III. Operation of Audit Firms

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A. Operations Management System

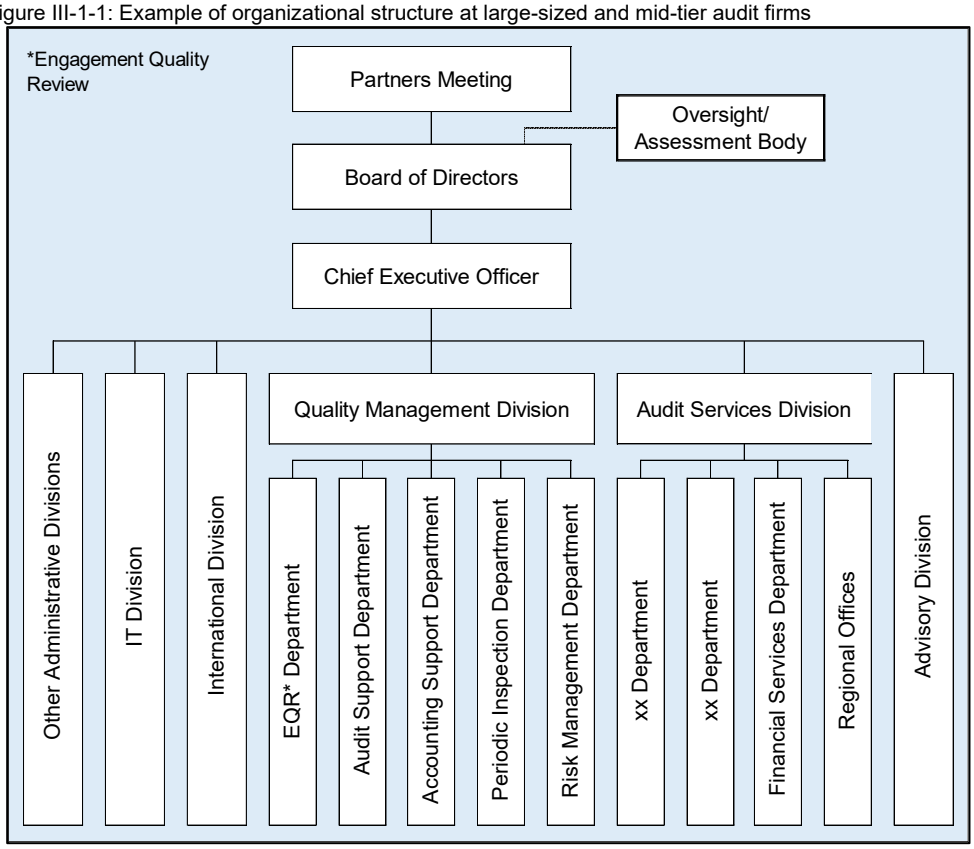
1. Organizational Structure of Audit Firms

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

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

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

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

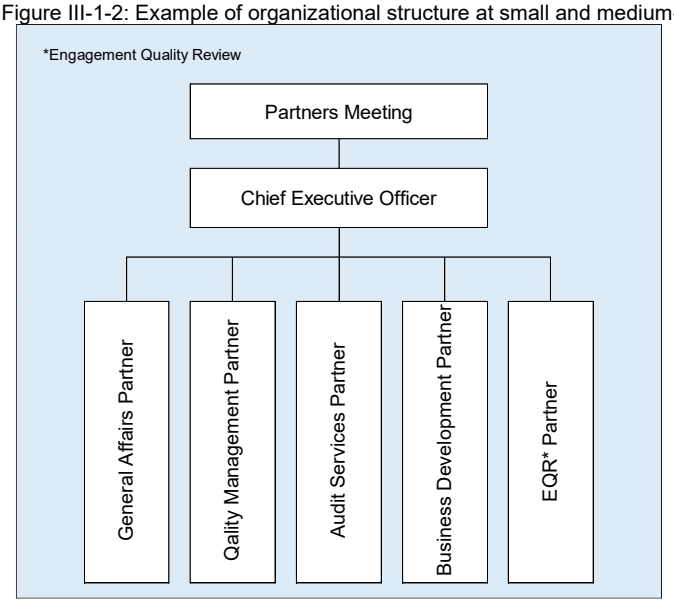


(Note) The organizational structure of mid-tier audit firms is often simpler than the structure shown in the above figure.
(Source) Prepared by the CPAAOB

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

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

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



(Source) Prepared by the CPAAOB

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

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

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

support audit engagements involving heightened audit risk.

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

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

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

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

2. Efforts in Response to Audit Firm Governance Code

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

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

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

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

Principle 2: Organizational structure (management functions)

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

Principle 3: Organizational structure (oversight/assessment functions)

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

Principle 4: Operation

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

Principle 5: Ensuring transparency

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

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

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

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

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

(i) Large-sized audit firms

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

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

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

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

(ii) Mid-tier audit firms

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

(iii) Small and medium-sized audit firms

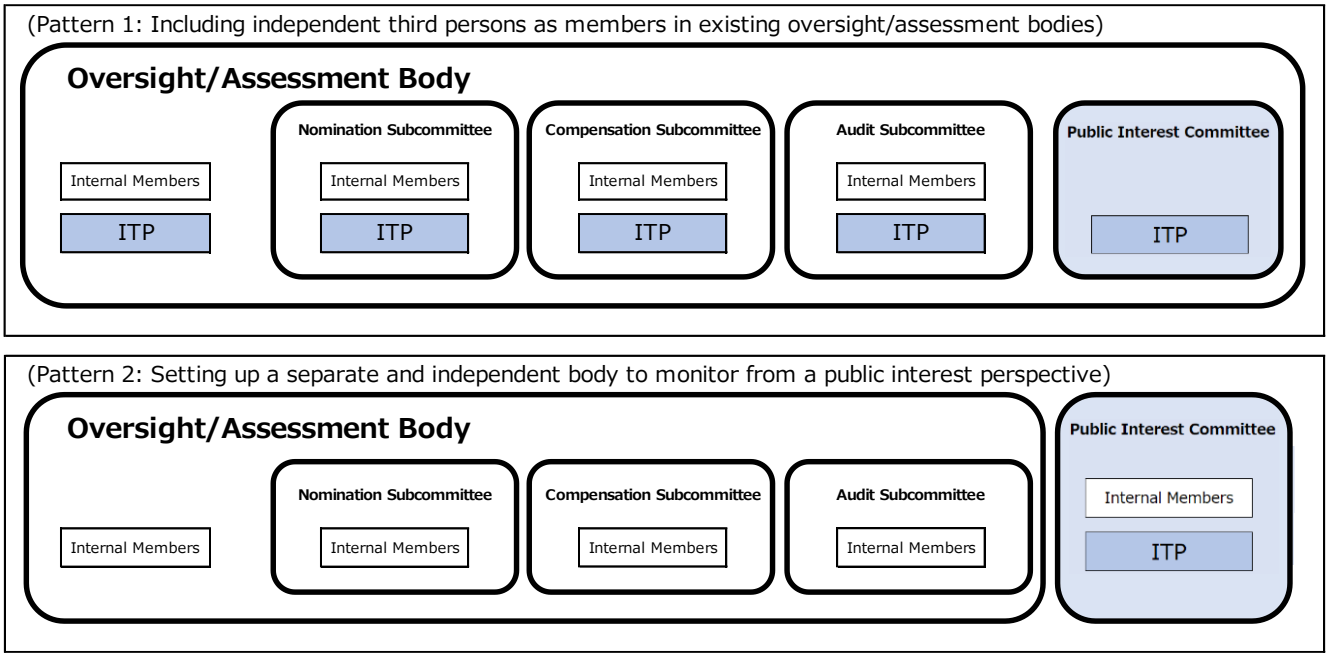
Of the 44 small and medium-sized audit firms subject to collection of reports, 23 have not established oversight/assessment bodies, citing their relatively small size and the effectiveness of mutual checks and balances among partners.

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

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

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

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



(Source) Prepared by the CPAAOB

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

(i) Large-sized audit firms

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

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

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

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

(ii) Mid-tier audit firms

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

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

(iii) Small and medium-sized audit firms

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

iii. Experience and expertise of independent third parties

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

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

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

b. Ensuring transparency (Principle 5)

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

(i) Large-sized audit firms

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

(ii) Mid-tier audit firms

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

(iii) Small and medium-sized audit firms

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

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

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

ii. Disclosure of AQIs

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

(i) Large-sized audit firms

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

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

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

(ii) Mid-tier audit firms

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

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

(iii) Small and medium-sized audit firms

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

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

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

(i) Large-sized audit firms

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

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

(ii) Mid-tier audit firms

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

(iii) Small and medium-sized audit firms

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

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

3. Human Resources of Audit Firms

a. Partners and full-time personnel

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

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

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

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

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

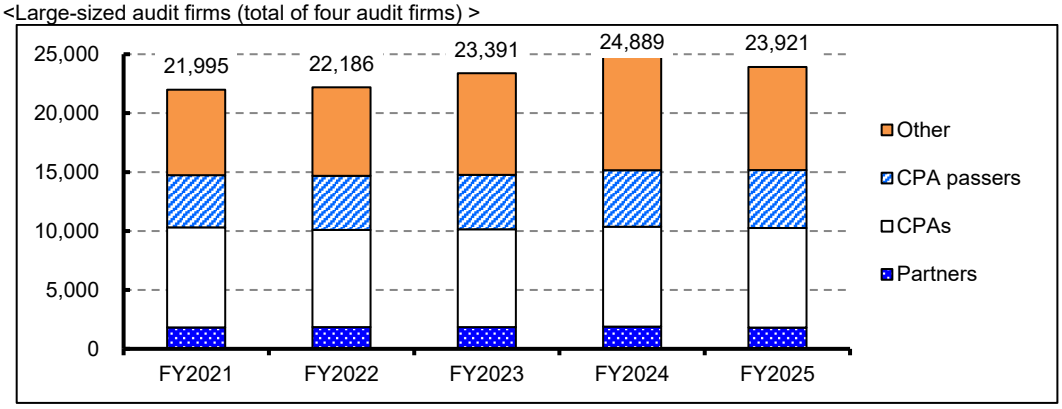
Taking into account the effects of the above-mentioned business transfer and merger, trends by personnel category indicate that the number of CPA exam passers, etc. has been increasing across audit firms of all sizes. The number of personnel other than partners and CPAs (including CPA exam passers) has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

