I. Monitoring by the CPAAOB

I. Monitoring by the CPAAOB

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.

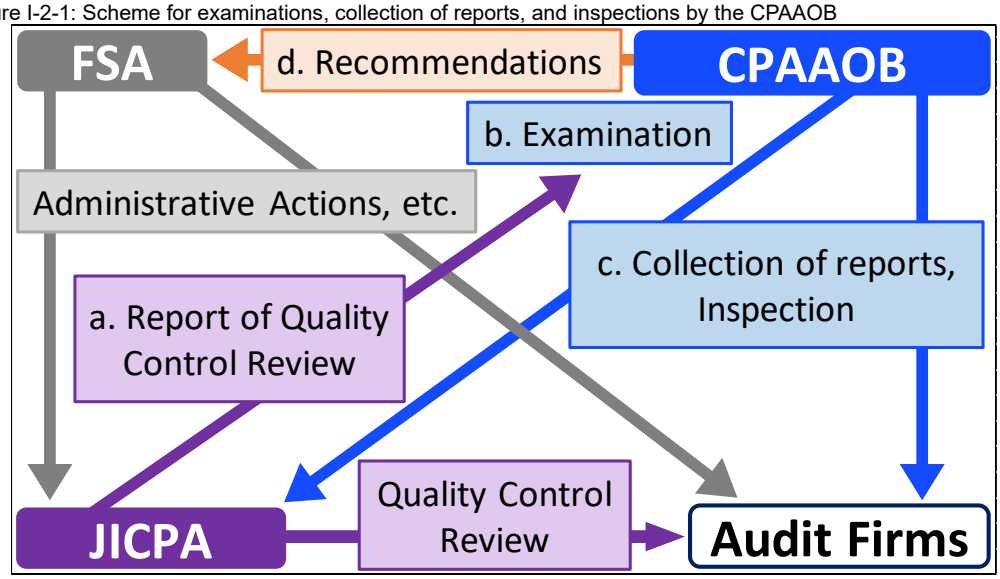
The CPAAOB receives and examines reports concerning Quality Control Review by the JICPA, collects reports from and conducts inspections of the JICPA and audit firms, etc. Based on the results of inspections etc., the CPAAOB recommends administrative actions or other measures to the FSA Commissioner when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

