

Annual Report

July 2015

Certified Public Accountants and Auditing Oversight Board



About this Annual Report

Pursuant to Article 16 of the Certified Public Accountants and Auditing Oversight Board (CPAAOB) Rules of Operation as below, which is stipulated on the basis of Article 2 of the CPAAOB Cabinet Order, this Annual Report publishes the activities of the CPAAOB for FY2014 (from April 1, 2014, to March 31, 2015).

To better meet the needs of readers, the Report also includes information on activities taken before and after FY2014.

- 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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1 Overview of the CPAAOB

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

The CPAAOB, government organization which has a council system, was established by the Financial Services Agency (FSA) in April 2004, based on Article 35, Paragraph 1 of the Certified Public Accountants Act (CPA Act) and on Article 6 of the Act for Establishment of the FSA.

The CPAAOB is comprised of a 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. They are appointed for a term of three years (Articles 36, 37-2 and 37-3 of the CPA Act).

The Chairperson and Commissioners exercise authority independently, and excluding situations where there are legal reasons, that independence shall not be violated by their dismissal during their appointed terms (Articles 35-2 and 37-4 of the CPA Act).

The CPAAOB, comprising 10 members (Chairperson Kunio Chiyoda, full-time Commissioner Toshiro Hiromoto, and eight part-time Commissioners), has been in operation for its fourth term (from April 2013 to March 2016) (See Annex 1, page 40).

The main work of the CPAAOB is as follows:

- Reviews of the “quality control review” and inspections
- Implementation of CPA Examinations
- Deliberation of disciplinary actions against CPAs and audit firms

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 Office of Coordination and Examination and the Office of Monitoring and Inspection, under the Secretary-General of the Executive Bureau. The Office of Coordination and Examination 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 Office of Monitoring

and Inspection is in charge of monitoring the operation of audit services provided by audit firms, etc., monitoring the appropriateness of the JICPA operation, and inspecting audit firms, etc., foreign audit firms and JICPA.

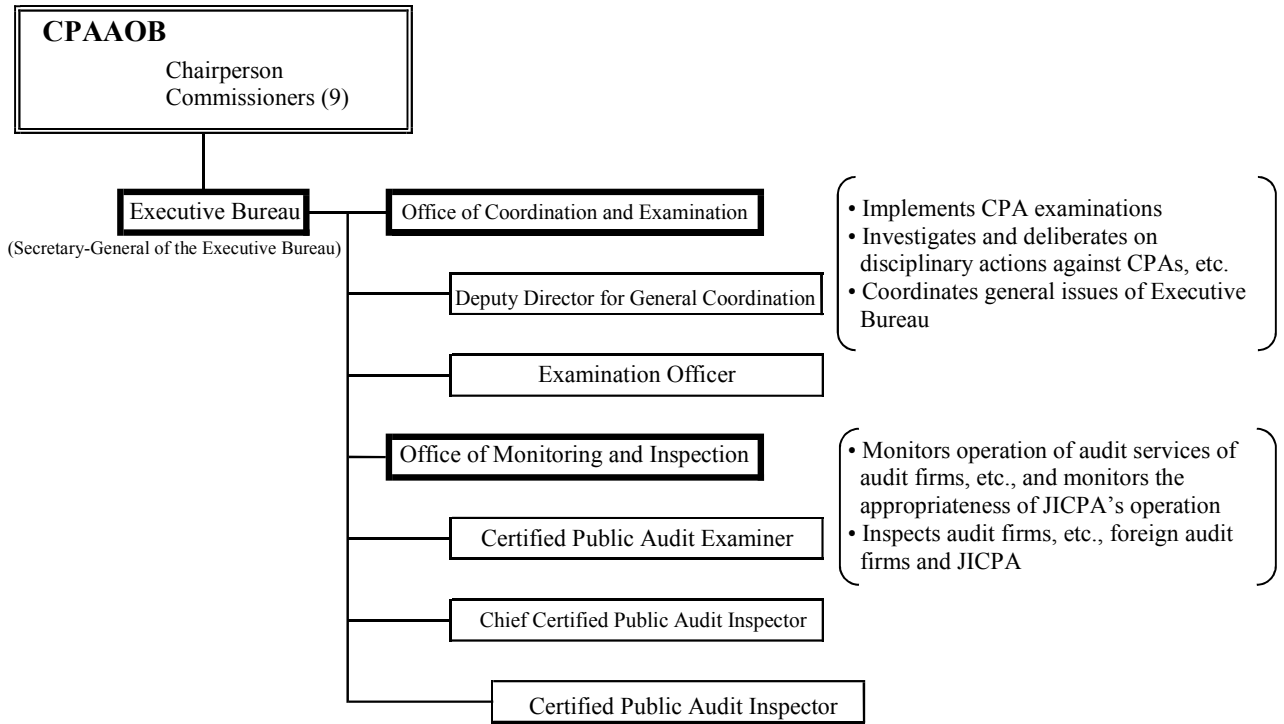
The Executive Bureau had 40 staff members when it was launched in April 2004. Its staff was steadily increased thereafter, to 14 in the Office of Coordination and Examination, and 42 in the Office of Monitoring and Inspection: for a total of 56 staff members on March 31, 2015.

Staffing of the Executive Bureau

(Fiscal year-end basis)

FY	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Office of Coordination and Examination	11	12	12	12	12	14	14	14	14	14	14
Office of Monitoring and Inspection	29	29	31	35	39	41	44	43	42	42	42
Chief Inspectors	4	4	4	4	5	5	7	7	7	7	7
Inspectors	18	18	20	24	26	28	28	27	26	26	26
Total	40	41	43	47	51	55	58	57	56	56	56

Organization Chart of the CPAAOB



2 Audit Firms Inspection and Post-Inspection Follow-up

2.1 Outline

Previously, JICPA's quality control reviews (see Note) of audit firms, etc. had been self-regulated. However, from the perspective of ensuring the fairness and transparency of capital markets and establishing a market capable of gaining the trust of investors, and as a measure for enhancing and strengthening the monitoring and oversight functions over audit firms, etc., the June 2003 revision of the law resulted in quality control reviews becoming statutory, and being monitored by the CPAAOB.

Furthermore, for the purpose of ensuring the soundness of Japan's financial and capital markets, as a result of the June 2007 revision of the law, foreign audit firms, etc. that audit foreign companies, etc. subject to the disclosure regulations under the Financial Instruments and Exchange Act became subject to the inspections and supervision of Japan's authorities, and the CPAAOB was given the mandate to collect reports and conduct on-site inspections.

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 JICPA on the operation of members' services (audit and attestation 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 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)

As a result, the CPAAOB is required to examine quality control review reports, and, if the CPAAOB considers it necessary and appropriate in light of public interest or investor protection, to collect reports and conduct inspections.