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

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

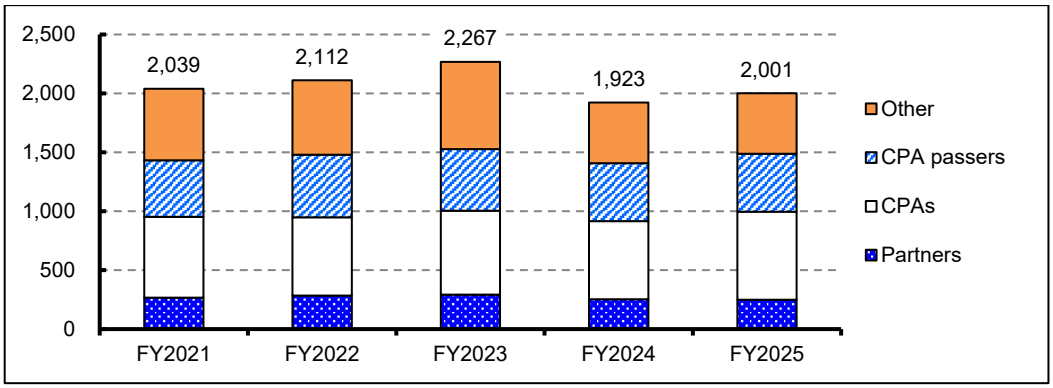
Figure III-1-5: Change in the number of partners and full-time personnel (unit: persons)

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



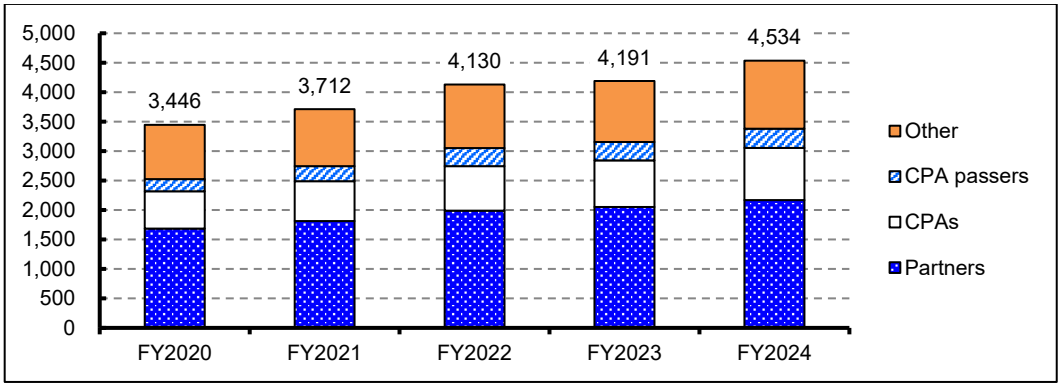
(Note) The number of PwC Kyoto in FY2023 is included in the mid-tier audit firms.
(Source) Prepared by the CPAAOB based on business reports submitted by audit firms.

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



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

<Small and medium-sized audit firms>



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

b. Side businesses of partners

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

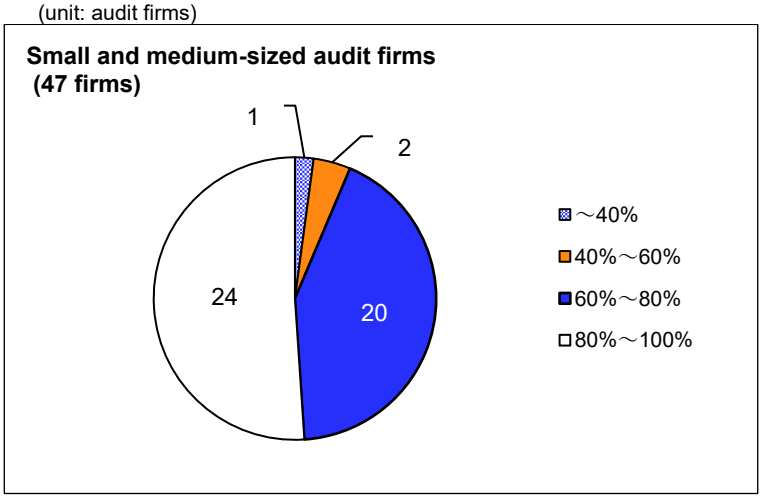
As with large-sized audit firms, some mid-tier audit firms do not permit a side business of

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

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

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

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



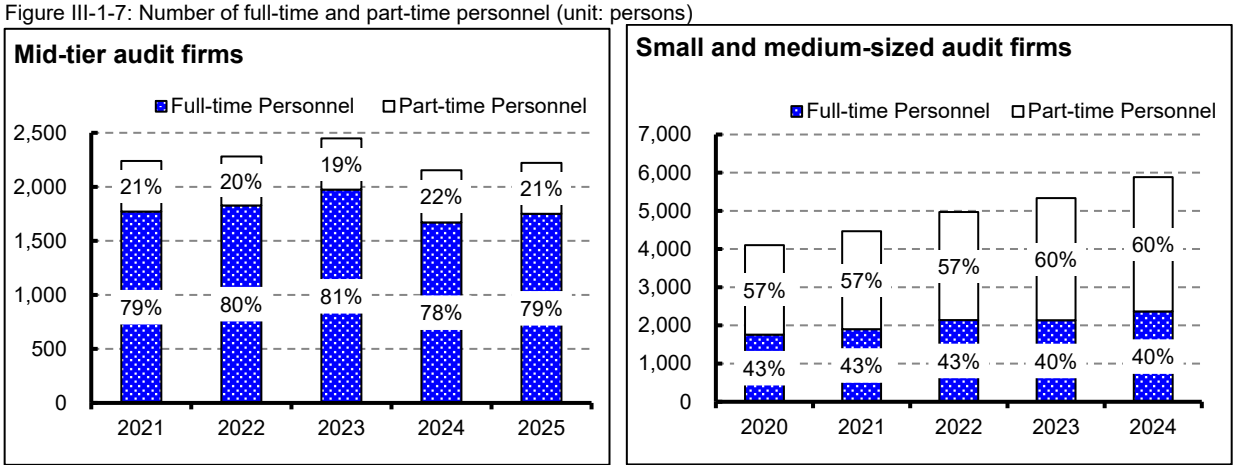
(Source) Prepared by the CPAAOB based on partners' declarations collected through the inspections and collection of reports in PY2024.

c. Part-time personnel

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

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

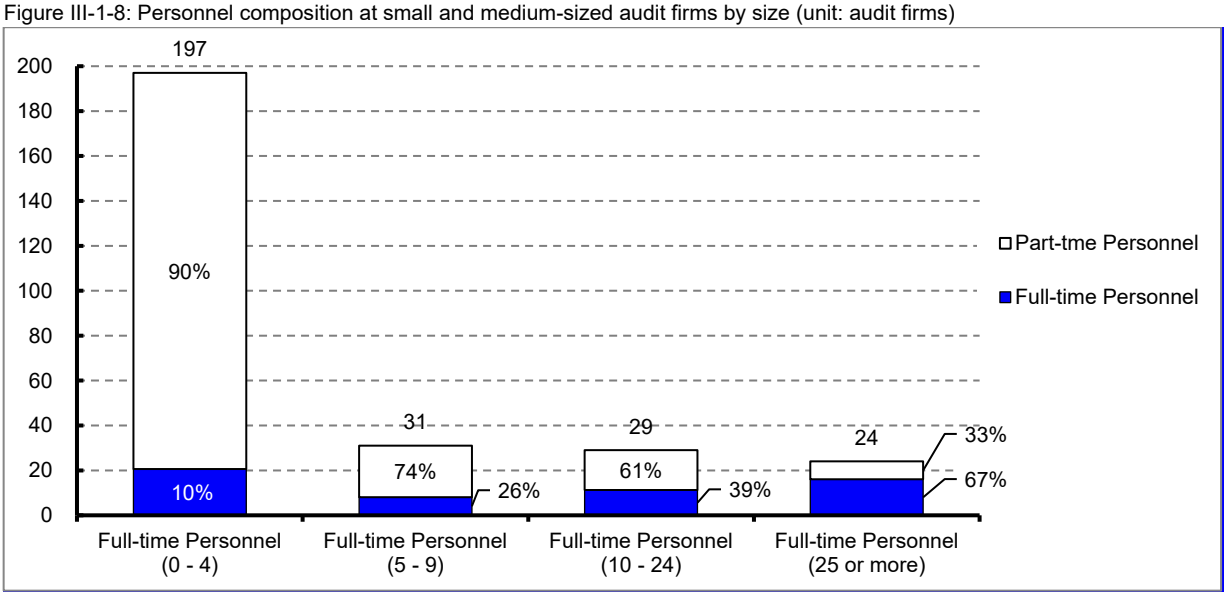
Figure III-1-7: Number of full-time and part-time personnel (unit: persons)



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

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

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



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

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

4. Organizational Structure for Providing Audit Services

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

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

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

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

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

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

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

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

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

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

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

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

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

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

<Structure of the engagement team in an IPO audit>

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

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

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

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

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

5. Organizational Structure for Supporting Audit Services

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

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

a. Overview of support systems

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

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

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

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

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

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

small and medium-sized audit firms.

