

# **Annual Report**

**May, 2020**

**Certified Public Accountants and Auditing Oversight Board**

### **About this Annual Report**

Based on Article 16 of the Certified Public Accountants and Auditing Oversight Board Rules of Operation determined pursuant to the provisions of Article 2 of the Certified Public Accountants and Auditing Oversight Board Cabinet Order, we hereby announce the status of the activities of the Certified Public Accountants and Auditing Oversight Board (CPAAOB) in FY2019 (April 1, 2019 to March 31, 2020).

For the convenience of readers, a portion of this Report will also mention information on activities taken before and after FY2019.

FY2019 and the current fiscal year shall refer to the period from April 1, 2019 to March 31, 2020. PY2019 and the current program year shall refer to the period from July 1, 2019 to June 30, 2020.

#### **○ The CPAAOB Rules of Operation**

**Article 16**      The CPAAOB shall, after the end of each fiscal year, publish its activities for that year, such as measures taken and the number of inspections conducted.

<<If you have any comments, etc., please contact the following address>>

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# Contents

## 1 Overview of the CPAAOB

1.1 Certified Public Accountants and Auditing Oversight Board (CPAAOB) .....	1 -
1.2 Executive Bureau.....	1 -

## 2 Examination and Inspection of Audit Firms

2.1 Outline .....	4 -
2.2 Basic Policy for Monitoring of Audit Firms, etc. ....	6 -
2.2.1 Basic Policy for Monitoring Audit Firms .....	6 -
2.2.2 Basic Plan for Monitoring Audit Firms .....	9 -
2.3 Monitoring and Inspections of Audit Firms .....	13 -
2.3.1 Quality Control Reviews by the JICPA .....	14 -
2.3.2 Examination of Quality Control Reviews .....	15 -
2.3.3 Collection of Reports from Audit Firms .....	16 -
2.3.4 Inspections of Audit Firms .....	17 -
2.3.5 Inspections Results .....	18 -
2.3.6 Recommendations to the Commissioner of the FSA .....	18 -
2.3.7 Inspections and Oversight on Foreign Audit Firms.....	18 -
2.4 Dissemination of Information relating to Examination and Inspection .....	20 -
2.4.1 Publication of “2019 Monitoring Report” .....	20 -
2.4.2 Publication of “Case Report from Audit Firm Inspection Results”.....	21 -
2.5 Cooperation with Relevant Organizations.....	22 -
2.5.1 Cooperation with Relevant Divisions of the FSA .....	23 -
2.5.2 Cooperation with the JICPA .....	23 -
2.5.3 Cooperation with the Financial Instruments Exchanges .....	23 -
2.5.4 Cooperation with the Japan Audit & Supervisory Board Members Association .....	23 -
2.6 Achievement in PY2019 agenda.....	24 -
2.6.1 Inspections of Business Management System Such as Governance .....	24 -
2.6.2 Monitoring Based on Trends Related to Audits.....	24 -
2.6.3 Strengthening of Off-site Monitoring .....	25 -
2.6.4 Verifications of the JICPA’s Quality Control Reviews as well as Cooperation with the JICPA .....	25 -
2.6.5 Monitoring of Technology Use and Cybersecurity at Audit Firms .....	26 -
2.6.6 Strengthening Dissemination of Information .....	26 -
2.6.7 Enhancement of the Monitoring Environment .....	26 -

### **3 Cooperation with Relevant Organizations in Other Jurisdictions**

3.1 Activities of the International Forum of Independent Audit Regulators (IFIAR)-	28 -
3.1.1 Background.....	28 -
3.1.2 Organization .....	29 -
3.1.3 Activities.....	30 -
3.1.4 Japan IFIAR Network.....	34 -
3.2 Bilateral Cooperation.....	34 -
3.3 Next challenges.....	35 -

### **Annex : List of Members of Certified Public Accountants and Auditing Oversight**

<b>Board (Sixth Term)</b> .....	37 -
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## 1 Overview of the CPAAOB

### 1.1 Certified Public Accountants and Auditing Oversight Board (CPAAOB)

The CPAAOB is an administrative body led by a council system that was established in April 2004 in the FSA based on Article 35, Paragraph 1 of the Certified Public Accountants Act (hereinafter, “the CPA Act”) and Article 6 of the Act for Establishment of the Financial Services Agency.

The CPAAOB is comprised of the Chairperson and up to 9 Commissioners with understanding and knowledge of matters concerning CPAs who are appointed by the Prime Minister after the approval of both Diet houses. Most of the Commissioners serve part-time, but one of them can serve full-time. The term of the members is three years. (Article 36, Article 37-2 and Article 37-3 of the CPA Act).

The Chairperson and Commissioners exercise authority independently. They shall not be dismissed against their will except for the reasons stipulated by the laws during their appointed terms (Articles 35-2 and 37-4 of the CPA Act).

The CPAAOB comprises 10 members, Chairperson SAKURAI Hisakatsu, full-time Commissioner MATSUI Takayuki, and eight part-time Commissioners. The Board was launched for its sixth term (April 2019 to March 2022) on April 1, 2019.

The key responsibilities of the CPAAOB are as follows:

- 1) Inspection of CPAs, audit firms, foreign audit firms (Note), and the Japanese Institute of Certified Public Accountants (“JICPA”)
- 2) Implementation of CPA Examinations
- 3) Deliberation of disciplinary actions against CPAs and audit firms
- 4) Cooperation and coordination with relevant organizations in other jurisdictions

(Note) Refers to a person or entity which conducts duties deemed to be equivalent to audit and assurance services in a foreign country and notifies a Commissioner of the FSA of the submission of financial documents by foreign companies in accordance with the stipulations of the Financial Instruments and Exchange Law.

### 1.2 Executive Bureau

The CPAAOB has an Executive Bureau to handle its administrative duties (Article 41, Paragraph 1 of the CPA Act).

The Executive Bureau is comprised of the Planning, Management and CPA

Examination Office and the Monitoring and Inspection Office, led by the Secretary-General of the Executive Bureau. The Planning, Management and CPA Examination Office is in charge of implementing the CPA examinations, investigating and deliberating on disciplinary actions against CPAs, etc., and coordinating general issues of the Executive Bureau. The Monitoring and Inspection Office is in charge of monitoring audit and assurance services provided by audit firms, etc. and the operation of the JICPA, and inspecting audit firms, etc., foreign audit firms and JICPA.

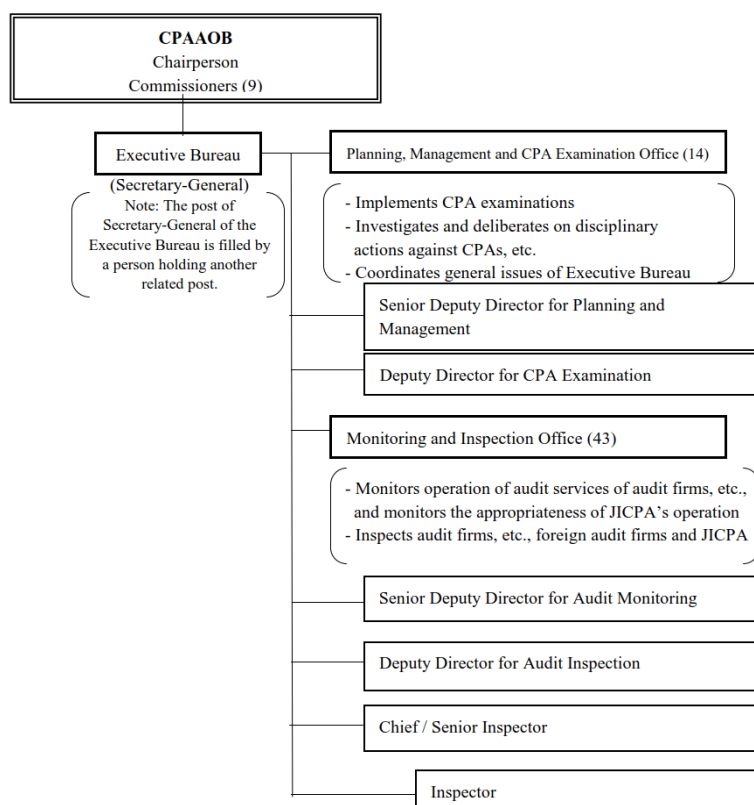
The Executive Bureau had 40 staff members when it was launched in April 2004. Its staff was steadily increased thereafter, to 14 in the Planning, Management and CPA Examination Office, and 43 in the Monitoring and Inspection Office, for a total of 57 staff members as of the end of FY2019.

## Staffing of the Executive Bureau

(Fiscal year-end basis)

FY	2004	2005	2006	2007	2008	2009	2010	2011	2012 ~ 2015	2016 ~ 2017	2018	2019
Planning, Management and CPA Examination Office	11	12	12	12	12	14	14	14	14	14	14	14
Monitoring and Inspection Office	29	29	31	35	39	41	44	43	42	42	43	43
Head of Chief Inspector	-	-	-	-	-	-	-	-	-	1	1	1
Chief Inspectors	4	4	4	4	5	5	7	7	7	6	6	6
Inspectors	18	18	20	24	26	28	28	27	26	26	27	27

## Organization Chart of the CPAAOB



(Note) Figures in parentheses denote the number of personnel at the end of FY2019.