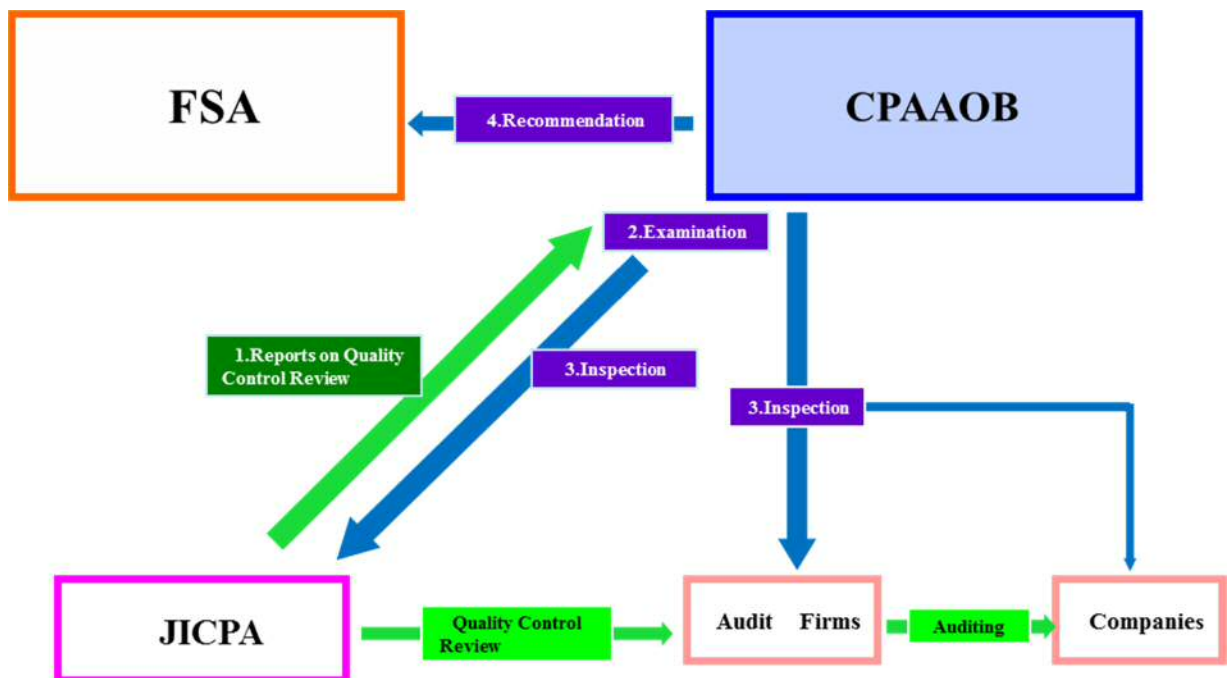
Furthermore, based on the results of examination or inspection, if the CPAAOB considers it necessary, it shall make a recommendation to the Commissioner of the FSA for administrative actions or other measures (Article 41-2 of the CPA Act).

(Note) Quality control reviews

These reviews are performed by JICPA to assess the status of audit quality control. They are performed for the purpose of “review by JICPA of the status of the operation of services set forth in Article 2(1) of the Act” as specified in Article 46-9-2 of the CPA Act.

Specifically, with the aim of maintaining and improving an appropriate quality level of audit service as well as maintaining and enhancing social confidence in auditing, JICPA reviews the status of the quality control of audits performed by audit firms and CPA offices (audit firms), makes recommendations for improvement as necessary, and receives reports on the status of improvement with regard to those recommendations.

Outline of Examinations and Inspections



1. Reports on quality control review

Once every three years in principle (or once every two years, if JICPA finds it necessary), JICPA reviews and assesses an audit firm’s compliance with laws, regulations, audit standards, JICPA’s rules, and other related regulations. The CPAAOB receives reports on the results of those reviews.

2. Examination

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

The CPAAOB may request the submission of reports or other materials from JICPA or audit

firms, if in the course of its examination, the CPAAOB finds it necessary to do so.

3. Inspection

Based on the results of its examination, the CPAAOB conducts inspections of JICPA, audit firms and any other audit related sites (such as those of audited companies), if the CPAAOB considers it necessary and appropriate in light of public interest or investor protection, or if the CPAAOB considers it necessary to do so from the viewpoint of securing the appropriate operation of JICPA.

4. Recommendation

Based on the results of examination or 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 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 2.3.8(ii) “A framework for Information requirements and Inspections on foreign audit firms, etc.” (see page 19).

2.2 Basic Program for Risk Assessment and Inspections of Audit Firms

2.2.1 Basic Program for Risk Assessment and Inspections

Considering that FY2013 was the tenth year from the foundation of the board, and from the viewpoints of further improving the quality of audits and improving the effectiveness of audits conducted by audit firms through risk assessment and inspections, the CPAAOB established and, published on April 26, 2013 the “Basic Policy for Risk Assessment and Inspections – To Ensure the Implementation of More Effective Audits –” for the fourth term (April 2013 to March 2016), based on the results of risk assessment and inspections during the first through third terms (April 2004 to March 2013).

<Details of the basic policies>

(i) Perspectives

Considering that the “standards for addressing fraud risks in audit” have been established and published after fraudulent corporate accounting practices were detected recently, and that people strongly expect audit firms to conduct more effective audits with the aim of meeting these expectations, the CPAAOB shall take a public-interest standpoint, always from the people’s perspective, and shall maximize the use of its authority, so as to actively work to ensure and enhance

audit quality in carrying out risk assessment and inspections by ensuring that new laws and regulations, various standards, etc. are always reflected in auditing services.

Also, the CPAAOB shall enhance the dissemination of information in Japan and overseas. It shall provide useful information from risk assessment and inspections in exchanging views with JICPA and other relevant organizations while communicating, through the IFIAR, etc., with foreign audit oversight authorities concerned and proactively responding to international trends.

(ii) Goals

Risk assessment and inspections implemented by the CPAAOB do not focus directly on whether individual audit opinions themselves are suitable. Instead, the basic goal shall be to promote further improvement of the effectiveness of investigations into the operations of audit firms which are conducted by JICPA, from a public-interest standpoint, and to ensure proper operation of audit firms and foreign audit firms, etc. For this purpose, the CPAAOB shall implement the following:

- Information sharing through proactive cooperation with related parties;
- Two-way dialogue with JICPA, etc.; and
- Improved inspection methods, etc. through cooperation, etc. with foreign authorities.

(iii) Basic policy for risk assessment

The CPAAOB receives reports on the results of investigations into the operations of audit firms which are conducted by JICPA. For these reports, JICPA requests, as needed, reports or materials from parties concerned, collects information through exchange of opinions with related parties, and examines the analysis, etc. of the operations of audit firms.

Risk assessment is conducted based on the following policy.

- Positive entrenchment of audit quality control
In view of the recent occurrence of fraudulent corporate accounting practices, it remains important to improve the effectiveness of audits. To ensure effective audits, therefore, the CPAAOB shall conduct risk assessment with a focus on whether audit firms are implementing quality control properly and encourage such audit firms to establish appropriate quality control.