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

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

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

b. Management of risk information

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

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

[Actions taken by risk management department]

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

[Actions taken by engagement teams]

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

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

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

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

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

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

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

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

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

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

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

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

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

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

6. Use of Technology in Audit and Cybersecurity Initiatives

a. Progress with the adoption of IT in audit engagements

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

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

i. Unification of audit tools

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

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

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

ii. Task automation (RPA[39])

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

iii. Sophistication and expansion of data analytics

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

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

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

iv. Use of AI in audit engagement

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

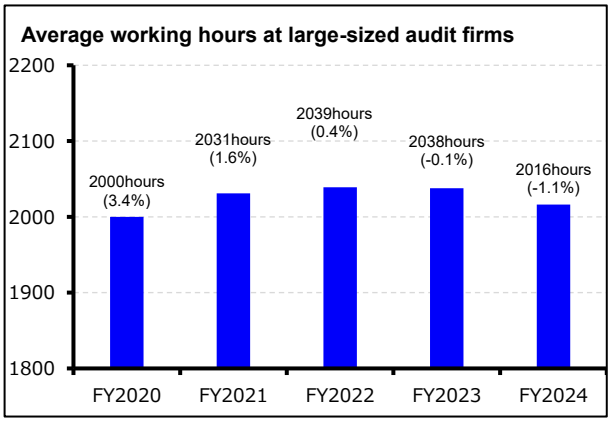
[40] “AI Discussion Paper - Preliminary Discussion Points for Promoting the Sound Utilization of AI in the Financial Sector” https://www.fsa.go.jp/en/news/2025/20250304/aidp_en.pdf

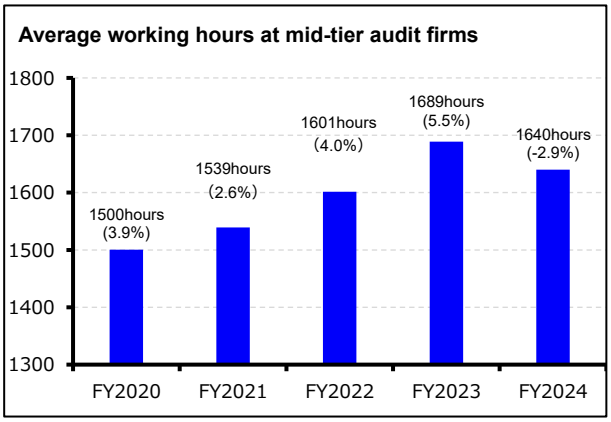
■ IT Tool Adoption and Its Impact on Average Working Hours at Large-sized and Mid-tier Audit Firms ■

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

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

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





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

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

b. Cybersecurity efforts

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

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

[Monitoring of audit firms]

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

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

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

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

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

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

7. Responses to Overseas Expansion of Companies

a. Group audits

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

i. Overview of group audits

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

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

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

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

ii. Risk assessment of the group financial statements

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

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

iii. Responding to the assessed risks of material misstatement

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

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

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

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

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

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

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

iv. Communication with component auditors

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

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

b. Status of affiliations with global networks

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

i. Membership of global networks

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

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

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

(Source) Prepared by the CPAAOB based on business reports

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

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

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

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

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

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

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

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

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

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

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

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

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

ii. Relationships with global networks

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

(i) Large-sized audit firms

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

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

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

by their global networks.

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

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

(ii) Mid-tier audit firms

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

(iii) Small and medium-sized audit firms

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

8. Treatment of Key Audit Matters

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

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

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

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

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

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

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

b. Responses by audit firms

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

i. Development of guidance for drafting KAMs

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

ii. Provision of training

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

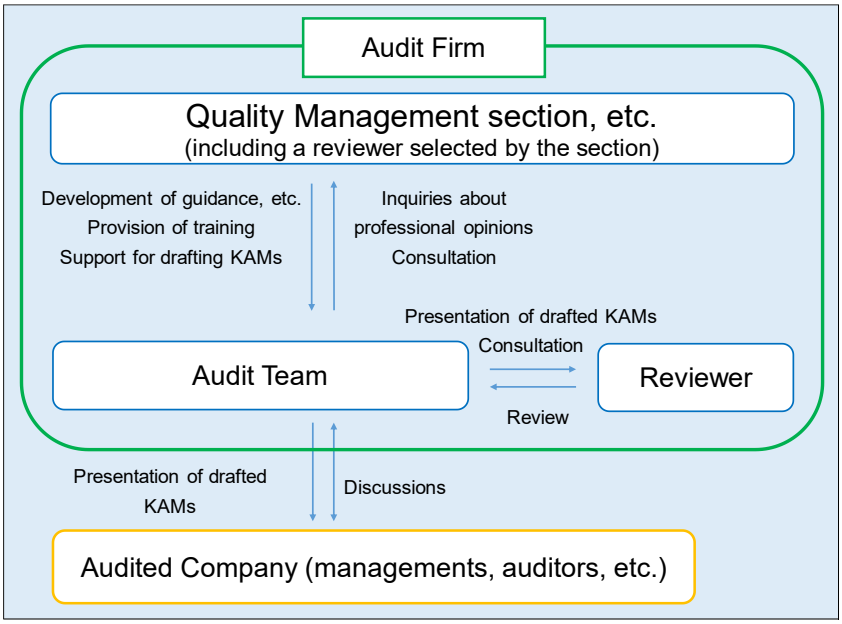
iii. Support for audit teams by the quality management function

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

iv. Reviews and technical consultations

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

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



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

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

9. Domestic Audit Firm Groups

a. Structure of domestic audit firm groups

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

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

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

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

b. Group operating revenues

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

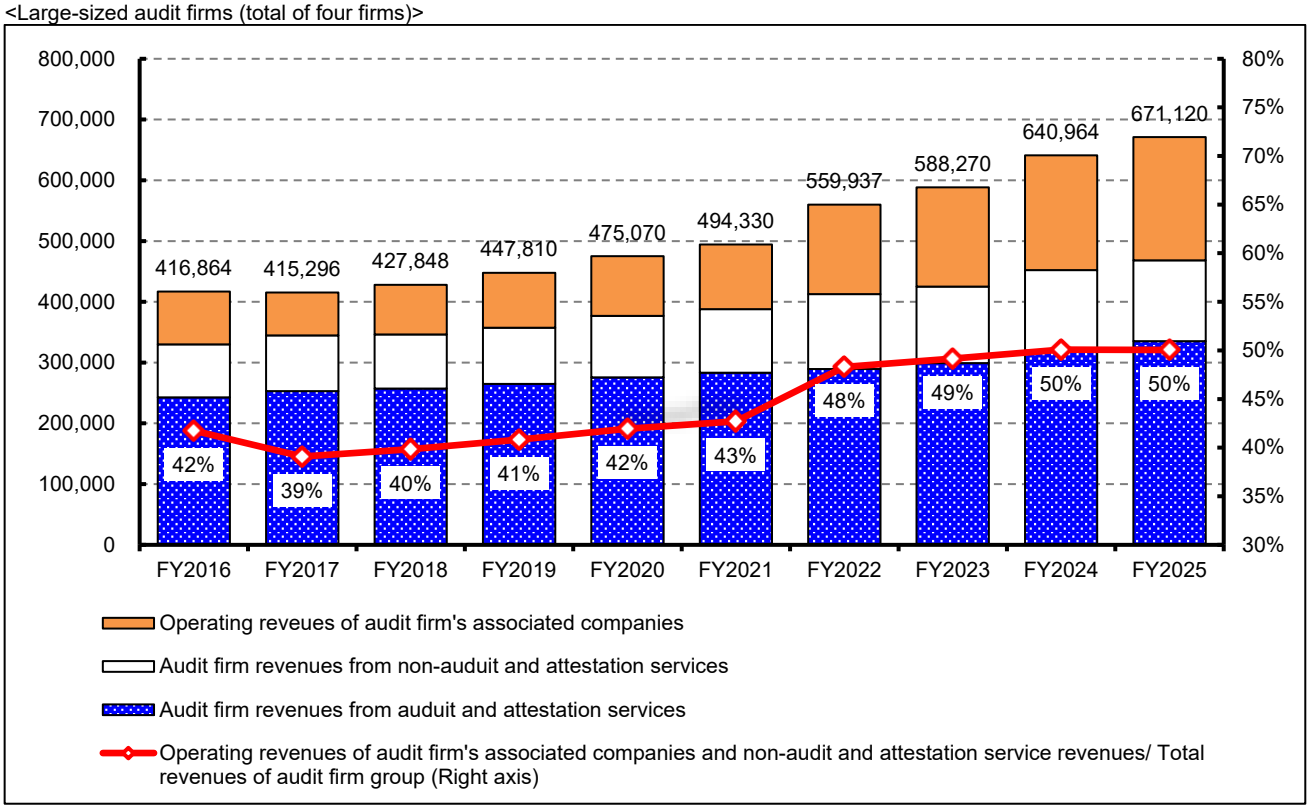
Among mid-tier audit firm groups, the ratio of non-audit and attestation revenue to total group revenue has remained lower than that of large-sized audit firm groups, staying roughly in a range between 10% and 14% from FY2016 through FY2025. The revenue structure of mid-tier audit firm groups differs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