## **2 Examination and Inspection of Audit Firms**

### **2.1 Outline**

To earn investor's trust in the capital market, the market should ensure fairness and transparency. Pursuing that goal, the Japanese Institute of Certified Public Accountants (JICPA)'s quality control reviews (see Note) of audit firms, which had been self-regulated, have become statutory since the June 2003 revision of the CPA Act, for the purpose of strengthening oversight of audit firms. Under the revision, the CPAAOB receives reports on the results of these reviews from the JICPA, examines them. If the CPAAOB deems it necessary, the CPAAOB requests that audit firms submit their information and conducts inspections.

For the purpose of ensuring the soundness of Japan's financial and capital markets, foreign audit firms that conduct audits of foreign companies subject to the disclosure regulations under the Financial Instruments and Exchange Act became subject to the inspections and supervision of the Financial Services Agency (FSA) and the CPAAOB after the June 2007 revision of the CPA Act, and the CPAAOB was given the mandate to collect the relevant information and conduct on-site inspections for these firms.

Specifically, the authority related to the following matters has been delegated from the Commissioner of the FSA to the CPAAOB (Article 49-4, Paragraphs 2 and 3 of the CPA Act):

- Business pertaining to the receipt of reports on the results of reviews by the JICPA on the operation of members' services (audit and assurance services) set forth in Article 2, Paragraph 1 of the CPA Act (Article 46-9-2, Paragraph 2 of the CPA Act)
- Collection of reports and inspections on the JICPA, CPAs and audit firms, which are conducted in relation to the above-mentioned reports (Article 46-12, Paragraph 1 and Article 49-3, Paragraphs 1 and 2 of the CPA Act)
- Collection of reports and inspections on foreign audit firms, etc. (Article 49-3-2, Paragraphs 1 and 2 of the CPA Act)

Based on the given mandate, the CPAAOB examines quality control review reports submitted by the JICPA and collects reports from and conducts inspections of audit firms when necessary and appropriate in light of public interest or investor protection.

The CPAAOB shall make a recommendation to the Commissioner of the FSA for administrative actions or other measures if necessary, based on the results of



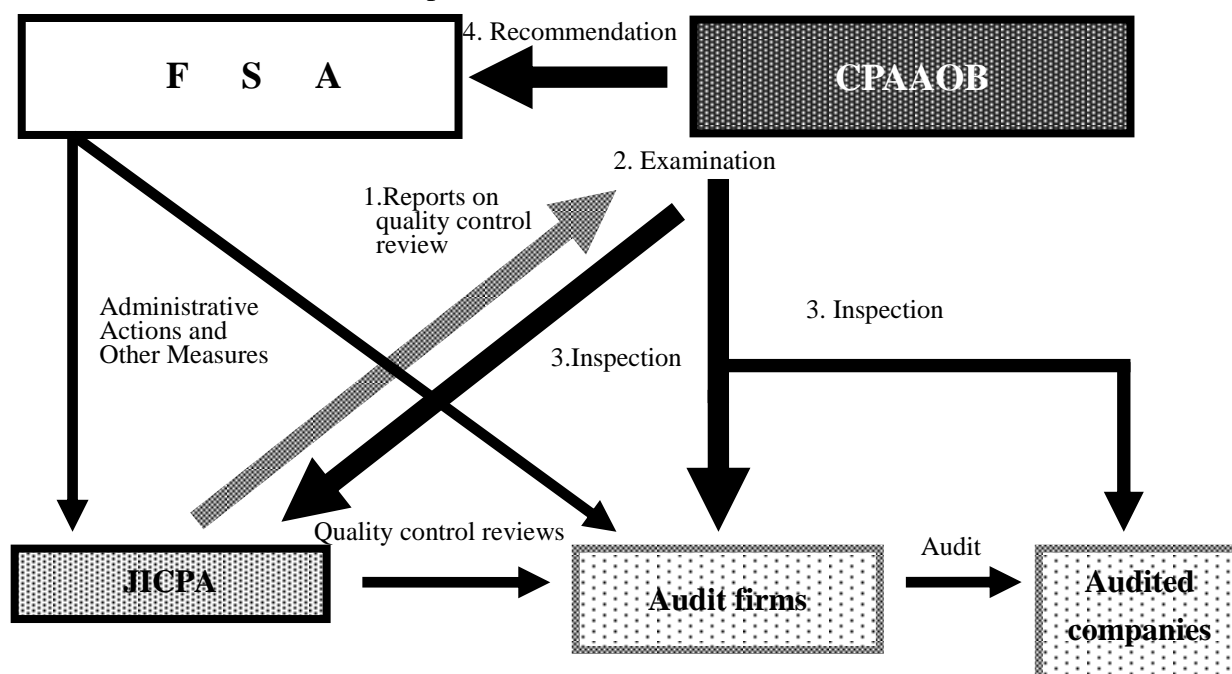
inspections (Article 41-2 of the CPA Act).

(Note) Quality control reviews

Quality control reviews are performed by the JICPA pursuant to the CPA Act, according to which the JICPA shall review the status of the operation of services by members set forth in Article 2(1) of the CPA Act. (Article 46-9-2 (1) of the CPA Act).

Specifically, the JICPA is obliged to review the status of the quality control of audits performed by audit firms with the aim of maintaining and improving an appropriate level of audit quality when providing audit service as well as maintaining and enhancing social confidence in auditing.

#### Outline of Examination and Inspections



##### 1. Reports on quality control review

Once every three years in principle (the time period may be shortened or lengthened in accordance with the situation), the JICPA reviews and assesses an audit firm's compliance with laws, regulations, audit standards, the JICPA's rules, and other related regulations. The CPAAOB obtains reports on the results of those reviews.

##### 2. Examination

The CPAAOB examines the JICPA's reports and ascertains: (i) whether the quality control review system is being properly operated by the JICPA, and (ii) whether audit services are being properly provided by audit firms.

The CPAAOB requests the submission of reports or other materials from audit firms, if in the course of its examination, the CPAAOB finds it necessary to do so.

### 3. Inspection

If the CPAAOB considers it necessary and appropriate in light of public interest or investor protection, it conducts inspections of audit firms (including companies which are audited by audit firms).

Furthermore, the CPAAOB conducts inspections of the JICPA when it considers it necessary to do so from the viewpoint of securing the appropriate conduct of administration by the JICPA.

### 4. Recommendation

Based on the results of inspection, the CPAAOB may make a recommendation to the Commissioner of the FSA for administrative actions or any other measures for securing fair operation of audit services by audit firms or that of administrative operations of the JICPA, when the CPAAOB considers it necessary.

(Note) Regarding the collection of reports from and inspections on foreign audit firms, etc., refer to item (ii), Section 2.3.7 “A framework for the collection of reports and inspections on foreign audit firms, etc.” (see page 19).

## 2.2 Basic Policy for Monitoring of Audit Firms, etc.

### 2.2.1 Basic Policy for Monitoring Audit Firms

In order to improve the effectiveness of audits conducted by audit firms through monitoring from the viewpoint of ensuring reasonable operation of auditing services including quality control, the CPAAOB published on May 17, 2019, the “Basic Policy for Monitoring Audit Firms - Aiming to Further Enhance Audit Effectiveness -” for the sixth term (April 2019 to March 2022), based on the results of monitoring (see Note) during the first through the fifth terms (April 2004 to March 2019).

(Note) Monitoring includes both on-site monitoring, i.e. inspections, and off-site monitoring, which refers to activities other than inspections including information obtained through the collection of reports, hearings, exchanges of opinions and cooperation, etc.

#### <Outline of the basic policies>

##### (i) Perspectives on monitoring

The CPAAOB shall implement more effective monitoring based on the scale

and the operations management system of audit firms as well as the degree of risk at audited companies, and work to secure the credibility of audits in the capital market by continuously encouraging audit firms to maintain and enhance audit quality.

In addition, the CPAAOB shall proactively share useful information it comes to understand through monitoring with the relevant divisions of the FSA, JICPA, industry groups related to financial auditing, as well as with the general public.

(ii) Purposes of monitoring and basic framework for achieving the purposes

The monitoring implemented by the CPAAOB is carried out not for the purpose of focusing on the validity of individual audit opinions themselves, but to ensure reasonable operation of auditing services at audit firms, including quality control of the audits, in addition to further improving the effectiveness of the quality control reviews by the JICPA. In order to achieve such purposes, the CPAAOB performs monitoring that encourages action taken by the audit firm itself, in consideration of the fact that the audit firm takes the lead in ensuring reasonable operation of auditing services.

Also, the CPAAOB focuses on whether audit firms exercise appropriate professional skepticism that can detect accounting fraud, and that the system of quality control practically maintains and enhances audit quality.

Furthermore, the CPAAOB continuously monitors if the business management system, such as governance, contributes to ensuring reasonable operation of auditing services at audit firms that have adopted the Principles for Effective Management of Audit Firms (The Audit Firm Governance Code), published by the FSA on March 31, 2017.