- Ensuring effectiveness of risk assessment

Not only JICPA's reports on the results of their investigations into the operations of audit firms, but also various information from relevant organizations, shall be taken into comprehensive consideration, and the revision of laws, regulations, audit standards, etc. and the cross-sectional topics surrounding the audit profession are matters to be particularly kept in mind when conducting risk assessment . As such, the CPAAOB shall be mindful of conducting effective risk assessment, such as specifying the groups of audit firms that have these kinds of common issues, and the areas and matters to be reviewed.

Furthermore, aside from cases of inspection in which it is recommended that supervisory authorities take administrative actions or other measures, with respect to any problems notified as part of inspection results, from the perspective of confirming the subsequent state of quality control, the CPAAOB shall, as necessary, require reports to be submitted after a certain period of time has elapsed since the notice of inspection results and utilize the results of risk assessment of these reports as important reference information for future inspections, etc.

(iv) Basic policy for inspections

Based on the results of the risk assessment of reports, the CPAAOB conducts inspections as it deems necessary.

Under the basic policy for inspections, the CPAAOB shall specifically state the circumstances under which inspections will be required for each organization to be inspected, and shall conduct them in accordance with the separately established “Basic Policy for Inspections Conducted by the CPAAOB”.

Furthermore, with regard to the collection of reports and inspections of foreign audit firms, etc., the CPAAOB shall conduct these in accordance with “A Framework for Inspection/Supervision of Foreign Audit Firms, etc.” which was published in September 2009, and with the “Basic Guidelines on Collection of Reports from and Inspection on Foreign Audit Firms etc. by the CPAAOB” which was published in January 2010.

(Reference) Basic Policies for Examinations and Inspections (for the first through third terms)

During the first term (April 2004 to March 2007), the CPAAOB established and published in June 2004 “To Ensure Reliability of Audits – Basic Policy for Examinations, etc. –”

Under this policy, the CPAAOB conducted risk assessment and inspections during the first term, adopting the basic concepts of “proactively responding to expectations for ensuring

the quality and more effectiveness of audits” and “continuing oversight of audit services and further enhancing JICPA’s quality control review function.”

During the second term (April 2007 to March 2010), based on the results of risk assessment and inspections during the first term, the CPAAOB established and published in June 2007 “For Further Improvement of Audit Quality – Basic Policy for Examinations, etc. –” Based on this policy, the CPAAOB conducted risk assessment and inspections during the term, adopting the basic concepts of “firmly establishing improvements for previously identified issues” and “responding to new challenges.”

During the third term (April 2010 to March 2013), the CPAAOB established and published in June 2010 “Basic Policy for Examinations and Inspections – To Ensure Reliability of Audits” based on the results of risk assessment and inspections during the second term. Under this policy, the CPAAOB conducted risk assessment and inspections during the term, adopting the basic concepts of “positive entrenchment of audit quality control,” “improvement of the functions of JICPA’s quality control reviews” and “effective risk assessment.”

2.2.2 Basic Plan for Risk Assessment and Inspections

The CPAAOB establishes a Basic Plan for Risk Assessment and Inspections every fiscal year as a guide for risk assessment and inspections for that year.

In FY2014, based on the Basic Policies for Risk Assessment and Inspections mentioned above, the CPAAOB established and published on April 4, 2014, “Audit Firms Inspection Policy for Fiscal Year 2014”, which provided for conducting well-balanced verifications focused on the essential problems in business operations by audit firms depending on their risks, and laying down the conditions for responses to industry-specific problems which were detected in previous risk assessment and inspections.

<Summary of the Audit Firms Inspection Policy for Fiscal Year 2014>

Based on the results of inspections conducted by the CPAAOB and quality control reviews conducted by JICPA, there have been cases confirmed of some audit firms whose establishment of quality control systems and whose voluntary improvements remain inadequate. In addition, CPAAOB made recommendations to the commissioner of the Financial Services Agency regarding that the business operations of certain audit firms were wholly inappropriate. Since inspection resources are limited, it remains

important to recognize the actual conditions of audit firms in a more proper manner and implement more effective inspections, etc. depending on their actual conditions.

(i) Basic Plan for Risk Assessment and Off-site Monitoring

The Basic Plan for Risk Assessment and Off-site Monitoring states that the CPAAOB shall conduct risk assessment to more accurately identify the risks of audit firms and individual audit services by enhancing the system for collecting and analyzing information, etc. through the utilization of reports on JICPA quality control reviews and exchange of views with JICPA and other relevant domestic organizations as well as overseas audit supervisory authorities, etc.

The Plan also mentions that the CPAAOB shall comprehensively review the appropriateness of JICPA's quality control review system because it is expected that further improvement in the effectiveness of JICPA quality control reviews will contribute to the firm establishment of appropriate audit quality control at audit firms and to the demonstration of strong leadership by JICPA, including responses to industry-specific problems, and in view of the fact that JICPA's quality control review system was enhanced by expanding the number of audit firms and the audit services subject to review .

In addition, the Plan states that the CPAAOB shall focus on reviewing the establishment and management of the quality control systems of audit firms, such as those noted as having a wide range of deficiencies in quality control, or those for which voluntary improvements need to be encouraged, and reviewing common industry-specific problems, etc. which are found in small and mid-sized audit firms, taking into consideration the features of each such audit firm.

The Plan further states that reports should be collected through interviews, instead of on-site inspections, from the viewpoint of conducting more effective and efficient monitoring since inspection resources are limited, and if serious problems are detected, the facts should be used as important reference information for future on-site inspections.

(ii) Basic Plan for On-site Inspections

The FY2014 Basic Plan for On-site Inspections states that the important matters are: (1) verification whether audit firms' management policies and business management-related measures, etc. are appropriate in light of their size, characteristics, etc.; and (2) verification, etc. whether audit firms conduct audits

by properly assessing the business risks of audited companies. In addition, the Plan clearly states that if deficiencies, etc. are detected in the process of inspection, the CPAAOB should verify not only direct causes of such deficiencies but also the root causes thereof and urge audit firms subject to inspection to take the necessary countermeasures. The Plan states that on-site inspections should be conducted on a regular basis (once every two years), in principle, for top-tier large audit firms (audit firms which audit at least 100 listed companies or which employ at least 1,000 full-time auditors).

In the case of top-tier large audit firms, it can be determined that quality control has worked effectively to certain degree in view of their past inspection results, etc. Therefore, the Plan states that risk-based inspection should be adopted more frequently to make inspections more effective and efficient. Accordingly, the CPAAOB obtained highly important information, selected themes common to leading audit firms, and conducted inspection by limiting the scope of verification to said themes and high risk sectors (inspection by theme).

Regarding the themes for FY2014 inspection by theme, the CPAAOB selected “revenue recognition,” “accounting estimate, etc.,” in which important deficiencies are detected frequently, as common themes which will remain unchanged for a certain period of time, and “verification of the state of compliance with the quality control policy by all departments of the organization, etc.” as temporary common themes in view of results of recent inspections, etc.