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

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

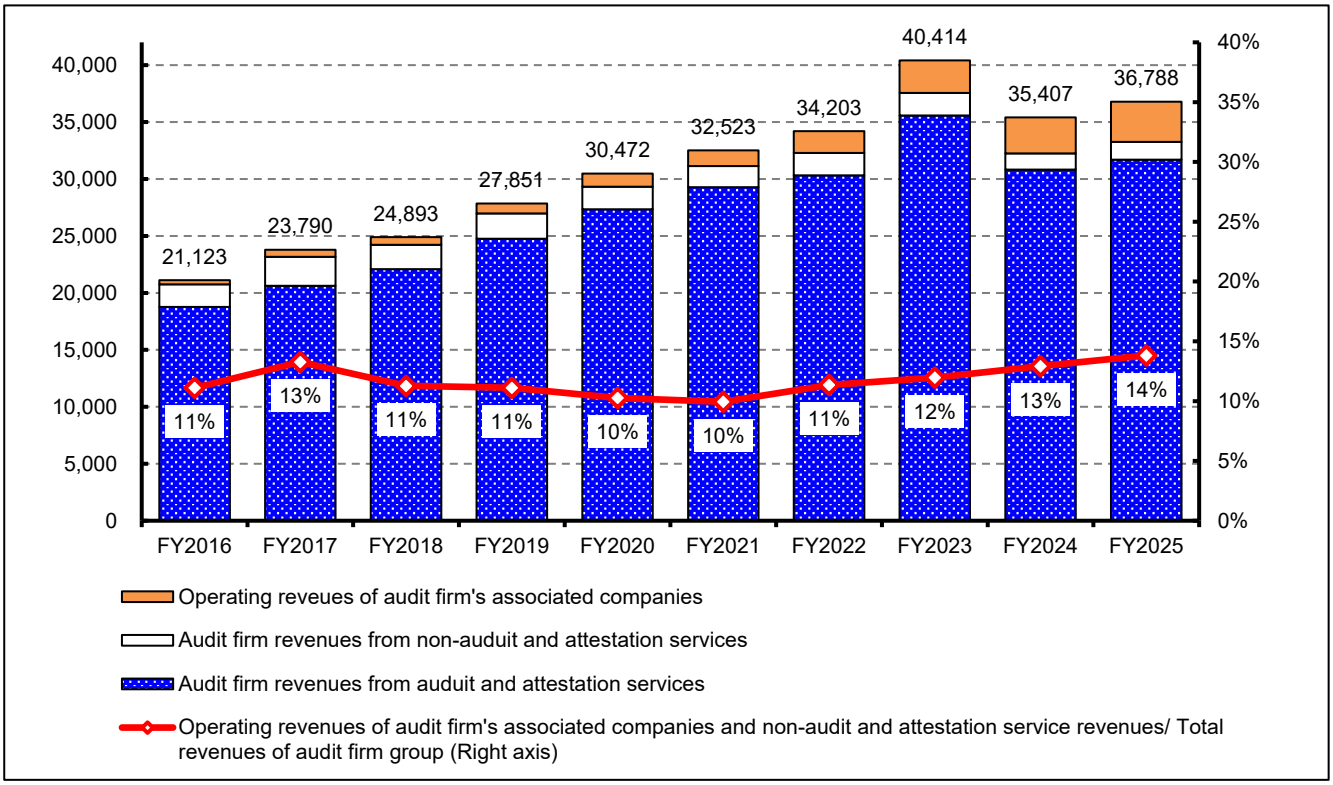
Figure III-1-21: Changes in the share of non-audit and attestation service revenues in audit firm group revenues (unit: million JPY (left axis))

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



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

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



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

B. Engagement Quality Reviews

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

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

a. Concurring review partner approach

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

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

b. Council approach

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

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

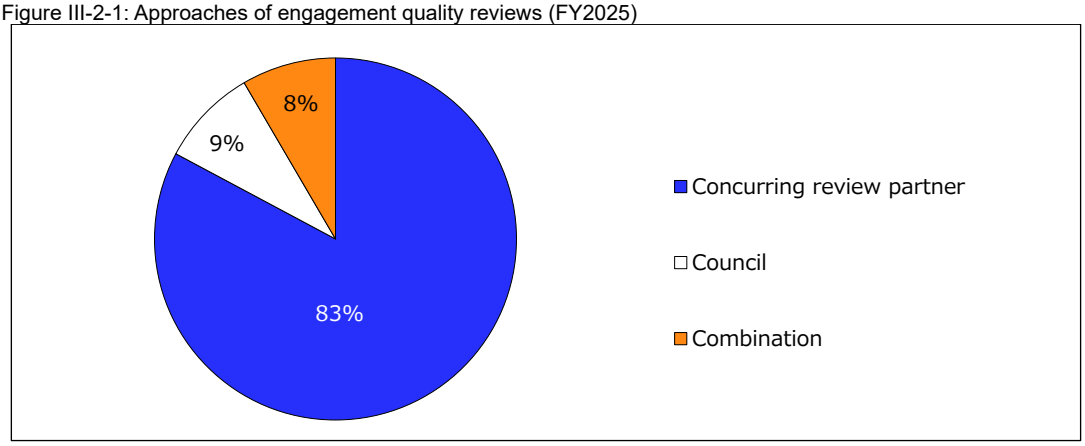
c. Combination approach

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

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

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

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



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

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

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

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

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

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

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

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

C. Monitoring of the System of Quality Management

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

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

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

1. Periodic Inspections of Audit Engagements

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

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

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

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

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

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

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

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

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

2. Utilization of Global Reviews

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

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

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

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

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

Figure III-3-2: Overview of global reviews

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

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

3. Monitoring Before Issuance of Audit Opinions

Among the responses designed to address quality risks within the audit firm's system of quality management, some firms have implemented monitoring activities targeting ongoing audit engagements prior to the issuance of the auditor's report, as illustrated in the application guidance to QCSCS 1, para 37 and A140.

Monitoring before the expression of audit opinions is conducted with respect to ongoing audit engagements. It is performed by reviewers designated by the quality management function or the audit operations division, with the objective of identifying quality management issues at an early stage and encouraging the audit team to take timely corrective actions.

Such monitoring is often focused on audit areas involving high risks, such as fraud risks or going concern, as well as audit areas in which deficiencies have been repeatedly identified through external inspections or periodic internal reviews, such as accounting estimates.

D. Development and Retention, Education and Training, and Evaluation of Professional Personnel

In order to maintain and improve audit quality, audit firms need to provide their professional personnel (including audit partners) with opportunities to acquire necessary expertise and also need to evaluate them appropriately. It is particularly important to train and properly evaluate the personnel who can exercise professional skepticism needed to detect accounting fraud. The CPAAOB examines, through its monitoring activities, including inspections, how audit firms recruit, develop, and assign personnel, as well as how they evaluate and determine the remuneration of partners and other personnel.

The following section describes initiatives undertaken for the development and retention of professional personnel, as well as the status of education and training, and performance evaluation.

1. Development and Retention of Professional Personnel

To deal with changes in the audit environment and the increasing sophistication and complexity of audit methodologies, large-sized and mid-tier audit firms have established medium- to long-term development strategies for personnel. They implement education and training programs and promote various development initiatives for personnel, including providing diverse professional opportunities that contribute to the growth and development of personnel as CPAs. (Figure III-4-1).

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

- Job rotations and interdepartmental transfers (including transfers to regional offices)
- Participation in quality management activities and provision of tax, advisory, and other non-attestation services
- Secondments to overseas member firms and overseas posting
- Secondments to organizations outside the audit firm (e.g., group firms, the JICPA and other professional organizations, commercial companies)

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

In addition, audit firms have implemented various initiatives aimed at improving staff retention, including the introduction of flexible working arrangements, such are remote work and flextime; the leveling of workloads (responsibilities of professional personnel) through the centralized management of assignments; the review of personnel evaluation systems, including compensation; and the presentation of diverse career paths through counseling, together with the provisions of work opportunities aligned with those career paths. Some audit firms also provide on-to-one on-the-job training for young staff members. Furthermore, some firms have introduced initiatives aimed at reducing turnover and leave-of-absence rates, including group counseling sessions involving peers to support employee motivation and mentor programs through which personnel can seek advice on personal concerns. In addition, some firms monitor turnover rates as an AQI while working to create an environment that enhances the attractiveness of audit work.

2. Education and Training of Professional Personnel

Audit firms are required to establish quality objectives related to ensuring that professional personnel are recruited, developed and retained, and that they possess the competence and capabilities to consistently perform high-quality engagements, including appropriate knowledge and experience relating to the engagements undertaken by the firm (QCSCS 1, para 31 (1)). To meet this requirement, audit firms have established education and training frameworks for professional personnel in proportion to their size (Figure III-4-2).