(iii) Basic policy for off-site monitoring

The CPAAOB receives reports on the results of quality control reviews conducted by the JICPA, and then the CPAAOB may collect reports related to the relevant report when deemed necessary. Also, the CPAAOB shall collect information through cooperating and exchanging opinions with relevant divisions of the FSA, JICPA, and related parties, as well as dialogues with audit firms, and thus share awareness of issues. In addition, from the viewpoint of precisely understanding the actual situations and risks at audit firms, the CPAAOB shall endeavor to strengthen the analysis of the data collected through this kind of off-site monitoring.

(iv) Basic policy on inspections

In addition to conducting effective and efficient inspections that reflect the circumstances of audit firms and the degree of risk at audited companies, the CPAAOB endeavors to enhance the effectiveness of inspections by, for example, improving inspection methods. The CPAAOB also works to maintain and enhance audit quality at audit firms by integrating inspections with off-site monitoring.

In consideration of the important role they play in capital markets, such as performing audits on many large-scale listed companies, the CPAAOB conducts annual inspections of large-sized audit firms (see Note 1), in principle.

Second-tier audit firms (see Note 2) have a considerable number of listed audited companies and are responsible for fulfilling a certain role in capital markets, but their operations management system and system of quality control are not considered adequate compared to large-sized audit firms. For that reason, the CPAAOB inspects them regularly (once every three years in principle), maintaining a close watch on the progress with establishing those systems.

The CPAAOB also conducts inspections of small and medium-sized audit firms (see Note 3) based on the results of quality control reviews, operations management system of audit firms and the degree of risk at listed audited companies, as necessary.

(Note 1) A large-sized audit firm: Audit firms that have more than approximately 100 domestic listed audited companies and whose full-time staff members performing actual audit duties total at least 1,000. In this report, this term specifically refers to four audit firms: KPMG Azsa LLC, Ernst & Young ShinNihon LLC, Deloitte Touche Tohmatsu LLC and PricewaterhouseCoopers Aarata LLC.

(Note 2) A second-tier audit firm: An audit firm that has a business scale second only to large-sized audit firms. In this report, this term specifically refers to five audit firms: Gyosei & Co., BDO Sanyu & Co., Grant Thornton Taiyo LLC, Crowe Toyo & Co., and PricewaterhouseCoopers Kyoto.

(Note 3) A small and medium-sized audit firm: audit firms other than a large-sized or second-tier audit firm.

#### (v) Policy on the provision of monitoring outcomes

In order to ensure and enhance audit quality, the CPAAOB not only shows the inspection results to audit firms, but also provides the results of monitoring widely to the general public in the form of reports and, from the point of view of the importance of increasing awareness of financial auditing, further enhances and revises information.

### 2.2.2 Basic Plan for Monitoring Audit Firms

Based on the Basic Policy for Monitoring Audit Firms, the CPAAOB formulates the Basic Plan for Monitoring Audit Firms, to provide a direction for monitoring in each program year.

The PY2019 Basic Plan for Monitoring Audit Firms was formulated based on the following and other information, and announced on July 5, 2019.

- In the past several years, there has been an increasing trend of listed companies that have performed timely disclosure related to improper accounting practices. There have been cases in which the internal controls of a company have not functioned adequately, and cases in which the management of group companies, including overseas companies, was not adequate. When evaluating the internal controls of an audited company, the implementation of audit procedures that allow for an in-depth understanding of the characteristics of a business, including overseas businesses, and the environment established in a business is becoming ever more important. In addition, in cases in which internal controls are found to be deficient, it is necessary to report in a timely manner to the audited company.
- Looking at recent inspection results, adequate cooperation between the head office quality control divisions and other divisions is an issue at large-sized audit firms. In addition, some small and medium-sized audit firms' risk evaluations and audit implementation in the conclusion of new audit engagements related to listed companies which are thought to have a high risk are not adequate.
- Based on the Audit Firm Governance Code, large-sized audit firms are making efforts to ensure the effectiveness of governance, such as making practical use of advice and proposals made by an oversight/assessment body composed of independent third parties. However, there are some second-tier audit firms that have adopted the Audit Firm Governance Code and have established an oversight/assessment body, but are not able to make adequate use of the knowledge of independent third parties, and issues are seen in ensuring the effectiveness.
- Large-sized audit firms, in particular, are promoting the use of IT in auditing in order to maintain and enhance audit quality. However, amidst progress with exchanging data with audited companies, there have been cases overseas in which damages have been caused due to cyberattacks targeting data retained by

audit firms. For audit firms, cybersecurity issues have become a major operational risk. Along with advances in the use of IT, it is necessary to enhance cybersecurity going forward.

<Outline of the Basic Plan>

(i) Basic Plan Pertaining to Off-site Monitoring

(a) Collection of reports

(a-1) Large-sized and second-tier audit firms

In terms of large-sized and second-tier audit firms, the CPAAOB will continue to collect the qualitative and quantitative information necessary to inspect their business management (governance) and operations management system, IT-based audit approaches, cybersecurity measures, etc., for improved audit quality based on the Audit Firm Governance Code. Also, the CPAAOB works to understand the actual situations in the audit and oversight environment for listed financial institutions, the audit of which requires sophisticated expertise and understanding of IT.

(a-2) Small and medium-sized audit firms

The CPAAOB will collect reports in a timely manner in order to encourage audit firms to achieve the appropriate quality control. In doing so, the CPAAOB conducts inspections prioritizing items such as the management policies of the senior management, earnings, the financial structure, as well as the organization and human resources, in addition to the progress with establishing the system of quality control at audit firms.

Also, regarding problems found in inspection results, the CPAAOB works to understand the state of progress through collecting reports after a certain period of time has passed since the notification of the inspection results, and holds hearings as necessary.

(a-3) Case in which improvement of items identified in inspections is urgently required

Regarding audit firms for which the results of inspections acknowledge that improvement is urgently required, the CPAAOB collects reports at the same time as the notification of inspection results and encourages speedy improvements.

(b) Inspections of the JICPA's quality control reviews as well as cooperation with the JICPA

While the quality of the JICPA's quality control reviews is improving, it remains questionable that the progress with the deficiencies identified through reviews is adequately confirmed in the next review. Also, regarding guidance for improvements, although efforts are being made in so far as possible to contribute to the voluntary efforts of audit firms, further inspections regarding the results thereof are necessary.

The CPAAOB is making efforts to increase cooperation between the CPAAOB and the JICPA to a high level in order to maintain and enhance audit quality by Japanese audit firms as a whole. Also, the CPAAOB and the JICPA hold discussions focused on the quality control reviews of large-sized audit firms and the enhancement of the JICPA's guidance and supervisory function for small and medium-sized audit firms in relation to the appropriate division of roles between the CPAAOB's inspections and the JICPA's quality control reviews. The JICPA is now taking actions based on the discussions with the CPAAOB, but discussions are continuing from the point of view of achieving the maximum overall effectiveness of the CPAAOB's inspections and the JICPA's quality control reviews.

(c) Collection and analysis of information on audit firms

The CPAAOB has periodic dialogues with the management level of large-sized and second-tier audit firms, including the senior management, from the points of view of understanding the current operations management system of audit firms and the issues, etc., that audit firms and the audit sector face. Because the management level, including the senior management, has a major impact on the organizational climate at audit firms, the CPAAOB will continue having dialogues with them going forward, and make efforts to implement more in-depth discussions. When having these discussions, the CPAAOB encourages audit firms to further enhance the information they disclose related to the quality control, and to actively disseminate information, so that market participants can obtain useful information.

Also, the CPAAOB works to further enhance the sharing of information through exchanges of opinions and cooperation with, in addition to the relevant divisions of the FSA and JICPA, international independent audit regulators, audit oversight authorities of foreign countries, and the global networks of audit firms. Furthermore, the CPAAOB endeavors to improve the collection and analysis environment of various materials and information in accordance with the risk of audit firms.

(ii) Basic Inspection Plan

- Whether the operations management system and the system of quality control are appropriate in accordance with the size and characteristics of the audit firm.
- What kind of impact the awareness of the management level, including the senior management, regarding quality control has on the operations management system of audit firms.
- Whether appropriate professional skepticism is exercised in carrying out auditing services.

The CPAAOB inspects audit firms in consideration of each firm's characteristics and the above points.

(a) Large-sized audit firms

Considering their important roles in capital markets, the CPAAOB inspects large-sized audit firms every year (alternating between regular inspection and follow-up inspection).

In the current program year, inspections will be conducted with an emphasis on the business management system and the operations management system, including the tone at the top, the effectiveness of the environment built based on the Audit Firm Governance Code, the procedures for taking on new audit engagements (especially for large-scale listed companies and listed companies with high risk) and related preparation/arrangement on audit quality, evaluation of internal controls at audited companies including overseas businesses, and the status of group audits including overseas subsidiaries.

(b) Second-tier audit firms

Second-tier audit firms have a considerable number of listed audited companies and are responsible for fulfilling a certain role in capital markets, but their operations management system and system of quality control are not considered adequate compared to large-sized audit firms, so the CPAAOB inspects them every three years in principle, maintaining a close watch on the progress with establishing those systems.