In the past, the CPAAOB has conducted inspection of second-tier audit firms on an as-needed basis. From now on, however, an inspection of second-tier audit firms will be conducted once every two or three years in principle. The Plan states that a priority should be placed on the verification of establishment and state of the operation control system, audit of financial institutions, audit of group companies, etc. from the viewpoint of focusing on risks common to second-tier audit firms.

In relation to small and mid-sized audit firms, the results of recent risk assessment, inspections and quality control reviews have revealed occasional cases of problems with the risk assessment associated with the replacement of auditors, with the establishment of operation control systems, and with improvements in findings identified in quality control reviews (all of such problems arise from the organization of small and mid-sized audit firms). For this reason, the Basic Plan for On-site Inspections states that the CPAAOB shall conduct inspections of small

and mid-sized audit firms, including newly established ones, as required, based on the results of risk assessment of JICPA's reports on quality control reviews, so as to effectively and flexibly verify or confirm their status of audit engagements execution, establishment of operation control systems, and efforts for the improvement of quality control reviews.

As follow-up measures after risk assessment and inspections, the CPAAOB shall collect reports from audit firms when a certain period of time has passed since giving notice of inspection results, so as to, if necessary, check and verify their status of quality control. On such occasions, the CPAAOB shall conduct checks and verifications, depending on the details or importance of the deficiency, in close coordination with the supervisory authorities of the Financial Services Agency, and the results of such checks and verifications shall be utilized in examining JICPA's reports on quality control reviews in order to improve the effectiveness and efficiency of inspections and enable smooth and seamless operations of risk assessment and inspections. The CPAAOB shall also ensure that the quality of audits is improved by extracting industry-specific problems, etc. from the deep analysis of the results of risk assessment and inspections and by exchanging views, etc. with JICPA and relevant organizations.

2.3 Risk Assessment and Inspections of Audit Firms

Audit firms (certified public accountants and audit corporations) may audit or attest financial documents for fees at the request of others (Article 2(1) of the CPA Act) and compile financial documents, examine or plan financial matters, or provide consulting services on financial matters for fees at the request of others (Article 2(2) of the CPA Act). As of the end of FY2014, the number of registered certified public accountants totals 27,313, and the number of audit firms totals 219. Audit firms earn approximately 80% of their business revenues from audit certification work.

(Reference)

	End of FY2010	End of FY2011	End of FY 2012	End of FY2013	End of FY2014
Number of registered certified public accountants	21,325	23,119	24,964	26,260	27,313
Number of audit firms	208	213	214	216	219

2.3.1 Quality Control Reviews by the Japanese Institute of Certified Public Accountants (JICPA)

In FY2014, JICPA performed 86 quality control reviews of audit firms (68 audit firms, including 4 joint CPA offices, and 18 CPAs). By March 31, 2015, 30 reports on those quality control reviews had been submitted to the CPAAOB (see Note). The status of quality control reviews is as follows.

(Note) The quality control review report (monthly report) consists of basically the following items:

- Quality control review report
- Recommendation for improvement report
- Response to recommendation for improvement report
- Quality control review documents

(i) Status of Implementation of Quality Control Reviews

The status of implementation of quality control reviews is as follows.

Status of Implementation of Quality Control Reviews

Date of quality control review	2014						2015			Total
	Jul.	Aug.	Sep.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	
Number of audit firms reviewed for quality control	10	16	1	10	13	21	14	1	0	86

(ii) Results of Quality Control Reviews

Of 30 cases reported to the CPAAOB, 24 cases included recommendations for improvement. The conclusions of those reports were as follows.

- Unqualified conclusion: 29 cases (24 audit firms, 5 CPAs)
- Qualified conclusion: 1 case (0 audit firm, 1 CPA)
- Negative conclusion: None

Also, in FY2014, JICPA performed follow-up reviews (see Note) of 71 audit firms (50 audit firms and 21 CPAs). The results of 62 reviews, which were reported to the CPAAOB by March 31, 2015, were as follows.

- Improvement measures sufficiently completed: 55 cases (37 audit firms, 18 CPAs)
- Improvement measures insufficiently conducted: 7 cases (4 audit firms, 3 CPAs)

(Note)

A “follow-up review” is a review conducted by JICPA as part of its quality control review to assess the status of improvement measures implemented by an audit firm. Specifically, JICPA assesses the status of improvement measures by confirming the status of (i) changes to the quality control systems, (ii) communication to the auditors (including their education and training), and (iii) corrective actions implemented through monitoring the quality control systems, etc., all of which are expected to be performed by the audit firm in accordance with the improvement measures contained in the improvement plan submitted during the earlier quality control review.

2.3.2 Risk Assessment of Quality Control Reviews

(i) Scope and perspectives for examination

During FY2014, the quality control reviews conducted by JICPA in FY2013 and FY2014 were examined. The results of the examination of the FY2013 quality control reviews are as follows. As for the FY2014 quality control reviews, the CPAAOB has progressively commenced examination of 30 cases for which reports had been received by March 31, 2015.

Quality Control Review Reports (FY2013)					(Number of audit firms)		
Category	Unqualified conclusion		Qualified conclusion		Negative conclusion		Total
	(a)	a/c	(b)	b/c	-	-	
Audit firm	60	95.2%	3	4.8%	-	-	63
CPA	25	83.3%	5	16.7%	-	-	30
Total	85	91.4%	8	8.6%	-	-	93

(Note) 86 out of 93 cases include recommendations for improvement.

(ii) Perspectives for examination

The CPAAOB analyzes the particulars of deficiencies in quality control reviews and reports on the conditions of audit firms subject to review, and conducts examinations from the following perspectives:

- Appropriateness of JICPA’s quality control reviews
- Status of the development and operation of quality control systems established for ensuring the quality of audit services in audit firms in a

reasonable manner

- Compliance of the quality control systems established in audit firms for individual audit services

2.3.3 Collection of Reports, etc. from Audit Firms

(i) Risk assessment of audit firms

The CPAAOB enhances the risk assessment of the audit firms to make inspections, etc. of them more effective and efficient.

The risk assessment methods include: (1) collection of reports; and (2) cooperation with not only related departments inside the Financial Services Agency but also related organizations, etc. such as JICPA, securities exchanges, the Japan Audit & Supervisory Board Members Association, etc. (see Section 2.4)

(ii) Collection of reports

Of the audit firms subject to quality control reviews, for audit firms for which inspections were not conducted by the CPAAOB, the CPAAOB conducts focused verification of improvements in quality control and collects reports to determine the problems involved in audits. In this fiscal year, the CPAAOB conducted focused verification by increasing the number of verification items over the previous fiscal year in order to conduct more effective audits. From the same viewpoint, the CPAAOB took a face-to-face approach, including visiting audit firms as far as possible.