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

Large-sized and mid-tier audit firms	・ Establishing a training section within the human resources department to design and operate training programs for each job classification and level of experience ・ Implementing a series of training programs covering updates to accounting and auditing standards, the use of audit tools including data analytics tools, responses to fraud risks, key considerations and emerging issues relating to specific industries/sectors and IPO audits, the results of periodic internal inspections, CPAAOB inspections and JICPA Quality Control Review, professional ethics and independence, and information security. ・ Providing training on sustainability-related disclosures and assurance engagements ・ Conducting examinations to measure understanding of training ・ Providing support for acquiring language-related qualifications and implementing language training programs at home and abroad (including online training) ・ Holding information-sharing meetings to provide updates on the latest industry trends and developments by industry and sector
Small and medium-sized audit firms	・ Providing opportunities to attend training sessions organized by the JICPA headquarters or regional offices as well as to access JICPA e-learning courses ・ Sharing the results of periodic inspections within the firm, CPAAOB inspections and JICPA Quality Control Review (including communication at firm-wide training sessions of improvement measures in response to the findings of periodic inspections and other internal reviews).

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

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

Even among small and medium-sized audit firms, some of the comparatively larger ones have introduced level-based training systems and e-learning systems, while others are providing opportunities for education and training by covering tuition fees for external training programs. On the other hand, many small and medium-sized audit firms face difficulties in providing tailored training programs that reflect the experience and competence of their professional personnel and the industry sectors of their audited companies. As a result, some firms are limited to confirming whether their partners and staff have satisfied the training requirements under the Continuing Professional

Development (CPD) system administered by the JICPA, including the completion of the required number of CPD credits.

<Education and training needed for IFRS adoption>

As the number of companies that applying or have decided to adopt IFRS in Japan has now exceeded 310, large-sized audit firms in particular are working to develop professional personnel involved in audits of companies applying IFRS. For that reason, the CPAAOB monitors the training structures relating to IFRS, with key examples shown below (Figure III-4-3). In some small and medium-sized audit firms, all professional personnel are required to take training provided by the JICPA on IFRS. However, in many cases, those involved in audits of companies applying IFRS are expected to rely on self-study.

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

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

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

3. Evaluation of Professional Personnel

The appropriate performance evaluation of professional personnel demonstrates that the audit firm is committed to audit quality, and ongoing efforts are particularly important for fostering the organizational culture that forms the foundation of audit quality. Audit firms must establish quality objectives that ensure professional personnel demonstrate a commitment to quality through their conduct and attitude, develop and maintain the appropriate competencies to fulfill their roles, and are held accountable and evaluated through timely assessments, compensation, promotions, and other incentives (QCSCS 1, para 32 (2)).

Furthermore, when conducting audits of listed companies, audit firms are expected under the Audit Firm Governance Code to establish and implement policies concerning human resource management, performance evaluation, and remuneration (Principle 4, Guidance 4-2).

a. Evaluation of partners

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

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

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

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

Evaluation results are generally fed back to the individuals concerned and are often used as a basis for setting objectives and developing specific action plans for the following year to address identified issues. In addition, some audit firms reflect evaluation results in partners’ remuneration, determine audited companies to be assigned based on such results, and where evaluations are extremely poor, impose restrictions on engagement responsibilities or take other remedial measures.

On the other hand, some small and medium-sized audit firms do not conduct periodic evaluations of partners, while others that do conduct such evaluations have not clearly established evaluation policies and procedures.

b. Evaluation of professional personnel

Audit firms evaluate professional personnel in accordance with established evaluation criteria and have policies under which promotions and other personnel decisions are determined based on the evaluation results.

Many large-sized and mid-tier audit firms include audit quality-related criteria in their evaluations of professional personnel, such as understanding of auditing standards and other professional requirements, communication within engagement teams, and management capabilities (including the ability to address international matters). In addition, large-sized and mid-tier audit firms generally establish policies and requirements for admission to partnership and promotion to manager and other positions, with such appointments and promotions determined through a selection process.

Although small and medium-sized audit firms evaluate professional personnel in a manner similar to that of large-sized and mid-tier audit firms, some have not established policies regarding admission to partnership, promotions, and related personnel decisions based on evaluation results. This is partly because they rarely recruit newly qualified CPAs and, in some cases, hire experienced professional personnel with the expectation that they will become partners. Furthermore, in some small and medium-sized audit firms, evaluation criteria have been established for part-time professional personnel but evaluations are not conducted in accordance with those criteria. In other cases, even where evaluations are conducted, the

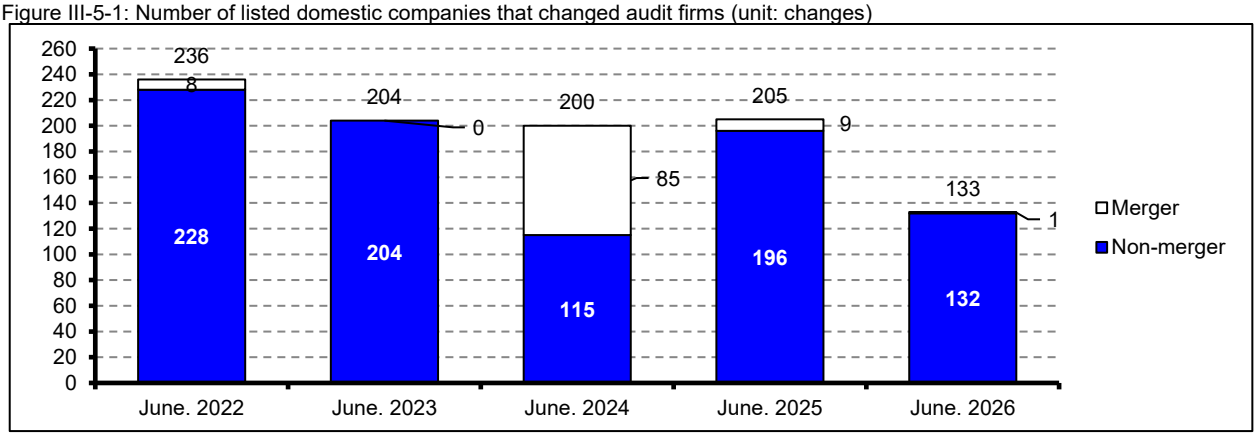
results are not reflected in decisions regarding revisions to employment terms and conditions or the renewal of employment contracts.

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

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

Looking at changes in accounting auditors of domestic listed companies, there were 133 cases in the twelve months ended June 2026, the lowest number recorded in the most recent five-year period. Compared to the twelve months ended June 2025, the number of changes attributable to reasons other than mergers[46] declined significantly (Figure III-5-1). These developments suggest that the number of changes in accounting auditors, which had remained at a high level and peaked in the twelve months ended June 2022, has been returning to the levels observed before that period, indicating that the trend of frequent changes in accounting auditors appears to have temporarily stabilized. For information on mergers, see "II. Overview of the Audit Sector, B. Audit Firms, 4. Mergers of Audit Firms".

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



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

As can be seen from the changes in audit firms by firm size for reasons other than mergers, the number of changes in the twelve months ended June 2026 decreased compared with the twelve months ended June 2025. Nevertheless, the trend of companies changing their auditors from large-sized audit firms to mid-tier audit firms or small and medium-sized audit firms has continued (Figures III-5-2 and III-5-3). This trend is considered to reflect the fact that large-sized audit firms continue to place importance on

[46] In the twelve months ended June 2026, there were no mergers between audit firms. However, transfers to audit firms established through business integration of regional offices of an accounting auditors are categorized as "mergers."

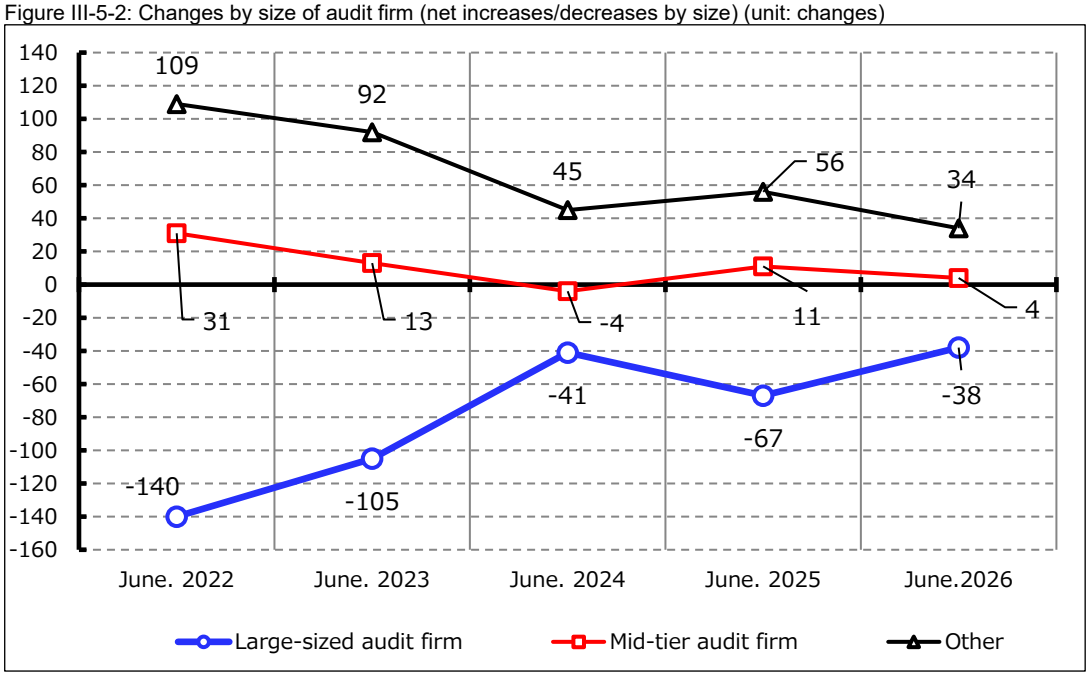
operational management by taking into account factors such as audit fees, audit risk, and the personnel required to perform the audit engagement when deciding whether to continue audit contracts. At the same time, audited companies are also considering the need to change auditors by taking into account factors such as the length of continuous audit engagements, the appropriateness of audit services in light of their business scale, and the reasonableness of audit fees.