In the current program year, in addition to understanding awareness and efforts of the management level, including the tone at the top toward improving audit quality, inspections will be conducted with an emphasis on the effectiveness of systems built to improve audit quality pursuant to the Audit Firm Governance Code and business management and operations management system, such as the integrity of the organization.



(c) Small and medium-sized audit firms

For small and medium-sized audit firms, the CPAAOB will inspect their system of quality control and the conformity of individual audit engagements to audit standards, in addition to the influence of the awareness and participation of the senior management on those items and the operations management system. When selecting inspection targets, the CPAAOB considers the necessity of an immediate inspection of the target's system of quality control, taking into consideration the JICPA's quality control review results and the degree of risk at audited companies.

In the current program year, inspections will be conducted with an emphasis on keeping in mind whether identified deficiencies have resulted from the business model and whether corrective measures against deficiencies are only a formality and palliative. The CPAAOB also inspects those firms' business management and operations management system, such as the integrity of the organization, the appropriateness of risk assessment when undertaking audits of listed companies with high audit risk, and the audit environment for those companies.

## 2.3 Monitoring and Inspections of Audit Firms

Audit firms may audit or attest financial documents for fees at the request of others (Article 2(1) of the CPA Act) and, using the title of "certified public accountant," they may also provide services such as compiling financial documents, examining or planning financial matters, or providing consultations on financial matters for fees at the request of others (Article 2(2) of the CPA Act).

As of the end of FY2019, the number of registered certified public accountants totals 31,793, of which the number of CPAs belonging to large-sized audit firms is 10,659 or approximately 34% of the total. The number of audit firms totals 245.

(Reference)

	End of FY2015	End of FY2016	End of FY2017	End of FY2018	End of FY2019
Number of registered certified public accountants	28,286	29,367	30,350	31,189	31,793
Large-sized audit firms	10,846	11,002	11,016	10,912	10,659
Number of audit firms	214	222	229	235	245

### 2.3.1 Quality Control Reviews by the JICPA

#### (i) FY2018

In FY2018, the JICPA performed 56 quality control reviews (46 audit firms (including two large-sized and two second-tier audit firms and five partnerships) and 10 CPAs). The conclusions are presented in the following table.

The Results of Reviews (FY2018)

(Number of audit firms)

Category	Unqualified conclusion		Qualified conclusion		Disclaimer of Opinion		Adverse Opinion		Total
	(a)	a/e	(b)	b/e	(c)	c/e	(d)	d/e	
Audit firm	42	91.3%	4	8.7%	—	—	—	—	46
CPA	7	70.0%	1	10.0%	—	—	2	20.0%	10
Total	49	87.5%	5	8.9%	—	—	2	3.6%	56

(Note) 51 out of 56 cases include recommendations for improvement.

#### (ii) FY2019

In FY2019, the JICPA performed 84 quality control reviews (58 audit firms (including two large-sized and two second-tier audit firms and one partnership) and 26 CPAs), as the table below shows.

Status of Implementation of Quality Control Reviews

Quality control reviews Month and year conducted	2019							2020			Total
	Jun.	Jul.	Aug.	Sep.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	
Quality control reviews Number of audit firms reviewed	0	7	11	2	18	18	14	12	1	1	84

Of the quality control reviews conducted in FY2019, 43 cases, the details of which had been approved by the Quality Control Committee, had been reported to the CPAAOB as of March 31, 2020. The conclusions of those reports were as follows.

- Unqualified conclusions: 42 (29 audit firms, 13 certified public

accountants)

- Qualified conclusions: 1 (zero audit firms, one certified public accountant)

## 2.3.2 Examination of Quality Control Reviews

### (i) Examination

The CPAAOB receives a report on quality control reviews from the JICPA, and examines the appropriateness of the JICPA's quality control and the auditing services of audit firms.

More specifically, the CPAAOB confirms the implementation of quality control reviews and guidance for audit firms on necessary improvement measures, and analyzes the findings of quality control reviews (to determine any adverse opinions or qualified conclusions applicable to the conclusions of the quality control reviews, or the nature of any deficiencies indicated in the quality control reviews) as well as details of improvement plans submitted by audit firms to the JICPA.

In addition to considering the need for conducting on-site inspections in light of these analysis results, the CPAAOB engages in exchanges of opinions with the JICPA (see page 23, "2.5.2 Cooperation with the JICPA," "2.5 Cooperation with Relevant Organizations").

When conducting examinations, the CPAAOB also utilizes information obtained from relevant organizations such as the FSA, the JICPA, stock exchanges, and the Japan Audit & Supervisory Board Members Association (JASBA).

### (ii) Analysis of FY2018 quality control reviews

In progress with improving the quality of quality control reviews, the CPAAOB found the following through the examination of the FY2018 quality control reviews:

- In some cases, quality control review plans were formulated based on the results of past quality control reviews for an audit firm and risk evaluations in the selection stage of individual audit engagements intended for review in order to enhance the risk approach, and the review period was extended in accordance with the risk information understood after the start of the review as well.
- There are increasing cases with items identified in individual audit engagements going beyond simple deficiencies in documentation and covering deficiencies in audit procedures based on the actual situations of the deficiencies.

### 2.3.3 Collection of Reports from Audit Firms

#### (i) Periodical collection of reports from large-sized and second-tier audit firms

In July 2019, the CPAAOB collected reports from all large-sized and second-tier audit firms for the purpose of monitoring their business management (governance) system and operations management system. Information obtained from report collection was used to make inspections effective and efficient through beforehand analysis of the actual situations of audit firms targeted for inspections, and as a reference for selecting points for attention when performing inspections, in addition to being utilized to make comparisons among large-sized and second-tier audit firms and find problems common across these audit firms. The CPAAOB will continue collecting reports annually.

#### (ii) Collection of reports from small and medium-sized audit firms

Based on the PY2019 Basic Plan for Monitoring Audit Firms, the CPAAOB collected reports from 31 audit firms for which it was deemed necessary to monitor improvements made by small and medium-sized audit firms in response to quality control reviews and to identify the business management system, etc. Those reports were collected in August 2019.

#### History of Collection of Reports

	PY2018		PY2019	
	No. of firms undergoing report collection	No. of firms undergoing QC reviews in FY2017	No. of firms undergoing report collection	No. of firms undergoing QC reviews in FY2018
Audit firms	53	92	31	52
Audit firms (Note)	44	68	22	42
Solo practitioners	9	24	9	10

(Note) Including partnerships.

Among the small and medium-sized audit firms which received the results of quality control reviews in FY2018, the CPAAOB chose the targets for report collection based on the severity of the quality control review results.

(iii) Collection of reports after inspections (follow-up monitoring)

In PY2019, the CPAAOB collected reports from two audit firms which were inspected in PY2018 in order to confirm improvements made in response to deficiencies identified during inspections.

#### 2.3.4 Inspections of Audit Firms

In PY2019, the CPAAOB conducted inspections of large-sized, second-tier, and small and medium-sized audit firms based on their characteristics as well as in accordance with the Basic Inspection Plan (see 2.2.2 (ii) above).

With regard to large-sized audit firms, inspections are generally performed once every two years, with a follow-up inspection conducted in the following program year. The CPAAOB conducted regular inspections of two firms and a follow-up inspection of one firm in PY2019.

With regard to second-tier audit firms, inspections are generally performed once every three years. The CPAAOB conducted inspections of two firms in PY2019.

With regard to small and medium-sized audit firms, inspections are performed as necessary. The CPAAOB conducted inspections of two firms in PY2019.

The CPAAOB carried out inspections aimed at encouraging the audit firms to make effective improvements based not only on the direct causes of deficiencies but also on the root cause analysis of the deficiencies, and to take fundamental responses.

Status of commencement of inspections in most recent five years (as of March 31, 2020)

FY/PY	2015	2016	2017	2018	2019
Large-sized audit firms	2	4	4	4	3
Second-tier audit firms	1	2	2	1	2
Small and medium-sized audit firms	6	5	3	5	2
Foreign audit firms	0	1	0	0	1
Total	9	12	9	10	8

(Note 1) July 2016 periods have been changed to program years (July through the following June). Because PY2016 was the year in which this change was made, the data for it includes inspections conducted in April-June 2016.

(Note 2) For PY2019 inspections, those started before or on March 31, 2020, were included in the total.

### 2.3.5 Inspections Results

The CPAAOB has included an overall rating of audit firms' operation of services in the inspection results notification since inspections commenced in PY2016 (excluding inspections for foreign audit firms and follow-up inspections). The overall rating is classified in five grades. No audit firms have yet qualified as "Generally satisfactory," the highest rating in the overall rating scheme, so quality control at all audit firms was rated as "Satisfactory with minor deficiencies" or lower. (See below)

For details on the overall rating, please refer to the Monitoring Report.

#### Overall ratings for inspections in PY2016 - 2019

(As of March 31, 2020)

Classification	Large-sized audit firms, second-tier audit firms	Small and medium-sized audit firms
Generally satisfactory	-	-
Satisfactory with minor deficiencies	9	3
Unsatisfactory	4	4
Unsatisfactory and in need of immediate remediation	-	3
Extremely unsatisfactory	-	4

(Note) Regarding inspections in PY2019, those for which inspection results notifications were issued before or on March 31, 2020, were included. We plan to update the above data in the 2020 Monitoring Report.