(a) Collection of reports for focused verification

The “Audit Firms Inspection Policy for Fiscal Year 2014” states that, from the viewpoint of encouraging audit firms to perform audit services in a strictly fair manner based on the quality control reviews conducted by JICPA, the CPAAOB shall focus on reviewing the establishment of the quality control systems of audit firms, such as those noted as having a wide range of deficiencies in quality control and reviewing common industry-specific problems, etc. which are found in small and mid-sized audit firms, taking into consideration the features of each such audit firm, and that management related items, including the business policy, earnings and financial structures, organization and personnel, in particular, should be included in the items for which reports are collected from audit firms because such items are closely connected with potential operational problems.

In FY2014, based on the policy, the CPAAOB collected reports from 63 audit firms for which it is necessary to check the state of audit quality control, out of

93 audit firms for which JICPA conducted quality control reviews in FY2013. To identify problems involved in the audit industry, the CPAAOB asked audit firms to report on the state of communications between accounting auditors and audit & supervisory board members, responses in cases where dependence of an audit firm's revenues on an audited company exceeds 15% and responses, etc. to the "standard of responses to risks of fraudulent audits," and newly asked them to report on items, etc. concerning their business management, etc. (implemented from August 2014).

(b) Collection of reports for fact finding

Although it was found unnecessary to immediately check the state of audit quality control based on the results of quality control reviews conducted in FY2013, with the aim of identifying problems involved in the audit industry, the CPAAOB collected reports from 4 audit firms on the state of communication between accounting auditors and audit & supervisory board members, responses in cases where dependence of an audit firm's revenues on an audited company exceeds 15%, responses, etc. to the "standard of responses to risks of fraudulent audits," responses, etc. to the Act on the Prevention of Transfer of Criminal Proceeds, and other matters, and newly asked them to report on items, etc. concerning their business management, etc. (implemented from August 2014).

History of Collection of Reports for Focused Verification and Fact Finding

	Record of Report Collection in FY2014					Record of Report Collection in FY2013		
	No. of firms undergoing report collection (a)			No. of firms undergoing QC reviews in FY2013 (b)	Report collection ratio a/b	No. of firms undergoing report collection (c)	No. of firms undergoing QC reviews in FY2012 (d)	Report collection ratio c/d
	Focused verification	Fact finding						
Audit firms	67	63	4	93	72.0%	70	95	73.7%
Audit firms	43	39	4	61	72.0%	34	50	68.0%
Individual firms (Note)	24	24	0	32	75.0%	36	45	80.0%

(Note) Including CPA joint office

2.3.4 Inspections to Audit Firms

In FY2014, under the “Audit Firms Inspection Policy for Fiscal Year 2014”, the CPAAOB inspected 15 audit firms in total (11 audit firms in relation to the FY2013 quality control review, three in relation to the FY2012 review, and one foreign audit firm).

* A joint CPA office is counted as one audit firm.

In the current fiscal year, the CPAAOB decided, in view of the limited number of personnel, etc., to conduct inspections with a focus on sharing information on problems, etc. concerning business operations of audit firms in particular and identifying findings in a proper and effective manner. For this purpose, necessary inspection teams are organized and utilized flexibly to use inspectors effectively and conduct inspections in an efficient manner. As a result, the number of inspections increased by two over the previous year (13 inspections) due to the use of flexible inspection methods, etc.

In the current fiscal year, if deficiencies, etc. are found in the course of inspections, the CPAAOB has not only verified the direct causes of such deficiencies but has also focused on identifying the root causes at the audit firms where the deficiencies occurred, in order to encourage audit firms subject to inspection to take effective remedial measures.

In the current fiscal year, the CPAAOB conducted international joint inspections in cooperation with multiple overseas audit oversight authorities from the viewpoint of verifying the effectiveness of inspection of overseas subsidiaries, etc. (group audit) in an effort to identify problems, etc. in verifying group audits which are conducted between global audit firms.

2.3.5 Recommendations to the Commissioner of the Financial Services Agency (FSA)

As a result of inspection, the CPAAOB found that the following audit firms performed audit services in a grossly inappropriate manner. Pursuant to the provisions of Article 41-2 of the CPA Act, the CPAAOB recommended that the Commissioner of the FSA take administrative actions and other measures against them:

- Seiwa Audit Corporation (June 13, 2014)
- Kudan Audit Corporation (July 11, 2014)
- Saiwa Audit LLC (October 24, 2014)
- Central Audit Corporation (January 30, 2015)
- CROSSTIER Audit Corporation (March 20, 2015)

2.3.6 Follow-up of improvements after the notification of inspection results

The Basic Policy for Risk Assessment and Inspections states that “supervisory authorities take administrative actions or other measures, with respect to any problems notified as part of inspection results, from the perspective of confirming the subsequent state of quality control, the CPAAOB shall, as necessary, require reports to be submitted after a certain period of time has elapsed since the notice of inspection results and utilize the results of risk assessment of these reports as important reference information for future inspections, etc.” Based thereon, the Audit Firms Inspection Policy for Fiscal Year 2014 states that “the CPAAOB shall collect reports from audit firms when a certain period of time has elapsed since giving notice of inspection results, so as to, if necessary, check and verify their status of quality control.”

In FY2014, the CPAAOB collected reports from five audit firms out of all the audit firms to which inspection results were notified in order to check and verify the status of improvements with regard to deficiencies detected in inspections. At the same time, the CPAAOB asked audit firms to submit reports on responses to communications between accounting auditors and audit & supervisory board members to identify actual issues across the audit industry (implemented from August 2014).

2.3.7 Dissemination of Information

(i) Preparation and publication of “Case Report: Audit Firm Inspection Results”

From the viewpoint of securing and improving the level of audit quality of audit firms, the CPAAOB annually reviews and revises the Case Report, which was published in February 2008. In FY2014, the CPAAOB published a revised version thereof in July 2014 in which the CPAAOB introduced cases of deficiencies for the issues, etc. identified in inspections conducted up to FY2013 and added or deleted certain issues with the aim of contributing to the improvement of common deficiencies (see Annex 2, page 41). The English version was similarly revised and published in November 2014.

From the viewpoint of “helping audit firms make voluntary efforts to maintain and improve the quality of their audits,” “presenting its level of expectation” and “providing reference information for directors and audit & supervisory board members of listed companies, etc., and general investors and other market players,” the version contains inspection standpoints, summarized inspection results (summary of deficiencies, analysis of their causes, and commendable efforts), and actions to be taken by audit firms, and introduces the particulars of deficiencies in

a concrete manner.

(ii) Lectures, etc., on inspection results (Case Report)

The CPAAOB actively participates in workshops organized by JICPA or other relevant organizations to lecture on inspection results so as to help perform appropriate audit procedures.

In FY2014, the CPAAOB delivered eight lectures for certified public accountants at seven workshops hosted by JICPA across Japan from September to November 2014, to promote voluntary activities aimed at securing and improving audit quality. The CPAAOB also delivered two lectures for audit & supervisory board members at the Japan Audit & Supervisory Board Members Association (JASBA) in November 2014 so that the Case Report may be widely used to understand the conditions regarding external audits.