For information about business operations concerning continuance of audit contracts at large-sized audit firms, see "3. Reasons for Changes in Accounting Auditors as Identified Through CPAAOB Monitoring".

In addition, although the number of changes from one small and medium-sized audit firm to another decreased in the twelve months ended June 2026 compared with the twelve months ended June 2025, the tendency for companies to switch from one small and medium-sized audit firm to another has continued (Figure III-5-3). Large-sized audit firms and mid-tier audit firms have maintained a cautious stance toward entering into new audit engagements with listed domestic companies previously audited by small and medium-sized audit firms, particularly from the perspective of audit fees and related considerations. At the same time, these listed domestic companies appear to be selecting successor auditors based on factors such as the appropriateness of audit services for their business scale and the reasonableness of audit fees, which has resulted in a greater tendency to appoint other small and medium-sized audit firms. In addition, among cases involving a change from one small and medium-sized audit firm to another, there were 35 cases in the twelve months ended June 2025 in which the predecessor auditor was not registered in the Register of Auditors for Listed Companies and Other Entities, compared with only seven cases in the twelve months ended June 2026. This suggests that the introduction of the auditor registration system for listed companies also affected the trends observed in the twelve months ended June 2025.

The above-mentioned shift from large-sized audit firms to mid-tier audit firms or small and medium-sized audit firms suggests that the role of small and medium-sized audit firms in auditing listed companies is expanding. However, the CPAAOB’s recent inspection of small and medium-sized audit firms has identified cases where the firms did not have adequate systems in place to properly perform audit engagements, making it an urgent priority for such firms to maintain and enhance audit quality. In light of these circumstances, the CPAAOB intends to place greater emphasis on inspections of small and medium-sized audit firms.

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



(Note1) Net increases/decreases in the number of changes
(Note2) Aggregate numbers of companies that had decided on an incoming auditor by the end of June of each period, based on timely disclosures by listed domestic companies
(Note3) Figures in the above table do not include changes due to mergers of audit firms.
(Source) Prepared by the CPAAOB

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

From/To			June 2024	June 2025	June 2026	Increase/Decrease
Large-sized	→	Large-sized	12	14	14	-
	→	Mid-tier	10	25	18	▲7
	→	Other	40	49	27	▲22
Mid-tier	→	Large-sized	5	3	5	2
	→	Mid-tier	-	2	1	▲1
	→	Other	11	14	13	▲1
Other	→	Large-sized	4	4	2	▲2
	→	Mid-tier	2	3	4	1
	→	Other	31	82	48	▲34
Total			115	196	132	▲64

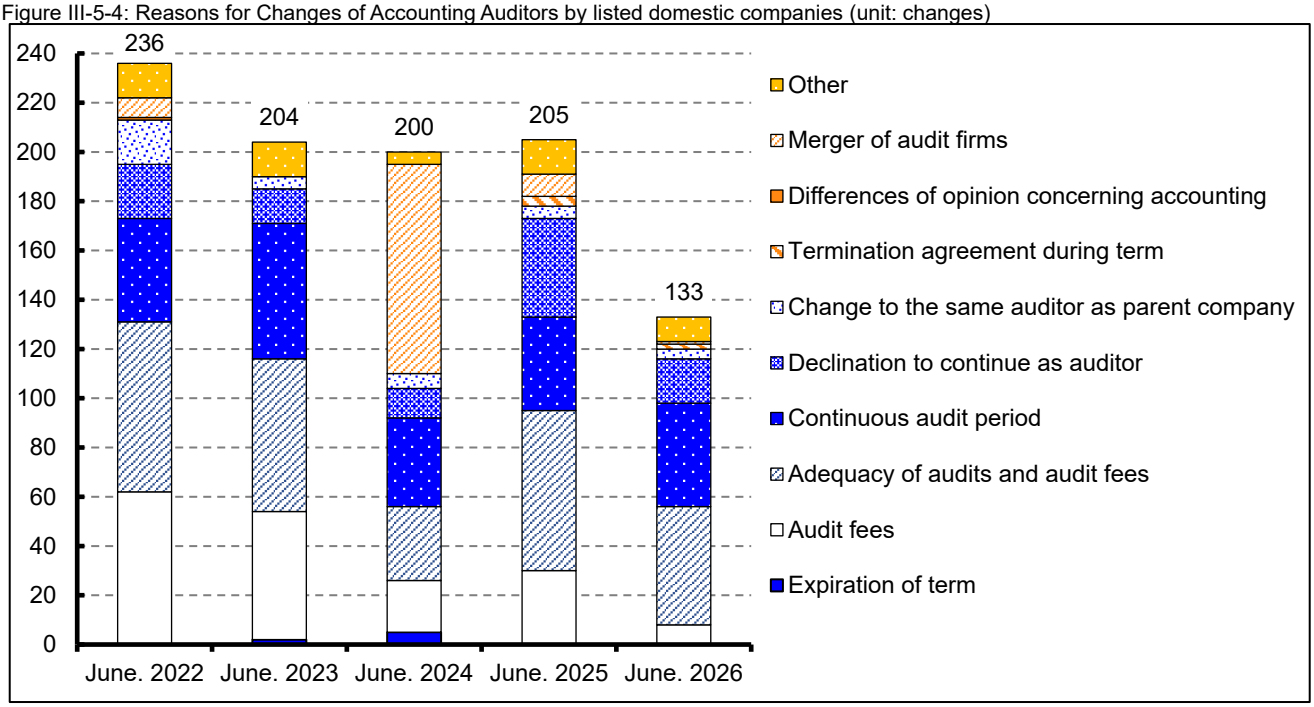
(Note1) Aggregate numbers of companies that had decided on a successor accounting auditor by the end of June of each period, based on timely disclosures by listed domestic companies
(Note2) "Other" in the figure refers to small and medium-sized audit firms, partnerships and solo practitioners.
(Note3) Figures in the above table do not include changes due to mergers of audit firms.
(Source) Prepared by the CPAAOB

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

When a listed domestic company changes its accounting auditor, the company shall disclose the change immediately (Article 402 of the Securities Listing Regulations, Tokyo Stock Exchange). In such cases, the company must specifically disclose the substantial reasons for the change and the background leading to the decision.

An examination of the reasons for the changes in accounting auditors disclosed pursuant to these regulations shows that many companies stated the proposed increases in audit fees, as well as the appropriateness of the audit services in light of their business scale and the reasonableness of audit fees, as reasons for the change. In addition, many companies stated that, after comparing alternative audit firms while taking into consideration the prolonged audit period of their incumbent auditor, they decided to change accounting auditors (Figure III-5-4). In the twelve months ended June 2026, many companies continued to state these factors as reasons for changing accounting auditors. In addition, there was a notable increase in cases categorized as “declination to continue as auditor,” where the incumbent accounting auditor declined to continue the audit engagement. In such cases, reasons cited included the expectation of increased audit workload arising from changes in the audit environment, coupled with difficulties in securing sufficient personnel to perform the engagement.

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



(Note1) Compiled based on timely disclosures by listed domestic companies choosing new auditors by the end of June each year.
(Note2) In the case of two or more reasons disclosed, the classification was made based on the principal reason.
(Source) Prepared by the CPAAOB

2. Reasons for Changes of Accounting Auditors during Fiscal Term

In the twelve months ended June 2026, there were two cases of changes in accounting auditors in the middle of the fiscal year out of a total of 133. The changes were primarily due to terminations or resignations initiated by the audit firms, following the discovery of inappropriate accounting practices at the audited companies.

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

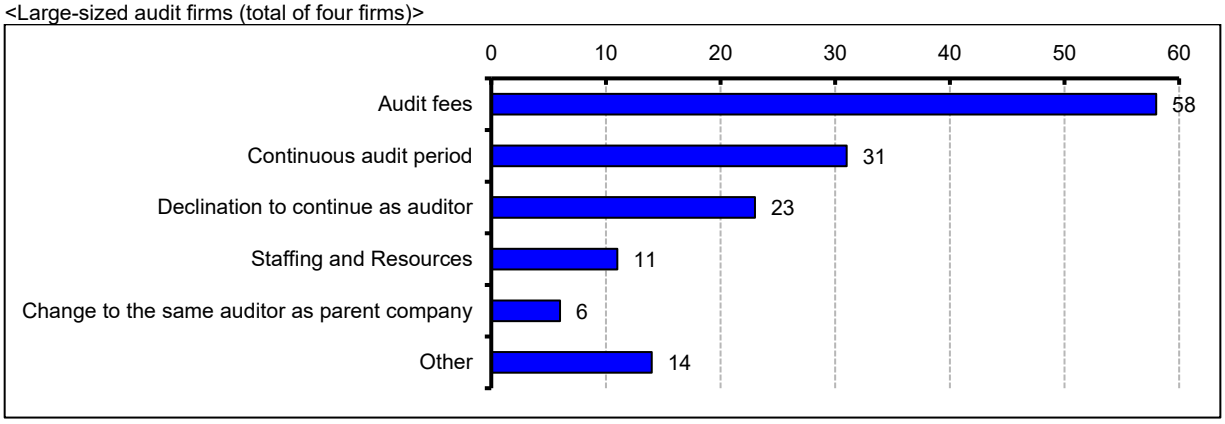
This section lays out the reasons for changes in accounting auditors identified through CPAAOB monitoring conducted in PY2025, in addition to the timely disclosures released by audited companies. It should be noted that inspections and the collection of reports were not conducted for all audit firms during PY2025. Furthermore, due to the timing of inspections and information collection, the cases reviewed may include reasons for changes that occurred in previous years. Accordingly, the number of changes identified through the monitoring does not necessarily correspond to the number of changes disclosed for each fiscal year.

a. Large-sized audit firms

Among the 94 cases of changes in accounting auditors reported by large-sized audit firms as predecessor accounting auditors through inspections and information collection, the most frequently cited reason for the change was “audit fees” (58 cases), followed by "continuous audit period" (31 cases). In addition, a number of cases cited both “audit fees” and “continuous audit period” as reasons for the change. On the other hand, from the perspective of the manner in which the change occurred, 23 cases involved the accounting auditor declining to continue the audit engagement. In a number of these cases, it appeared that the audit firm had concluded that continuation of the engagement was difficult after comprehensively considering factors such as audit risk, audit workload, and fee levels in the course of allocating audit resources and reviewing its client portfolio (Figure III-5-5).