### 2.3.6 Recommendations to the Commissioner of the FSA

The CPAAOB found that operation of the following audit firms was extremely inappropriate during its inspection. Pursuant to the provisions of Article 41-2 of the CPA Act, the CPAAOB recommended the Commissioner of the FSA to take administrative actions and other measures against these firms.

- Seiryu Audit Corporation (July 5, 2019)
- Ootemon Law and Accounting (December 6, 2019)

### 2.3.7 Inspections and Oversight on Foreign Audit Firms

#### (i) Foreign audit firms

Foreign CPAs and audit firms providing audit and attestation services for the financial statements, which are subject to FIEA disclosure rules, are required to register with the FSA Commissioner in advance. Registered foreign audit firms,

etc., are as follows:

Registered foreign audit firms, etc.		(As of March 31, 2020)
	Number of countries/regions	Number of foreign audit firms
North America	2	9
Central & South America	2	8
Europe	15	47
Asia & Pacific	10	28
Middle East	1	1
Total	30	93

- (ii) A framework for the collection of reports and inspections on foreign audit firms, etc.

The CPAAOB collects reports from and conducts inspections of foreign audit firms, etc. in accordance with “A Framework for Inspection/Supervision of Foreign Audit Firms, etc.”

Under the Framework and Guidelines, the CPAAOB will collect reports from foreign audit firms, etc. once every three years, in principle. The CPAAOB will analyze information submitted from the firms and assess the need for further examinations based on aspects including whether or not the firms properly conduct services corresponding to audit and assurance services. Inspections will be conducted for the firms that have been selected based on the analysis. The CPAAOB will generally rely on oversight by the competent authorities of the firms’ home jurisdictions, instead of seeking to obtain information from or conducting inspections on firms, provided that (a) the audit and public oversight systems in the firms’ home jurisdictions are equivalent to those of Japan, (b) necessary information can be provided from such competent authorities through appropriate arrangements of information exchange, and (c) reciprocity is ensured.

- (iii) Collection of reports from foreign audit firms

In accordance with the Framework described in (ii) above and “Basic Guidelines on Information Requirements and Inspection on Foreign Audit Firms etc. by the Certified Public Accountants and Auditing Oversight Board,” the CPAAOB collected reports from 79 foreign audit firms, etc., in 29 countries or regions in PY2018. Furthermore, the CPAAOB asked the competent authorities of the particular firms’ home jurisdictions to provide information on

these firms, in accordance with the information exchange framework with competent authorities in these countries or regions.

(Note) See “3.2 Bilateral Cooperation” on page 34 for details of the information exchange framework.

(iv) Inspections of foreign audit firms, etc.

In accordance with the results of the analysis of the information that was presented by foreign audit firms, etc. in the collection of reports conducted in PY2018 and cooperation with the oversight authorities of the home jurisdictions of foreign audit firms, etc. as indicated in (iii) above, the CPAAOB conducted inspections on one foreign audit firm in PY2019.

## 2.4 Dissemination of Information relating to Examination and Inspection

### 2.4.1 Publication of “2019 Monitoring Report”

Since 2016, the Certified Public Accountants and Auditing Oversight Board (“CPAAOB”) has been annually releasing the Monitoring Report with the aim of providing readily comprehensible information on audit firms not only to auditors and accounting experts, but also to market participants and general users.

Since the role of audits in capital markets is becoming increasingly important, the CPAAOB believes that it is vital to enable as many stakeholders as possible, including enterprises and investors, to be able to properly assess audit quality at audit firms.

The CPAAOB revised the report by renewing data and adding new items in the 2019 edition, in addition to restructuring the contents since the 2018 edition. The revised points in this year’s edition are as follows:

- Section I Overview of the Audit Sector

This section provides an overall look at the audit sector, such as statements on the current conditions of CPAs, audit firms, audited companies, etc., and the concentration of audits at large-sized audit firms.

- Section II The CPAAOB Monitoring

This section includes a comprehensive evaluation of large-sized or second-tier audit firms as well as small and medium-sized audit firms in the inspections over the last three program years and the situation with the activities of the CPAAOB (organization outline, examinations, report collection and inspections).



- Section III Operation of Audit Firms

This section includes information on the operation of audit firms understood through monitoring, such as efforts with the Audit Firm Governance Code and personnel transfers of auditors.

- Section IV Responses to Changes in the Global Environment Surrounding Audits

This section includes information on responses to changes in the environment surrounding audits, such as important recent trends at audit firms.

The full text of the 2019 version is available at

<https://www.fsa.go.jp/cpaaob/shinsakensa/kouhyou/20190730-2/20190730-1.html>

The English version released in December 2019 is available at

<https://www.fsa.go.jp/cpaaob/english/oversight/20191220/20191220.html>

## 2.4.2 Publication of “Case Report from Audit Firm Inspection Results”

### (i) Publication of “Case Report from Audit Firm Inspection Results”

Since February 2008, the CPAAOB has published cases pointed out in inspections of audit firms as “Case Report of Inspections Related to Quality Management of Audits” (Title changed to “Case Report from Audit Firm Inspection Results” in 2012).

The purpose of this Case Report is to promote voluntary efforts by audit firms to ensure and improve their audit quality by presenting the level of audit quality that the CPAAOB expects. In addition, this Case Report also serves as reference to be provided to market participants such as the directors/audit & supervisory board members of listed companies, investors, etc.

In the 2019 edition of the Case Report published on July 30, 2019, in addition to the recent deficiencies, revisions were made to include a description in as much detail as possible to the background in which the deficiency occurred. The revised points are as follows:

- Section I Operations Management System (Root Cause Analysis)

Added examples of problems in operations management system based on the Audit Firm Governance Code.

- Section II System of Quality Control

Provided thorough examples of problems with system of quality control regarding the conclusions of new audit engagements, the recruitment of personnel, and the supervision of partners and professional staff who work with engagement partners.

- Section III Individual Audit Engagements

Taking into account the continuing focus on fraudulent financial reporting by listed companies and accounting fraud at overseas subsidiaries, this section includes more about deficiencies related to “Fraud in Financial Statement Audits” and “Group Audit.”

The full text of the Case Report is available at

<https://www.fsa.go.jp/cpaaob/shinsakensa/kouhyou/20190730-2/20190730-2.html>

The English version released in November 2019 is available at

<https://www.fsa.go.jp/cpaaob/english/oversight/20191129/20191129.html>

- (ii) Lectures about the Case Report

CPAAOB inspectors provide lectures about the Case Report together with lectures from chairperson and commissioner of the CPAAOB in JICPA’s training sessions.

In PY2019, the CPAAOB gave a total of 11 lectures at the head office of the JICPA and 10 regional chapters across Japan from October 2019 to January 2020 in order to encourage voluntary efforts at audit firms to ensure and improve audit quality.

In addition, the CPAAOB gave lectures for audit & supervisory board members twice in December 2019 at the JASBA and for internal auditors twice in January and February 2020 at the Institute of Internal Auditors–Japan. The aim of the lectures was to promote proactive communication between auditors and audited companies by referencing the Case Report.

To encourage the use of the Case Report as a reference for operations in audit firms, etc., the CPAAOB also worked on publicity efforts such as publishing articles about the revision of the Case Report in the journals of the JICPA, the JASBA, etc.

## 2.5 Cooperation with Relevant Organizations

In order to ensure and improve audit quality, it is important not only to monitor audit firms, but also to cooperate with audit-related organizations to share issues and awareness of audit firms.

Therefore, the CPAAOB exchanges opinions not only with the relevant divisions of the FSA but also with other relevant organizations, including the JICPA and the financial instruments exchanges.

#### 2.5.1 Cooperation with Relevant Divisions of the FSA

Cooperation with the relevant divisions of the FSA will lead to more effective and efficient inspections by sharing audit engagement issues. The CPAAOB discussed issues regarding the disclosures and audits of listed companies with the Securities and Exchange Surveillance Commission, and applied the obtained information to monitoring. The CPAAOB also shared the inspection results of audit firms with the relevant divisions of the FSA.

#### 2.5.2 Cooperation with the JICPA

The CPAAOB is making efforts to build firm cooperation with the JICPA for the purpose of enhancing the effectiveness of quality control reviews by the JICPA, such as by holding discussions between the CPAAOB inspectors and the JICPA reviewer regarding issues found through monitoring.

In PY2019, the CPAAOB and the JICPA held discussions about issues related to the quality control review system and audit firms found through monitoring, and exchanged opinions on policies to improve the effectiveness of quality control reviews.

#### 2.5.3 Cooperation with the Financial Instruments Exchanges

For mutual understanding, the CPAAOB cooperated with Financial Instrument Exchanges and self-regulatory organizations for listed companies, by exchanging opinions concerning issues identified through monitoring that are common to all listed companies such as the problems of internal-control and changes in auditors.

#### 2.5.4 Cooperation with the Japan Audit & Supervisory Board Members Association

The CPAAOB places importance on cooperation with audit & supervisory board members who play an important role in corporate governance in light of proper disclosure of financial information. Therefore, the CPAAOB has checked communication between audit & supervisory boards, as well as auditors in its inspections. In addition, the roles of audit & supervisory boards have become increasingly important due to the revised Companies Act and the Corporate Governance Code.