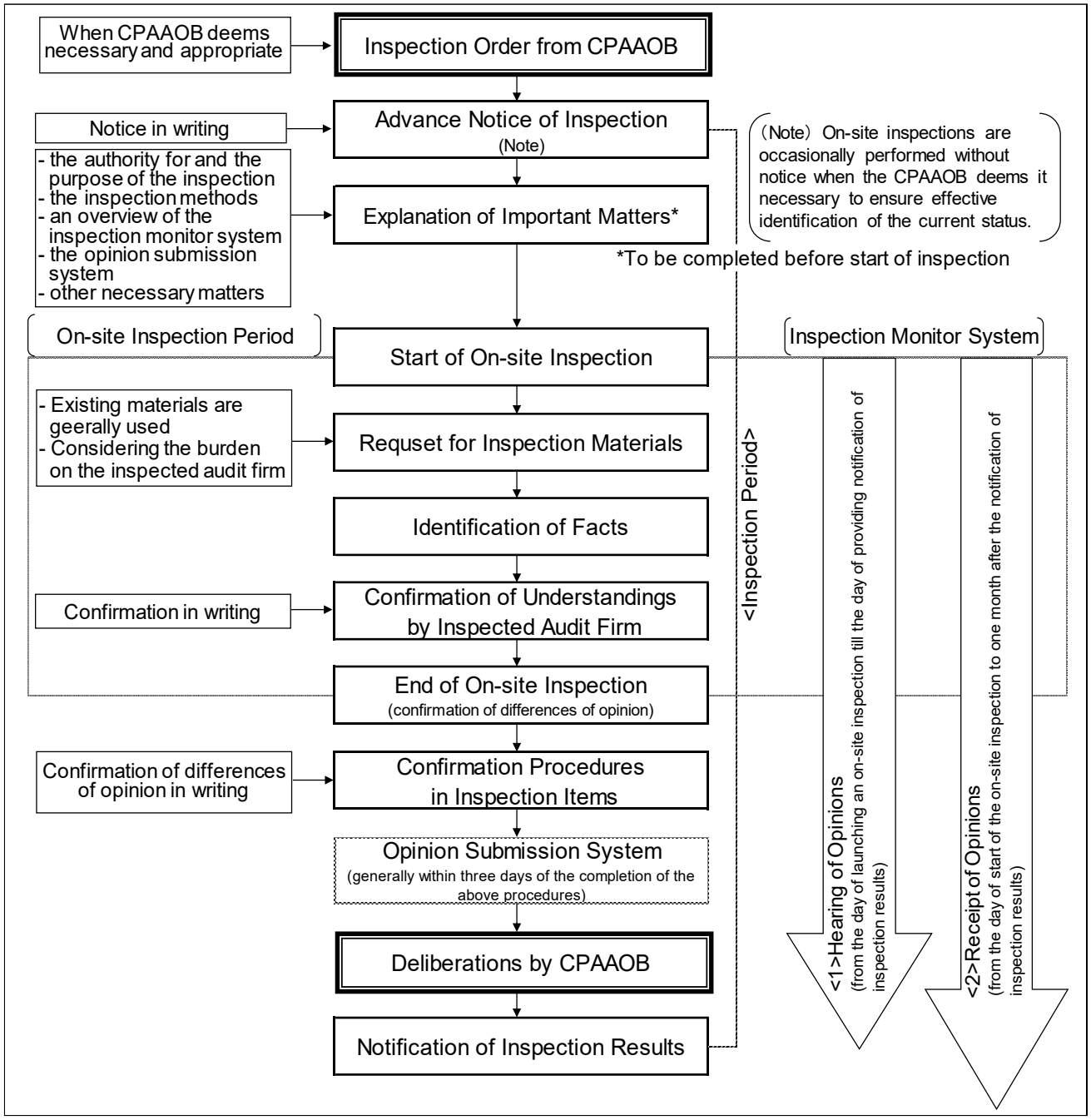
a. Overview

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.

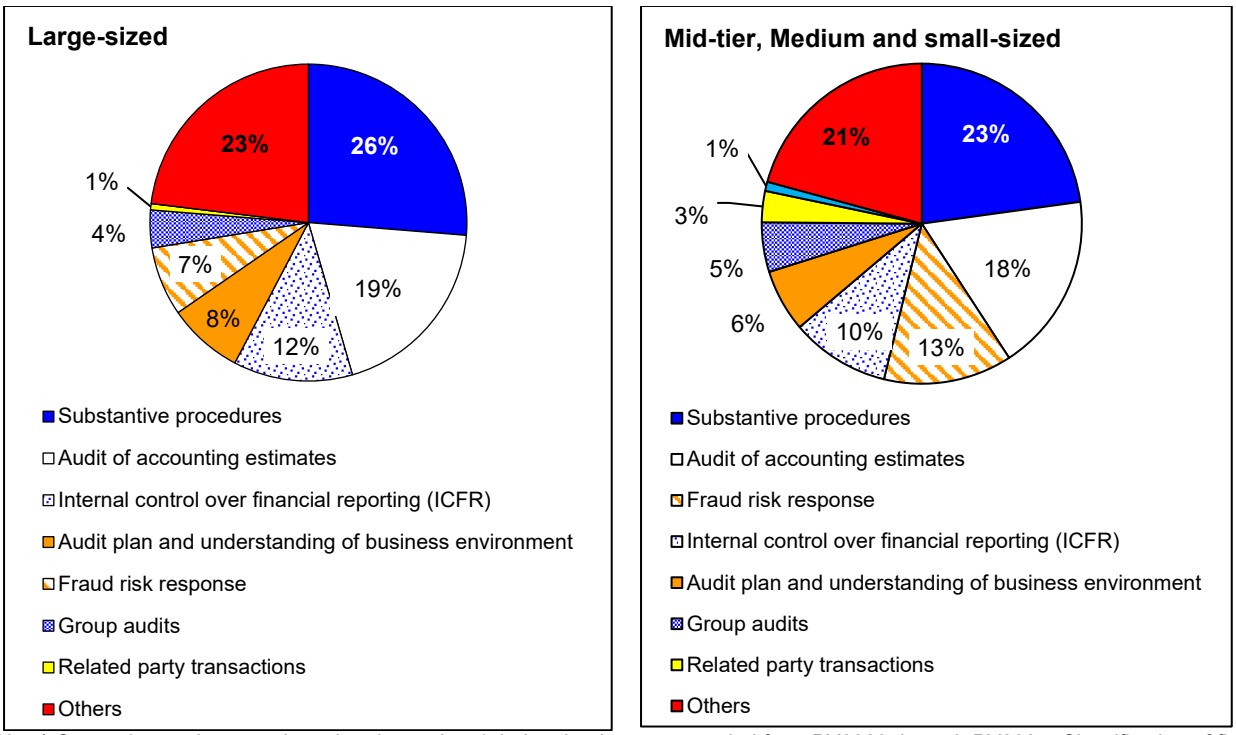
At small and medium-sized audit firms, challenges remain, including insufficient awareness of quality management on the part of CEO and quality management leaders, an inadequate