Compared with the previous year, both the number of changes in accounting auditors (57 cases in the previous year) and the number of cases in which the accounting auditor declined to continue the engagement (4 cases in the previous year) increased significantly. This trend can be attributed in part to the growing tendency of audited entities to consider changing their auditors based on factors such as continuous audit period and audit fees. In addition, when determining whether to continue audit engagements, large audit firms analyze individual audit engagements and their audit portfolios as a whole, taking into account factors such as whether audit fees are commensurate with audit risk, whether audit risk remains within an manageable range, and whether sufficient personnel can be secured to perform the audit. Audit engagements are then managed in accordance with the results of such analyses.

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

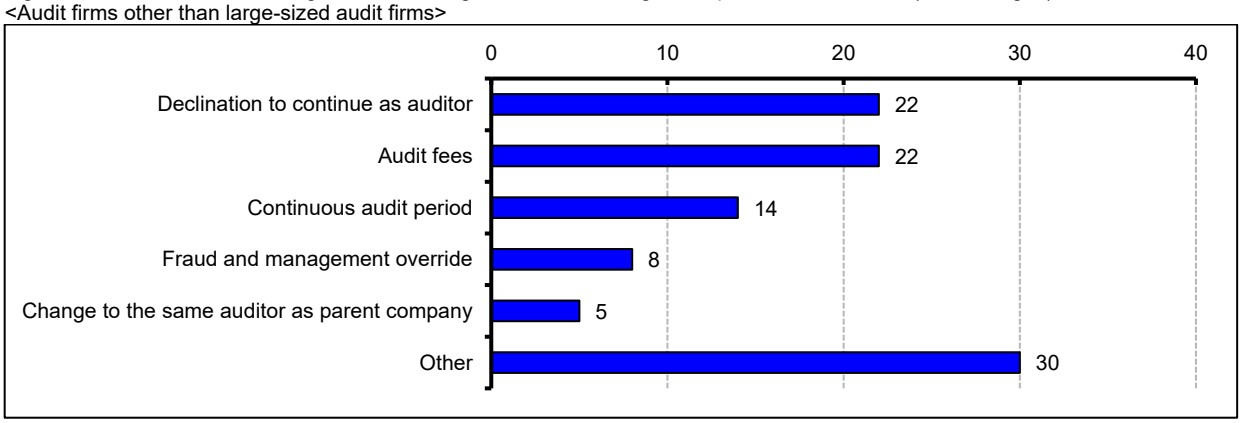


(Note1) Based on data from 94 changes identified through inspections and report collection during PY2025.
(Note2) If there was more than one reason, that change is included in the figure for each reason (a cumulative total of 143).
(Source) Prepared by the CPAAOB

b. Mid-tier audit firms and small and medium-sized audit firms

Among the 66 cases of changes in accounting auditors reported by mid-tier audit firms and small and medium-sized audit firms through inspections and information collection, the most frequently cited reasons reported by predecessor accounting auditors excluding “other,” were “declination to continue as auditors” and “audit fees”, followed by “continuous audit period” (Figure III-5-6). The underlying reasons for “declination to continue as auditor” included cases in which audit risk had increased due to factors such as deteriorating business performance or weaknesses in the audited company’s accounting systems, making it difficult to secure sufficient audit resources for the audit effort required. In a number of cases, audit firms also concluded that continuation of the engagement was not feasible in light of the level of audit fees. In addition, some cases cited constraints on the audit firm’s own audit resources as the primary reason for declining to continue the engagement. With respect to “other” reasons, there were cases in which the audited company reviewed its accounting auditor in order to obtain audit services more suited to its business activities or scale, or to respond to the requirements of a global audit framework.

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



(Note1) Based on data from 66 changes for which the reason was identified through the inspections by the CPAAOB in PY2025 and reports collected from four mid-tier audit firms and 49 small and medium-sized audit firms.
(Note2) If there was more than one reason, that change is included in the figure for each reason (a cumulative total of 101).
(Source) Prepared by the CPAAOB

F. Audit Fees

1. Rules on Audit Fees

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

On the other hand, the JICPA Code of Ethics, as most recently amended June 2025, states that an audit firm may quote whatever fee it deems appropriate based on the content and value of services provided. It also states that quoting an unduly low fee without proper justification may make it difficult to perform professional services in accordance with applicable technical and professional standards. As a result, such fee arrangements may give rise to a self-interest threat to compliance with the principles of professional competence and due care.

2. Methods for Calculating Audit Fees

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

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

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

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

According to the reports collected in PY2025, audit fee estimates are calculated as follows.

a. Large-sized audit firms

All large-sized audit firms state that they adopt the hourly rates approach for audit fee estimates. Hourly rates are established for each rank of audit personnel, and are calculated to include indirect costs associated with the firm's management and quality management activities, such as personnel expenses for administrative functions and IT system-related costs.

In some cases, firms also establish more granular charge rates not only by staff rank, but also by factors such as the complexity of the audit engagement and the specific service provided.

b. Mid-tier audit firms

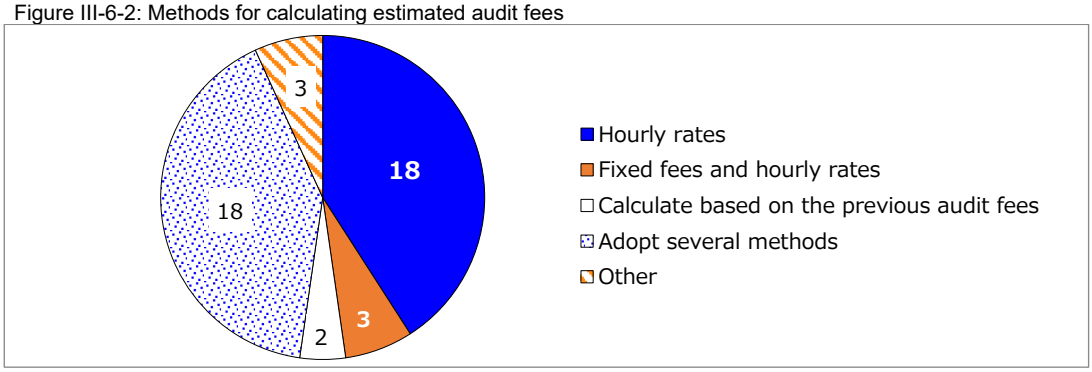
With respect to audit fee estimation, three mid-tier firms stated that they adopt the hourly rates approach, while one firm stated that it adopts the fixed fees and hourly rates approach. In addition, one of the firms using the hourly rates approach does not establish charge rates

according to the rank of audit personnel. The other three firms stated that they set charge rates according to the rank of audit personnel.

c. Small and medium-sized audit firms

Based on a compilation of responses from the small and medium-sized audit firms that were subject to collection of reports (44 firms, all of which were small and medium-sized audit firms), many firms stated that they adopt either the hourly rates approach or multiple fee-calculation methods, such as using the hourly rates approach as the principal method while combining it with other approaches (Figure III-6-2).

Figure III-6-2: Methods for calculating estimated audit fees



(Note) Aggregated from reports collected from small and medium sized audit firms in PY2025
(Source) Prepared by the CPAAOB

In addition, many small and medium-sized audit firms stated that they do not set charge rates according to the rank of audit personnel (Figure III-6-3).

Figure III-6-3: Setting of charge rates by rank of audit personnel

Setting	Number of audit firms	Percentage
Charge rates set	10	23%
Charge rates not set	34	77%
Total	44	100%

(Note) Aggregated from reports collected from small and medium-sized audit firms in PY2025
(Source) Prepared by the CPAAOB

3. Audit Fees Before and After Changes in Accounting Auditors

As audit fees are often reviewed following a change of accounting auditors, the CPAAOB analyzed pre- and post-transfer audit fees for 185 cases of changes in accounting auditors at listed domestic companies disclosed through timely disclosures between July 2024 and June 2025, excluding changes resulting from mergers of audit firms. In conducting the analysis, particular attention was paid to changes in the size of the successor accounting auditor, and the analysis revealed the following trends.