Therefore, the CPAAOB and the JASBA discussed issues such as overall rating of the operation of audit firms and communication between audit & supervisory board members and auditors in October 2019. The CPAAOB also provided a

lecture on deficiencies identified in inspections, as well as problems at audit firms to audit & supervisory board members through the JASBA lecture meetings, etc.

## 2.6 Achievement in PY2019 agenda

### 2.6.1 Inspections of Business Management System Such as Governance

In order to continuously improve audit quality, the CPAAOB performed inspections on the awareness of the management level, including the tone at the top, and if that is reflected in specific measures, etc.

The CPAAOB checked the large-sized and second-tier audit firms which have adopted the Audit Firm Governance Code, evaluating how the effectiveness of their governance has been strengthened based on the Code in terms of improving audit quality; sharing information and cooperating with the relevant divisions of the FSA; and performing inspections on whether the oversight/assessment body composed of independent third parties adequately demonstrated its function.

As a result, on an overall level at large-sized and second-tier audit firms, the CPAAOB found that there has been progress with efforts to make use of the expertise of independent third parties, such as requesting opinions from independent third parties upon providing the necessary information to them.

### 2.6.2 Monitoring Based on Trends Related to Audits

#### (i) Group audits including auditing of overseas subsidiaries

Due to a saturated domestic market, listed companies are seeking to increase sales by expanding overseas. Amidst this trend, a great number of fraud cases are being found at overseas subsidiaries. Taking into account this, the CPAAOB inspected the correspondence of not only engagement teams, but also audit firms regarding group audits which includes auditing of overseas subsidiaries.

As a result, the CPAAOB found that many audit firms have developed audit instruction formats and manuals. On the other hand, the CPAAOB found some cases in which the necessary audit procedures were not carried out, such as when information regarding the risk management procedures planned by component auditors was not obtained while visiting and receiving explanations from overseas component auditors of audited companies, assuming that component auditors had adequately reviewed the procedures, and as such the appropriateness of those procedures was not evaluated.

#### (ii) Acceptance of audit engagements

Recently, many listed companies are changing their auditors from large-sized

audit firms to second-tier/small and medium-sized audit firms. The CPAAOB inspected whether audit firms assess risk appropriately, and whether they formulate engagement teams based on risk assessment when accepting new engagements with high audit risk.

As a result, regarding companies with high audit risk, the CPAAOB found some cases in which audit firms estimated that they would need much less auditing time than the predecessor auditor, and accepted the engagement without adequately considering if that would actually be enough time to conduct the audit.

#### 2.6.3 Strengthening of Off-site Monitoring

The CPAAOB works to strengthen off-site monitoring in order to implement efficient, effective monitoring. Based on recent trends, the CPAAOB has periodic dialogues with the management level of large-sized and second-tier audit firms, including the senior management, regarding the environment supporting auditing, such as the use of IT in auditing, and the policy of acceptance of new audit engagements for companies making their IPOs. Also, the CPAAOB exchanges opinions in a timely manner with the relevant divisions of the FSA, financial instruments exchanges, the JASBA, and others, and in addition collects reports from the aforementioned audit firms. The CPAAOB makes effective use of the collected information and the results of its analysis in ways such as grasping industry trends and selecting points to focus on when implementing inspections.

#### 2.6.4 Verifications of the JICPA's Quality Control Reviews as well as Cooperation with the JICPA

The CPAAOB verifies the effectiveness of the JICPA's quality control reviews through inspections of audit firms and shares information on detected issues with the JICPA for encouraging further improvements of quality control reviews.

Since PY2015, the CPAAOB and the JICPA have continued to carry out the working level review meeting for discussing problems of quality control reviews. Based on the discussions at the review meeting, the JICPA makes flexible use of the review plan and selects individual audit engagements based on the risks. Further, awareness has grown strong regarding connecting the points identified in individual audit engagements to deficiencies in the system of quality control.

Also, at the same review meeting, the CPAAOB and the JICPA hold discussions focused on the quality control reviews of large-sized audit firms and the enhancement of the JICPA's guidance and supervisory function for small and medium-sized audit firms in relation to the appropriate division of roles between the CPAAOB's inspections and the JICPA's quality control reviews. Discussions

are now progressing on achieving the maximum overall effectiveness of the CPAAOB's inspections and the JICPA's quality control reviews.

#### 2.6.5 Monitoring of Technology Use and Cybersecurity at Audit Firms

In recent auditing, the use of IT is becoming necessary in order to implement efficient, effective audits in response to the growing complexity, diversification, and sophistication of corporate activities. Therefore, large-sized audit firms and some second-tier audit firms are further promoting the use of IT in auditing for the purpose of ensuring and improving audit quality.

As a result of the monitoring of large-sized audit firms, it was found that those firms are using audit tools developed by the global accounting network and undertaking R&D for inventing audit tools. The firms are also actively employing IT specialists and investing in IT-related human resource developments such as providing IT training. Also, the CPAAOB found efforts to improve audit quality by enabling CPAs to concentrate on the duties necessary to making high-level judgements by the proactive introduction of AI for risk assessments that include comprehending the business of audited companies and detecting abnormal journal entries as well as RPA (a form of automation technology for business processes) in standardized audit procedures and the accompanying operations.

Regarding cybersecurity, large-sized audit firms have experts and specialized departments in place, and are cooperating with the global accounting network. Second-tier audit firms are making efforts with cybersecurity, such as by participating in the FSA-sponsored "Financial Industry-wide Cybersecurity Exercise (Delta Wall IV)" in October 2019 and strengthening responses to the outbreak of large-scale incidents.

#### 2.6.6 Strengthening Dissemination of Information

The 2019 Monitoring Report includes the results of monitoring carried out by the CPAAOB, in addition to data provided by audit firms, so as to contribute to increasing the comprehension of audits by market participants. The CPAAOB revised its content to increase the comprehension of financial auditing not only by market participants but also for a wide range of general users. In addition, the CPAAOB worked to actively provide information in ways such as holding lectures and briefings, as well as making contributions to the relevant journals.

#### 2.6.7 Enhancement of the Monitoring Environment

In order for the monitoring of the CPAAOB to properly respond to the above-mentioned issues surrounding audit firms and the internationalization of accounting practices, it is important to carry out thorough monitoring by, for

example, securing human resources and strengthening collection/analysis of information. In PY2019, the CPAAOB endeavored to secure personnel for inspections by reviewing its internal operations, and in addition enhanced its ability to collect and analyze all kinds of information so as to contribute to effective and efficient inspections grounded in a risk-based approach.

### **3 Cooperation with Relevant Organizations in Other Jurisdictions**

#### **3.1 Activities of the International Forum of Independent Audit Regulators (IFIAR)**

##### **3.1.1 Background**

Triggered by accounting scandals such as those at U.S. companies Enron and WorldCom, the need to ensure and improve audit quality was recognized. Since 2002, audit oversight regulators which are independent from the accounting profession have been established in jurisdictions throughout the world.

Amid such circumstances, the first unofficial meeting of audit oversight regulators was held in Washington, D.C., in September 2004, organized by the Financial Stability Forum (FSF) (now the Financial Stability Board (FSB)), for the purpose of sharing information among respective members' jurisdictions. The meeting was attended by nine jurisdictions: Japan, the U.S.A., the U.K., Germany, France, Italy, Canada, Australia, and Singapore. Subsequently, a series of further informal meetings were held. Momentum was gathered for the establishment of a permanent international forum, and at the fifth meeting of audit oversight regulators held in Paris in September 2006, formal approval was given for the establishment of the International Forum of Independent Audit Regulators (IFIAR). Its first Plenary Meeting was held in Tokyo in March 2007, hosted by the CPAAOB, and was attended by the audit oversight authorities of 22 jurisdictions.

According to the Charter adopted at the 4th Plenary Meeting, which was held in Cape Town in September 2008, the purpose of the IFIAR is to engage in activities i-iii below. Later, at the 13th Plenary Meeting held in Noordwijk in April 2013, the Charter was revised with the addition of iv below.

- i. Sharing knowledge of the audit market environment and practical experience of independent audit regulatory activity with a focus on inspections of auditors and audit firms;
- ii. Promoting collaboration and consistency in regulatory activity;
- iii. Initiating and leading dialogue with other policy-makers and organizations that have an interest in audit quality; and
- iv. Forming common and consistent views or positions on matters of importance to its Members, taking into account the legal mandates and missions of individual members.

In January 2015, the CPAAOB and the FSA made a bid to host the IFIAR secretariat in Tokyo with the aim to contribute to improving audit quality globally through IFIAR, enhancing Japan's influence in international financial regulatory activities including auditing, and establishing Tokyo's presence as an international



financial center. As a result of bid campaigns in collaboration with industry, government, and academia, the establishment of the IFIAR Secretariat in Tokyo was approved at the 16th Plenary Meeting in London in April 2016, and the secretariat was opened in April 2017.