In addition, the CPAAOB gave wide publicity to the inspection results, such as by printing the Case Report in the bulletins and other publications of relevant organizations, so that audit firms, etc., can actively use them for reference purposes.

(iii) Lectures on activities, etc. of the CPAAOB

The CPAAOB delivers lectures for market players, including audit & supervisory board members of listed companies and internal audit departments, etc., to introduce its activities and future challenges.

In FY2014, the CPAAOB delivered lectures at the JASBA, the Institute of Internal Auditors-Japan (IIAJ), the Securities Analysts Association of Japan (SAAJ), and the Capital Markets Research Institute (CaMRI) to introduce various issues, etc. identified during its inspections of audit firms.

2.3.8 Framework for Inspections and Oversight on Foreign Audit Firms

(i) Notifications of foreign audit firms

When providing services deemed to correspond to the audit attestation services prescribed in the CPA Act, for financial statements submitted by foreign companies, etc. under the Financial Instruments and Exchange Act, foreign audit firms, etc., shall notify the Prime Minister (who shall delegate his/her authority to the Commissioner of the Financial Services Agency under the CPA Act) in

advance. (As of March 31, 2015, 86 audit firms, etc. from 31 countries)

Number of notifications of foreign audit firms, etc. (as of March 31, 2015)

	Number of countries/regions	Number of audit firms, etc.
North America	3	14
Central & South America	2	2
Europe	15	43
Asia & Pacific	10	26
Middle East	1	1
Total	31	86

(ii) A framework for Information requirements and Inspections on foreign audit firms, etc.

In relation to the treatment of foreign audit firms, etc., the CPAAOB and the FSA prepared and published “A Framework for Inspection/Supervision of Foreign Audit Firms, etc.” in September 2009, based on the “FY2009 Basic Plan for Examinations and Inspections”.

In view of “A Framework for Inspection/Supervision of Foreign Audit Firms, etc.”, the CPAAOB also published the “Basic Guidelines on Information Requirements and Inspection on Foreign Audit Firms, etc. by the CPAAOB” in January 2010. The Guidelines establish basic procedures and points to be considered regarding inspections and information gathering from foreign audit firms, etc.

With respect to information requirements and inspections regarding foreign audit firms, etc., the CPAAOB will, in principle, rely on such actions by the competent authorities of the firms’ home jurisdictions (“foreign competent authorities”), instead of seeking to obtain information from or conducting inspections on firms themselves, provided (a) audit and public oversight systems in the firms’ home jurisdictions are equivalent to those of Japan, (b) necessary information can be provided from the foreign competent authorities through appropriate arrangements of information exchange, and (c) reciprocity is ensured in the Framework and Guidelines.

(iii) Information requests to foreign audit firms

The Basic Guidelines state that the CPAAOB should ask, once every three years in principle, foreign audit firms, etc. who submit a notification to the FSA and

analyze and evaluate the particulars of the materials submitted.

(iv) Inspections of foreign audit firms, etc.

Based on the results of analysis and evaluation of the collected reports as specified in (iii) above, the CPAAOB conducts a detailed study of the implementation of inspection of foreign audit firms, etc., establishes a setup for implementing such inspections, and further enhances cooperation with foreign supervisory authorities. In FY2014, the CPAAOB conducted an inspection of a foreign audit firm (one firm) for the first time.

2.4 Cooperation with Relevant Organizations

To maintain and improve the quality of audits, it is important not only to secure the effectiveness of audits conducted by audit firms but also to share information on common audit-related challenges and take the same stance on issues by further enhancing cooperation with audit firms and relevant organizations of companies subject to audit (individual companies, etc.)

For this purpose, the CPAAOB exchanges opinions not only with the relevant FSA divisions but also with other relevant organizations, including the JICPA, stock exchanges and the Japan Audit & Supervisory Board Members Association (JASBA), and large and mid-sized audit firms.

Furthermore, since it was increasingly important to secure effective audits from a global viewpoint due to increased overseas expansion, etc. of companies subject to audit and therefore it was urgently necessary to identify the actual conditions regarding reviews of member firms of networks of international audit firms, the CPAAOB exchanged opinions with executives and reviewers of leading networks.

2.4.1 Cooperation with the Japanese Institute of Certified Public Accountants (JICPA)

The CPAAOB conducts risk assessment and inspections to facilitate further improvements in the effectiveness of JICPA's quality control reviews from the public interest standpoint, and ensure that audit firms perform audit services in a proper manner. It is expected that, as the organ responsible for conducting quality control reviews, JICPA further improves the effectiveness of its reviews through enhancement of the review implementation structures to ensure that audit firms manage the quality of

audits in a proper manner. Therefore, the CPAAOB holds discussions with the JICPA Chairperson, other executives and reviewers on problems identified through risk assessment and inspections.

In April 2014, JICPA established a project team to review the register of listed company audit firms on which the CPAAOB and JICPA have exchanged opinions. In November 2014, the project team publicized the “Draft of Partial Revision of the Registration System for Listed Company Audit Firms (Exposure Draft).” In FY2014, in consideration of the above, etc., the CPAAOB exchanged opinions with the Quality Control Committee concerning the implementation of the revision. The CPAAOB exchanged opinions with JICPA about various challenges in improving the self-regulating functions of JICPA in connection with the issues surrounding quality control reviews detected in inspections, etc. of the CPAAOB such as measures to enhance communication between external auditors and internal auditors.

2.4.2 Cooperation with the Stock Exchange

The CPAAOB has a mission to enhance the fairness and transparency of capital markets in Japan by ensuring audit reliability through inspections, etc. Therefore, the CPAAOB cooperates with the Stock Exchange which self-regulate listed companies by exchanging opinions concerning industry-specific audit-related issues, etc. which are obtained from the results of inspections, etc. so that both parties can have the same stance on issues.

In FY2014, the CPAAOB exchanged opinions with the Tokyo Stock Exchange, the Sapporo Stock Exchange and the Fukuoka Stock Exchange concerning audit-related challenges, etc. in capital markets.

2.4.3 Cooperation with the Japan Securities Dealers Association (JSDA)

In recent examinations, etc., the CPAAOB verified individual audit services for securities companies. In addition, the CPAAOB identified audit-related issues for companies registered on the green sheet market.

In view of the above, the CPAAOB cooperates, in FY2014, with the JSDA which self-regulates member companies, including securities companies, and operates the green sheet market, exchanges opinions on a regular basis with the JSDA on various audit-related issues with respect to securities companies, and makes efforts to take the

same stance on various issues.