In cases where companies changed to larger audit firms (8 cases), audit fees increased in many instances, rising in approximately 70% of cases (6 cases), while they decreased in approximately 30% of cases (2 cases). In cases where companies changed to audit firms of the same size (91 cases),

audit fees increased in approximately 60% of cases (56 cases) and decreased in approximately 30% of cases (28 cases). Meanwhile, in cases where companies changed to smaller firms (86 cases), audit fees decreased in approximately 70% of cases (64 cases), while they increased in approximately 20% of cases (19 cases) (Figure III-6-4).

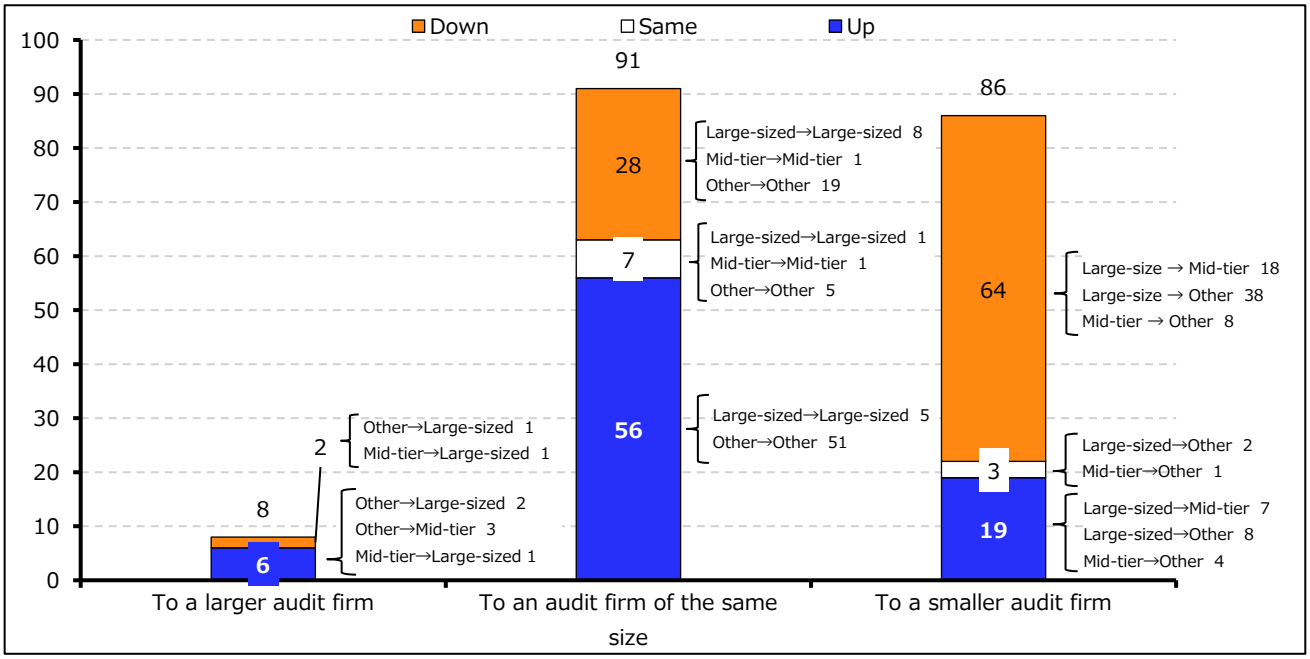
As noted earlier in 1. Reasons for Change of Accounting Auditors Given in Timely Disclosures by Audited Companies, many listed domestic companies cite the appropriateness of audit services and audit fees in relation to their business scale as reasons for changing accounting auditors. Based on the above findings, it appears that some listed domestic companies determine that the audit fees charged by their incumbent auditors were excessive relative to their business scale and other circumstances, and therefore tend to appoint primarily small and medium-sized audit firms as successor accounting auditors with the aim of reducing audit fees.

On the other hand, in PY2025, even in cases where companies changed to smaller audit firms, increases in audit fees were observed more frequently than in the previous program year. This is considered to reflect situations in which audited companies, while placing importance on the appropriateness of audit fees, prioritized obtaining audit services from accounting auditors whose scale was better suited to their business scale and therefore accepted increases in audit fees. In other words, the findings suggest an emerging trend in which a reduction in audit fees is no longer necessarily associated with a change to a smaller audit firm.

Cases in which audit fees increased following a change of auditors were also observed in substantial numbers when companies changed to audit firms of the same size, particularly in changes between small and medium-sized audit firms (51 cases). Given the increasing number of cases in which incumbent accounting auditors have declined to continue audit engagements, audited companies may have found it necessary to appoint a successor promptly and, may therefore have accepted higher fees proposed by prospective auditors.

The CPAAOB will continue to monitor trends in audit fees before and after changes of accounting auditors, while paying close attention to changes in the size of successor accounting auditors.

Figure III-6-4: Audit fees following changes of accounting auditors (unit: changes)



(Note1) Included are cases of changes in accounting auditors by listed domestic companies disclosed between July 2024 and June 2025, for which audit fees both before and after the change were publicly disclosed.
(Note2) Breakdowns of these changes are shown in the graph
(Note3) "Other" in the figure refers to small and medium-sized audit firms.
(Source) Prepared by the CPAAOB based on timely disclosures of changes in accounting auditors and securities reports submitted by June 2026

4. Fee Dependency (Safeguards)

When the proportion of audit fees received from a specific audited company becomes high relative to the total revenue[47] of the audit firm[48] (fee dependency), the resulting fee dependency and concerns over losing that source of income may increase the level of self-interest threats and create undue pressure on the audit firm, potentially impairing its independence.

The JICPA Code of Ethics includes provisions relating to fee dependency. Under these provisions, where the fee dependency of a particular audited company exceeds, or is likely to exceed, 15% for two consecutive years, the audit firm is required to implement a safeguard by obtaining a review equivalent to an engagement quality review conducted by a member who is not affiliated with the audit firm, prior to expressing its audit opinion. Furthermore, where the fee dependency of a particular audited company that is a public interest entity exceeds 15% for five consecutive years, the audit firm is required to resign from the engagement following the issuance of the audit opinion for the fifth year.

With regard to the application of safeguards related to fee dependency, no applicable cases were identified among large-sized audit firms or mid-tier audit firms. However, among small and medium-sized audit firms, safeguards relating to fee dependency were applied in 13 engagements across eight firms, out of 49 firms (all of which were small and medium-sized audit firms) subject to inspections and the collection of reports conducted in PY2025.

[47] Total audit and attestation revenue and non-audit service revenue (e.g. advisory and tax services)
[48] Audit firms and business entities that are linked through control relationships, including those established through contractual arrangements, personnel relationships, or other means.

■ Enhancing Audit Quality and Improving Profitability and Operational Efficiency ■

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

Although the number of registered CPAs has increased gradually in recent years, the number of CPAs employed by audit firms has not grown at the same pace. This is partly due to the increasing availability of career opportunities in other attractive fields, such as consulting firms and positions including CFOs at commercial companies, where compensation and remuneration levels may be more attractive. As a result, concerns have been raised regarding a shortage of professionals available to perform audits.

At the same time, large-sized audit firms in particular have been promoting initiatives to standardize and centralize audit processes. These initiatives include assigning less specialized audit tasks to audit assistants and processing certain audit procedures centrally through delivery centers, thereby enabling CPAs and other professionals to devote more time to higher-value and more complex areas of audit work. In addition, audit firms have continued to develop and deploy audit tools utilizing technologies such as AI, advancing efforts not only to address shortages in audit personnel but also to improve the efficiency and sophistication of audit engagements.

However, the environment surrounding audits is changing at a rapid pace. Factors such as the diversification and increasing complexity of audited companies' business activities, the continued globalization of business operations, the growing complexity of applicable accounting standards, and the need to respond to new auditing requirements are expected to require ongoing investment by audit firms in both human capital and technology. In particular, continued investment in securing and developing personnel, as well as in technologies such as AI, is likely to remain necessary across audit firms.

Under these circumstances, audit firms have been reviewing their audit fee levels by more precisely estimating the audit hours necessary to ensure sufficient and appropriate audit quality and by proposing revisions to audit fees to audited companies.

According to business reports submitted to the Local Finance Bureaus and other authorities, large-sized audit firms have experienced a decline in the number of audit clients subject to audits under the FIEA, while total audit fee revenue has increased. In addition, disclosures regarding audit fees in annual securities reports filed by listed domestic companies indicate that, among large-sized audit firms, audit fees increased from the previous fiscal year for more than half of their audit clients, suggesting that the review of audit fee levels has been progressing. However, an analysis of timely disclosures relating to changes of auditors by listed domestic companies shows that many companies cited proposed increases in audit fees, as well as the appropriateness of audit services and audit fees in relation to their business scale, as reasons for changing auditors. These findings suggest that, although progress has been made in revising audit fee levels, a gap still remains between the level of audit fees required to support the roles and responses expected of audit firms in enhancing audit quality and the level of audit services expected by audited companies. Accordingly, revisions to audit fee levels cannot yet be said to have become fully established.

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

Ensuring the reliability of capital markets requires strengthening market governance[49], and further enhancement of the audit function is essential. However, the importance of audits in capital markets and the public-interest role of

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

audit firms are sometimes overlooked. Therefore, in light of the recent emergence of several cases of accounting fraud at listed domestic companies, it is expected that, in addition to discussions on improving audit quality, more active dialogue will take place from the perspective of the capital market as a whole, including audited companies and market participants, regarding the importance of financial audits, the fair evaluation of audit work, and the future role that audit firms should play.