### 3.1.2 Organization

The IFIAR comprises the audit oversight authorities from 55 jurisdictions as of the end of March 2020.

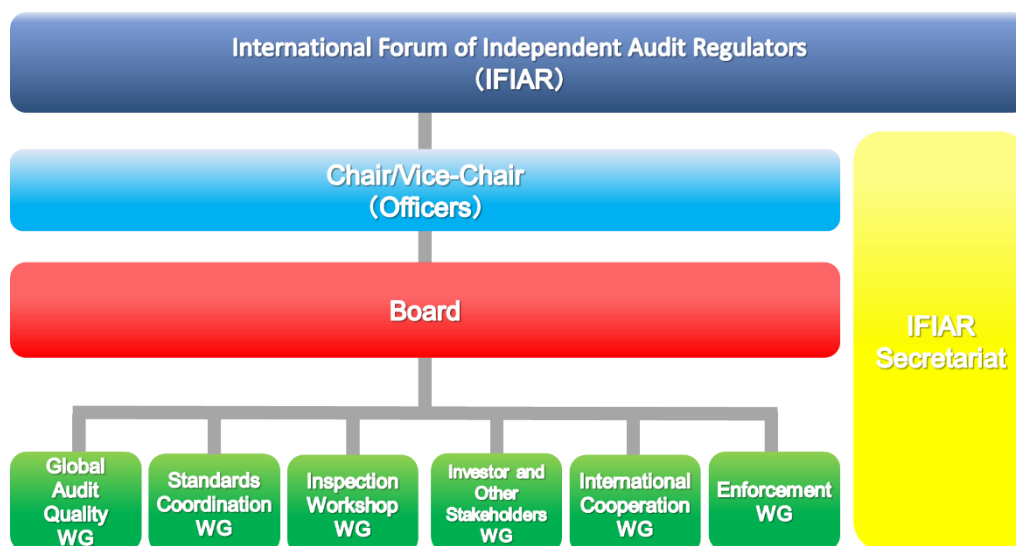
Every year, IFIAR convenes a plenary meeting for all member representatives to make important decisions. The 19th plenary meeting was held in Greece in April 2019.

The post of Chair and Vice Chair are assigned to elected individuals to conduct IFIAR's activities efficiently. As of the end of March 2020, the chair country is Switzerland, and the vice chair country is the United States.

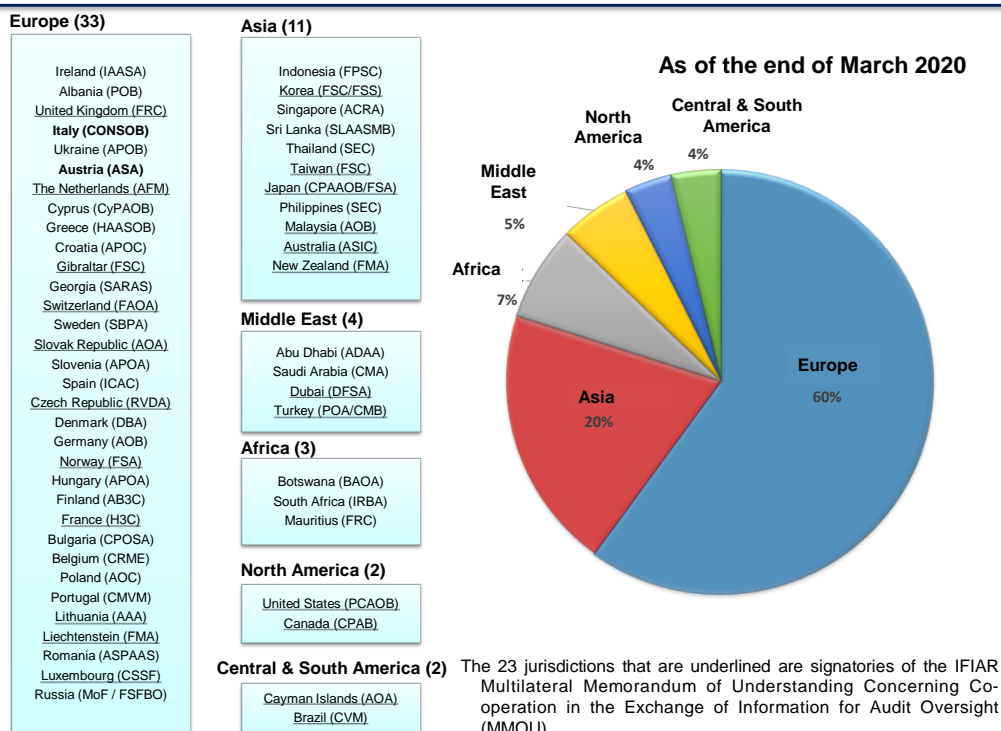
In April 2017, the IFIAR Board, (the new governing body comprised of 15 Board Members including Japan,) was established, and had its first meeting in Tokyo.

Also, the IFIAR has six Working Groups as of the end of March 2020. The objective and activities of each Working Group are described in detail in 3.1.3 (ii).

IFIAR organization chart (As of the end of March 2020)



## IFIAR Members 55 Jurisdictions



### 3.1.3 Activities

#### (i) Activities of the Plenary Meeting

##### (a) 19th Plenary Meeting in Greece

The 19th Plenary Meeting was held in Greece from April 30 to May 2, 2019.

Major accounting fraud cases have occurred in some countries, such as the UK and the Netherlands, which led to the discussion on fundamental reform of audit to restore confidence in audit and audit regulators. Amidst these circumstances, the IFIAR's role in the changing world of audit was discussed, based on the reconsideration of what an audit is, and what should be audited in what way. In the meeting, the idea was shared that all stakeholders in the financial reporting ecosystem, including not only auditors but also financial report preparers and users, must play their role to improve audit quality. Furthermore, the attendees discussed risk awareness in each network, the ideal form of audits in the future, and other topics with the CEOs of the Six largest networks (Note).

(Note) Six largest networks: Deloitte Touche Tohmatsu, Ernst & Young, KPMG, PricewaterhouseCoopers, BDO, and Grant Thornton

(b) Board

In 2015, IFIAR's governance structure, which had hitherto been led by the Chair and the Vice-Chair, was overhauled in order to improve the IFIAR function as an international body. The members agreed to establish a governance structure based on a council system led by the member countries (board structure). As a result of these governance reforms, IFIAR established the Board in April 2017, and the Advisory Council, which had served as an advisory body to the Chair and Vice-Chair was replaced by the Board. The Board is a decision-making body comprising up to 16 members including 8 nominated members and up to 8 elected members. Japan was officially appointed as a four-year term nominated member in accordance with the selection procedures (points system) prescribed in the IFIAR Charter at the IFIAR Plenary Meeting held in April 2017.

The Board deliberates on IFIAR's Strategic Plan and conducts discussions on the administration of IFIAR's operations. In FY2019, the Board meetings were held in Greece on May 2 and 3, 2019, in Paris on October 24 and 25, 2019, and in Abu Dhabi on January 21 and 22, 2020.

Also, after the board meeting in Greece, a new task force, the Internationally Relevant Developments in Audit Markets (IRDAM), was established as a subgroup under the Board. This task force is aiming to keep up on the discussions on audit reform of IFIAR member countries, in response to the fundamental reform proposals being considered in the UK and the Netherlands.

(c) Inspection Findings Survey Report

Since 2012, the IFIAR has been publishing "Inspection Findings Survey Report" to provide information broadly on features of the results of inspections performed by member authorities on the member firms of the Six largest networks. In this survey, inspection results are aggregated in the two categories of quality control systems and individual audit engagements, and the inspection findings rate is calculated in each of the categories.

Forty-nine member authorities participated in the eighth survey in 2019. (The total number of IFIAR member authorities is 55 as of the end of March 2020.) The inspection findings rate of all member authorities related to individual audit engagements of listed companies was 33%. The rate was 47% when aggregation started in the 2014 survey, indicating a continuing overall decline.

(ii) Activities of each working group

(a) Global Audit Quality (GAQ) Working Group

The aim of this working group (WG) is to exchange views with the Six largest networks on the desirable quality of global audits. The WG maintains dialogue with each network on such topics as the quality control systems of global audit networks, and shares information between authorities on improvements in quality control and on the organizational expansion of each network.

The WG took the initiative aiming to reduce the inspection findings rate of the

member firms of the Six largest networks by 25% over a four-year period up to 2019 from a baseline of 39% in 2015 (targeted rate: 29% or less). Publicized in January 2020, the inspection findings rate of the WG member countries in the final year of 2019 was 31%. There was a 21% decrease over the four years, but the result was short of the target decrease of 25%. The WG and the member firms of the Six largest networks have agreed to a new initiative aimed at further reduction of the inspection findings rate. Approximately half of the IFIAR member countries are participating in the new initiative. The target is a further 25% reduction of the inspection findings rate on a 2019 basis over the four years until 2023.

Also, since September 2015, this WG has been regularly conducting risk calls in order to widely discuss the risks currently confronting auditors as well as risks that may impact auditing in the future, such as the macroeconomic environment. Since the sixth risk call in November 2018, Japan replaced the United States as the Chair. In the seventh risk call in November 2019, matters discussed included digitalization at audit firms as well as audit clients, cryptoassets / blockchains, and key audit matters (KAM).