2.4.4 Cooperation with the Japan Audit & Supervisory Board Members Association (JASBA)

Considering that cooperation with accounting auditors and audit & supervisory board members, etc. who perform a corporate governance function for their companies is important in facilitating proper disclosure of financial information by companies, the CPAAOB has verified the state of communication between audit & supervisory board members, etc. and accounting auditors in the course of inspections, etc. of audit firms. In the revised audit standards and the standards for addressing fraud risks in audits which were publicized in April 2013, communication between accounting auditors and audit & supervisory board members, etc. is required as part of the audit standards. In the 2014 revised Companies Act, the functions of auditors such as internal auditors are enhanced and the necessity of cooperation with internal auditors was included in the Corporate Governance Code (Draft). Thus, cooperation between external auditors, internal auditors, etc. is increasingly important.

Therefore, the CPAAOB cooperates with the JASBA and exchanges opinions with them concerning various issues, etc. relating to communication between audit & supervisory board members, etc. and accounting auditors.

Furthermore, in view of the importance of communication between both parties, the CPAAOB clarified the method by which accounting auditors notify audit & supervisory board members of companies subject to inspection of the inspection results sent from the CPAAOB. In November 2013, the JASBA and the JICPA publicized a report on a joint study on communications between audit & supervisory board members, etc. and accounting auditors which contains the above disclosure method. In consideration of the revised Companies Act and the establishment of the Corporate Governance Code, etc., the CPAAOB decided to exchange opinions with the JASBA concerning new cooperation, etc. between internal auditors and external auditors.

2.4.5 Cooperation with Relevant Organizations of the Financial Services Agency

The CPAAOB has identified industry-specific audit-related issues, etc. based on the results, etc. of inspections of individual audit services by audit firms for financial institutions (banks, Shinkin banks and credit cooperatives, securities companies, life insurance companies, etc.) Since it is expected that cooperation with relevant FSA

divisions which supervise or inspect companies subject to audit will enable more effective and efficient supervision, inspection, etc., the CPAAOB positively enhanced cooperation with the relevant FSA divisions (Planning and Coordination Bureau, Inspection Bureau, Supervisory Bureau, Securities and Exchange Surveillance Commission), including information sharing and exchange of opinion. Furthermore, for the purpose of information sharing, the CPAAOB provided local finance bureaus with information concerning the state, etc. of audits which are conducted by small and mid-sized audit firms whose principal offices are located in local areas or by local offices of large audit firms.

2.4.6 Cooperation with International Networks of Audit Firms

Networks of international audit firms, large networks in particular, regularly review the quality of audit services of member audit firms in each country included in such networks on a periodic basis and ask member audit firms to comply with networks' policies in order to maintain and improve the quality of the audit services of their member audit firms.

Therefore, the CPAAOB made efforts to identify the actual state of reviews, etc. made by networks. Furthermore, considering that if a network's supervision of member audit firms is conducted in a proper manner, more effective and efficient inspections, etc. will be possible by utilizing the results, etc. of such reviews, etc., the CPAAOB exchanges opinions and cooperates with executives and reviewers of those networks.

2.5 Future challenges

- (1) Enhancement of self-regulating functions of JICPA, including further improvement of its function of quality control review

With the aim of stimulating further improvement of the functions of quality control reviews conducted by JICPA from a public standpoint, since FY2004, the CPAAOB has continued to review the appropriateness of quality control review systems and operations and to conduct two-way discussion with JICPA. Given that the present framework has been one where the results of inspection are reported to JICPA via audit firms, any problems identified through examinations and inspections are being shared with JICPA in a more concrete form, and efforts are being made to share a sense of the issues surrounding quality control reviews

through the bilateral exchange of views with JICPA.

JICPA reviews the quality control review and the registration system for listed company audit firms for further improvement, and reviews the character of the quality control review, to expand the scope of audit firms subject to review as necessary and enhance the registration system for listed company audit firms.

The CPAAOB believes it necessary to strongly promote a framework whereby feedback on CPAAOB activities is given directly and indirectly to JICPA through the two-way exchange of views and results of inspections, etc. and to strengthen cooperation with JICPA for the purpose of enhancing its self-regulating functions, including the quality control review and the registration system for listed company audit firms.

(2) Strengthening of information collection and analysis systems

The CPAAOB conducts examinations and inspections by utilizing the quality control reviews conducted by JICPA and a variety of other information. In order to conduct more efficient and effective examinations and inspections, the CPAAOB needs to strengthen its systems for information collection and *ex ante* and *ex post facto* information analysis.

In particular, the CPAAOB believes that it will be important in the future to upgrade the information collection and analysis system depending on types of risks faced by audit firms.

For this reason, the CPAAOB believes it necessary to collect and analyze information concerning audit firms through off-site monitoring, including hearings, exchange of opinions, etc. with audit firms, to proactively collect information on markets, and to further enhance cooperation with JICPA, relevant FSA divisions and other relevant organizations.

The CPAAOB also believes it important to strengthen both the quality and quantity aspects of its information collection and analysis systems, such as by further enhancing and strengthening report collection and through close cooperation with supervisory authorities after the notification of inspection results.

The CPAAOB also considers it important to enhance the combination with continuous off-site monitoring efforts in which the analysis of various materials,

information obtained from interviews, etc. is made to identify risks in audit firms on a real-time basis.

(3) Implementation of effective inspections

Considering that the operation of audit firms, including their audit system and business models, greatly differ from each other depending on their size, etc., the CPAAOB believes it important to conduct an inspection of audit firms depending on their risk profiles.

In the case of large audit firms, it can be determined that various types of reviews are conducted and the quality of audits is secured to a certain degree. Therefore, the CPAAOB plans to place a priority on off-site rather than on-site monitoring for large audit firms, and when on-site monitoring is conducted, the CPAAOB plans to conduct inspections by theme as far as possible to make inspections more efficient and effective.

In the case of second-tier audit firms, the CPAAOB aims to conduct effective and well-balanced inspections focusing on their essential problems in business operations after having obtained important information on their quality control and individual audit services, reviewed past inspection results and the monitoring activities of overseas networks.

The CPAAOB also believes that, for small and mid-sized audit firms, an important issue is to conduct inspections paying attention to problems, such as the responsibility for business operations and quality control, which arise due to the structures observed in small and mid-sized audit firms, which includes audit firms now subject to quality control reviews.

Furthermore, the CPAAOB believes it important to identify industry-wide problems through the inspections and to share information through exchange of views on such problems with JICPA, relevant FSA divisions, and other relevant organizations.

(4) Strengthening the dissemination of information

To help audit firms make voluntary efforts for maintaining and improving the quality of their audits, the CPAAOB disseminates a variety of information, such as by collating problem areas in audit firms identified through inspections and publishing them in the Case Report, and by holding briefing sessions on the Case

Report as part of the training at JICPA.

Other than just voluntary improvements at audit firms, the CPAAOB believes that an important issue with regard to problem areas in audit firms identified through examinations and inspections is to get an overall picture, conducting analyses in a way so as to extract cross-sectional industry-wide problems and, through the exchange of views, etc., making suggestions to JICPA, relevant FSA divisions and other relevant organizations.

