https://www.ifrs.org/groups/international-sustainability-standards-board/



Certified Public Accountants and Auditing Oversight Board

https://www.fsa.go.jp/cpaaob/english/index.html