GAQ WG's meeting in fiscal 2019 was held in Paris from October 21 to 23. The WG discussed efforts to reduce the inspection findings rate and efforts to develop broader measures of audit quality, in addition to the use of a centralized service center and the implementation of internal inspections.

(b) Standards Coordination Working Group

The aims of this WG include the exchange of views on the setting of international standards at the International Auditing and Assurance Standards Board (IAASB) and International Ethics Standards Board for Accountants (IESBA) and the preparation of comment letters in response to exposure drafts published by these standard-setting bodies.

(c) Inspection Workshop Working Group

This WG holds the IFIAR inspection workshop every year for the purpose of skill training for inspectors and to share inspection methods and experiences. The WG plans and coordinates inspection workshop, and performs evaluations after it is completed.

At the first IFIAR Plenary Meeting in Tokyo in 2007, it was agreed to hold the inspection workshop, led by the inspectors of the IFIAR members, for the purpose of sharing information on the inspection methods of audit oversight authorities and on issues related to inspections, as well as providing training for inspectors. Since then, the workshop has been held every year, with planning and coordination by this WG.

The 14th inspection workshop was held between February 4 and 6, 2020, in Washington D.C., and was hosted by the Public Company Accounting Oversight Board (PCAOB) of the United States. A total of 117 inspectors participated from 40 jurisdictions, including Japan. One senior inspector and one deputy director participated as panelists from the CPAAOB. They served respectively as panelists of the “Firmwide (Quality Control System) and International Standard on Quality Management 1 (ISQM1)” and “Communication with the Audit Committee” sessions.

(d) Investor and Other Stakeholders (IOS) Working Group

The aim of this WG is to engage in dialogue with investors and other stakeholders as users of audit reports on various issues such as the audit quality and audit reports. The WG also plans and coordinates the exchange of views with investor representatives at the IFIAR Plenary Meeting.

Also, the IFIAR has established within IOSWG an Advisory Group which consists of investors and other stakeholders. A lawyer, Mr. Ken Kiyohara is the member of the group from Japan.

(e) International Cooperation Working Group

The aim of this WG is to promote the practical information exchange on regulations and inspections between audit oversight authorities. The WG is performing the assessment of application for the Multilateral Memorandum of Understanding concerning Co-operation in the Exchange of Information for Audit Oversight (MMOU).

The MMOU was signed by audit oversight authorities from 22 jurisdictions, including the CPAAOB and the FSA, at the Tokyo Plenary Meeting in April 2017. In 2019, the audit oversight authority of Norway became signatories, bringing the total to 23 jurisdictions.

#### (f) Enforcement Working Group

The aim of this WG is to promote cooperation between audit oversight authorities in the area of enforcement, including investigations, and facilitate exchange of information on enforcement regimes and developments in member jurisdictions, in order to enhance investor protection and improve audit quality.

In 2018, the WG conducted its second survey after 2014 on audit enforcement regimes for each IFIAR member (42 participated), and published the results in the Report on Survey of Audit Regulators' Enforcement Regimes in January 2019.

#### 3.1.4 Japan IFIAR Network

The IFIAR is the first international organization of financial institutions to have a secretariat in Japan. To enhance Japan's/Tokyo's international position as a financial center, the support from industry, government, and academia were needed. Against this backdrop, in December 2016, the Japan IFIAR Network was established which aimed to build a stakeholders network in Japan, strengthen relationships between the stakeholders and IFIAR, support the activities of the secretariat, raise the awareness about audit quality in Japan, and contribute to the IFIAR's goal of improving audit quality globally.

The Japan IFIAR Network contributes to the domestic networking of the secretariat and works on sharing discussions on audits in Japan with the secretariat and introducing IFIAR's activities through seminars and publications by the officers from IFIAR or CPAAOB/FSA officials of audit oversight division.

In June 2019, the third general meeting was held, and the discussion at the Greece Plenary Meeting in April was shared with the network members. The members also reported their efforts to ensure and improve audit quality.

#### 3.2 Bilateral Cooperation

In light of the globalization of corporate activities, ensuring the quality of audit procedures that, such as using the audit results of overseas audit firms in the audit of consolidated financial statements, has become globally more important than ever before. Moreover, enhancing cooperation with foreign audit oversight authorities has become indispensable for establishing a global audit oversight system. In addition to the participation in the activities at IFIAR, for the purpose of sharing information on internationally operating audit firms and issues on audits and inspections, the CPAAOB has been striving to build and enhance its bilateral cooperative relationships with foreign audit oversight authorities by constantly exchanging

views with those authorities, performing equivalence assessments and mutual reliance concerning the audit system and the audit supervision system in order to facilitate the establishment of the framework for exchanging information on audit oversight activities as well as examination and inspection activities (Note).

(Note) Overseas authorities which have a framework for exchanging information on audit supervisory activities with the CPAAOB and FSA

U.S. Public Company Accounting Oversight Board (PCAOB)

Canadian Public Accountability Board (CPAB)

Audit Oversight Board of Malaysia (AOB)

Netherlands Authority for the Financial Markets (AFM) \*

Commission de Surveillance du Secteur Financier (CSSF)

U.K. Financial Reporting Council (FRC)

Haut Conseil du Commissariat aux Comptes (H3C)

Chinese Ministry of Finance

\* Includes mutual reliance of supervisory activities such as inspections.

### 3.3 Next challenges

As the globalization of corporate activities has also led to the advance of cross-border audit services, ensuring and improving global audit quality has become challenging. Also, audit oversight authorities are sharing concerns over the confidence in audit firms stemming from accounting fraud cases that have occurred in each country, and over the relevance of future audits impacted by innovation. Furthermore, some countries are making progress with fundamental audit reforms against audit oversight authorities, including establishing the new organization.

Under such circumstances, it is required for the CPAAOB to strengthen cooperation with foreign audit oversight authorities, and to address the issues related to audits and audit oversight appropriately by gathering information on international discussion, analyzing its impact on audit firms and the oversight activities, and reflecting the results on its monitoring. The CPAAOB recognizes the following as major issues:

#### 1) Prepare for the new international auditing standards

As of March 2020, the formulation of ISQM1 in the IAASB is underway. The fundamental principle will change from “Quality Control” in the current International Standard on Quality Control (ISQC1) to “Quality Management.”

#### 2) Raise awareness of risks that may impact audits

The CPAAOB will raise awareness of risks which may affect audits in the

future, and actively gather information related to such risks. The potential risks include:

- Progress of digitalization and automation at both audit clients and audit firms,
- Increase in crypto-audits and
- Impact of climate change.

3) Gathering information on audit inspection systems of foreign authorities:

The CPAAOB will gather information related to the inspection systems and leading efforts of foreign audit oversight authorities by participating in the discussions of the IFIAR and utilizing the bilateral information exchange framework. The CPAAOB will leverage such information on best practices for improving its own inspection system.

4) Contribution to the IFIAR activities:

- Actively contribute to the activities of the IFIAR and enhance the multilateral cooperative network to improve global audit quality.
- Provide support for the smooth operation of the IFIAR secretariat in Tokyo.
- Share the discussions in IFIAR meetings with Japanese stakeholders through the Japan IFIAR Network.
- Support the outreach of the IFIAR to all countries in Asia, and as part of that, coordinate speeches or presentations by the IFIAR secretariat in the international conferences held by members of the Japan IFIAR network.

5) Secure and acquire global-minded personnel:

It is important to develop global minded personnel who can build a close relationship with foreign audit oversight authorities on middle/long-term basis, and flexibly respond to changes in audit and audit oversight.



**List of Members of  
Certified Public Accountants and Auditing Oversight Board  
(CPA AOB)  
(As of March 31, 2020)**

Chairperson (full-time)	SAKURAI Hisakatsu	Professor Emeritus, Kobe University  Former Professor School & Graduate School of Business Administration, Kwansei Gakuin University
Commissioner (full-time)	MATSUI Takayuki	Former Professor Graduate School of Professional Accountancy, Aoyama Gakuin University
Commissioner (part-time)	KATSUO Yuko	Graduate Program Chair and Professor, Graduate School of Management, Gakushuin University  Professor, Faculty of Economics, Gakushuin University  Outside auditor, DAIKEN CORPORATION
	SATO Yoshiko	Executive Managing Director and Chief Research Fellow, Japan Investor Relations Association
	TAMAI Yuko	Partner, Nagashima Ohno & Tsunematsu  Outside Director, Mitsui Sugar Co., Ltd.  Outside Corporate Auditor, Japan Bank for International Cooperation
	TOKUGA Yoshihiro	Vice-President and Professor, Kyoto University
	MIZUGUCHI Keiko	Counselor, Japan Credit Rating Agency, Ltd.
	MINAKAWA Kunihiro	Outside Director, Sony Corporation  Outside Director, Santen Pharmaceutical Co., Ltd.
	YAMADA Tatsumi	Specially Appointed Professor Faculty of Commerce, Chuo University Statutory Auditor NOMURA Co.,Ltd.
	YOSHIDA Keita	Partner, Deloitte Touche Tohmatsu LLC