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

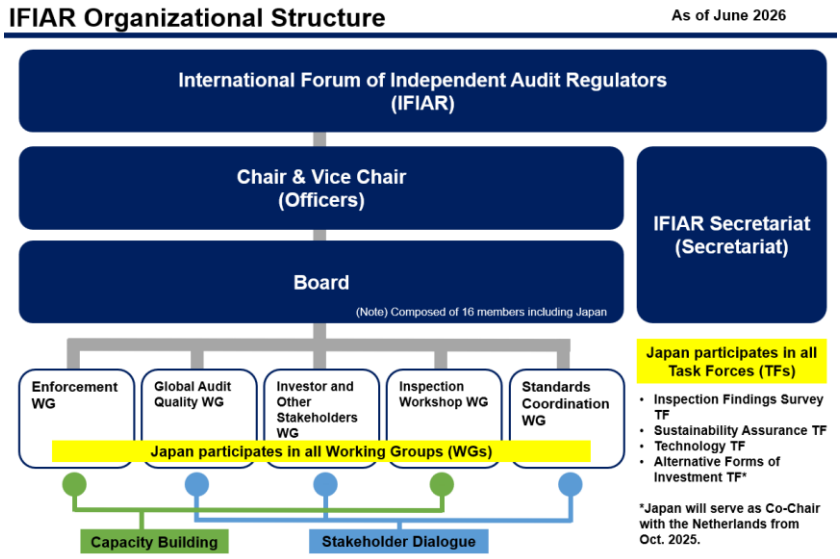
1. Participation in International Discussions through the International Forum of Independent Audit Regulators (IFIAR)

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.

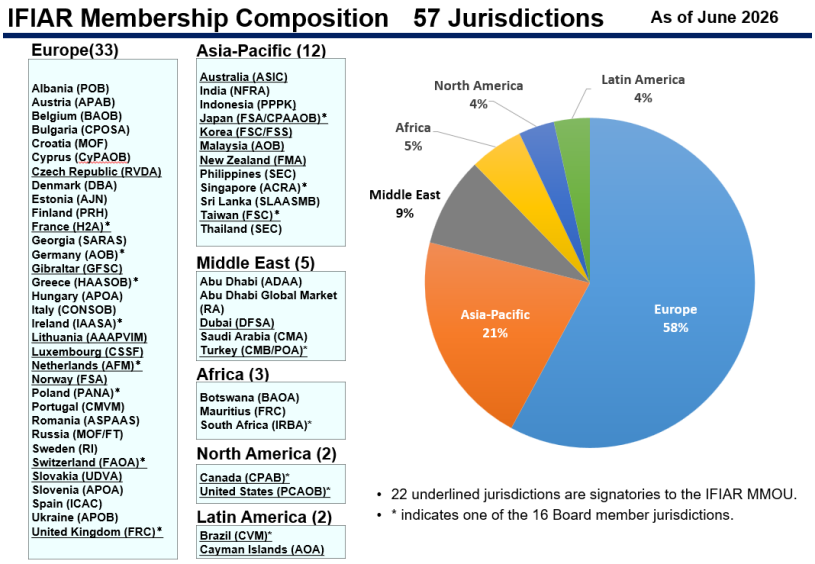
As business activities have become increasingly globalized, the importance of ensuring consistently high-quality audits worldwide has grown in order to maintain the reliability of corporate reporting. Reflecting this need, IFIAR's membership has expanded from 18 jurisdictions at the time of its establishment 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.