Furthermore, the CPAAOB also believes it important to revise the Case Report taking into account the standpoint of providing market practitioners with reference information, and to actively disseminate information through briefing sessions on the Case Report.

(5) Enhancing the structure for addressing problems surrounding audits firms

The results of recent inspections, etc. of audit firms revealed that they have fundamental problems in their business operations, perhaps arising from the adoption of international accounting practices due to increased overseas expansion, etc. of companies subject to audit and an increase in overseas transactions, the introduction of IT-assisted audit procedures, etc. In this connection, it must be noted that new legal standards, such as the standards for addressing fraud risks in audits and the revised Companies Act, had to be complied with by audit firms. Furthermore, cooperation with various overseas authorities is progressing, such as the holding of various meetings with the IFIAR, or the exchange of letters with the US PCAOB, Canadian CPAB, Malaysian AOB, Dutch AFM, and Luxembourgian CSSF regarding cooperation in the area of audit oversight.

Given these circumstances, the CPAAOB believes it important to provide effective training programs that pay attention to system revisions and international trends. Furthermore, it believes it to be still important to procure personnel who properly analyze and respond to domestic and foreign information, the internationalization of accounting practices, systems of Japan's audit firms, etc. in order to address this situation and for inspections to be carried out appropriately, and to establish an inspection system which can correspond to the various risk profiles of audit firms.

3 Cooperation with Relevant Organizations in Other Jurisdictions

3.1 Outline

Triggered by accounting scandals such as at Enron and WorldCom in the United States (USA), the need to secure and improve the audit quality was recognized, and since 2002, audit oversight regulators 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) (see Note), for the purpose of sharing information among respective members' jurisdictions. The meeting was attended by nine jurisdictions: Japan, USA, UK, 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 (hereinafter the "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. Since then, 14 meetings have been held by the end of March 2015; and the number of jurisdictions has grown to 51 as of March 2015.

In addition to cooperating with the audit oversight authorities of each country through actively participating in the activities of the IFIAR, by exchanging views individually with the audit oversight authorities of each country, the CPAAOB is also making efforts to establish and enhance international cooperative relationships aimed at securing and improving the audit quality.

(Note) In light of the declaration of the second Summit on Financial Markets and the World Economy (London Summit), held in April 2009, the FSF was reorganized into the Financial Stability Board (FSB), as an organization with a stronger organizational base and with greater capacity.

3.2 International Forum of Independent Audit Regulators (IFIAR)

3.2.1 Organization

(i) Activities of IFIAR

The IFIAR's Charter specifies the following as its activities:

- 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.

(ii) Organization

The IFIAR is made up of the audit oversight authorities of various jurisdictions that have membership, and decisions are, in principle, made at the plenary meeting at which all member authorities can participate. Individuals serve as the Chair and Vice-Chair to facilitate the activities of the IFIAR, and an Advisory Council providing support and advice to the Chair and Vice-Chair has been established. As of the end of March 2015, the Advisory Council comprises the seven jurisdictions of Abu Dhabi, Australia, Canada, France, Singapore, Sri Lanka and UK.

As of the end of March 2015, there are six working groups established in the IFIAR, and the goals of which are described below.

(a) Global Public Policy Committee (GPPC) Working Group

The aim of this working group (WG) is to exchange views with the six largest international audit networks (see Note) on the quality control 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.

(Note) The six largest international audit networks are comprised of Deloitte Touche Tohmatsu, Ernst & Young, KPMG, PricewaterhouseCoopers, BDO and Grant Thornton.

(b) Standards Coordination Working Group

The aim of this WG is to exchange views on such topics as the setting of international auditing standards at the International Auditing and Assurance

Standards Board (IAASB) and on cooperation with respective standards-setting bodies that set auditing standards.

(c) Inspection Workshop Working Group

This WG plans, coordinates and evaluates IFIAR inspection workshop. This workshop has been held for the purpose of skills training for inspectors and to share inspection methods and experiences, and is held every year.

(d) Investor and Other Stakeholders Working Group

The aim of this WG is to engage in dialogue with investors—the users of audit reports—and other stakeholders on issues such as the audit quality and how audit reports ought to be. The WG also plans and coordinates the exchange of views with investor representatives at the IFIAR plenary meeting.

(e) International Cooperation Working Group

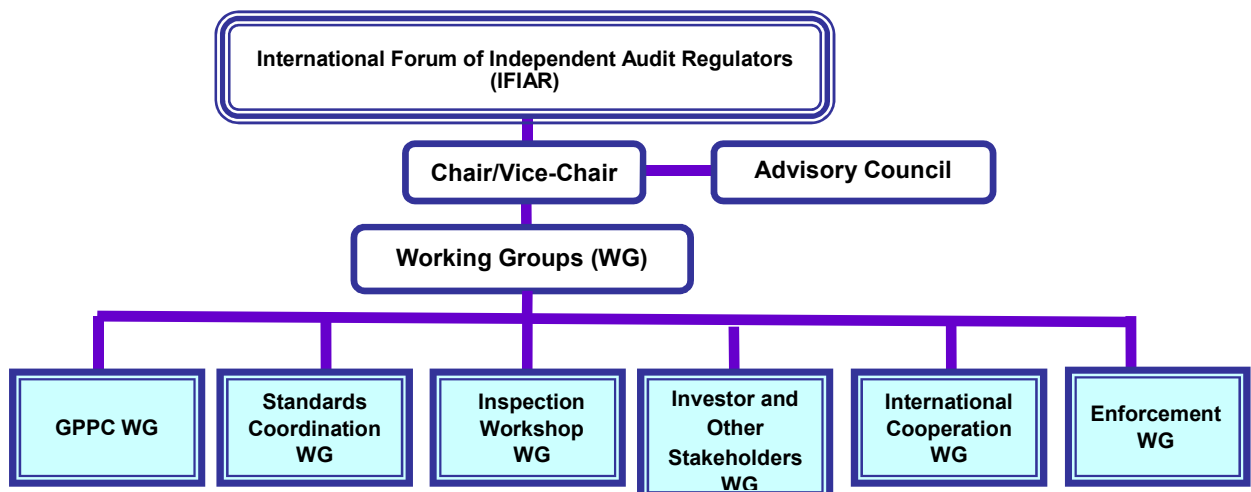
The aim of this WG is to promote the practical exchange of information on regulations and inspections between audit oversight authorities.

(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.

(Note) Japan has been chairing this WG since its foundation in July 2013.

IFIAR organization chart



3.2.2 Main Activities of the IFIAR and Japan's Contribution

(i) Plenary meeting

- 14th meeting (Washington D.C., USA)

The meeting was held from April 7 to 9, 2014, and was hosted by the U.S. Public Company Accounting Oversight Board (PCAOB).

At the meeting, not only the establishment of the IFIAR's permanent secretariat but also challenges, etc. in evaluating business models and the audit quality of audit firms were discussed. Furthermore, CPAAOB and FSA recommended Mr. Fumio Muraoka, Chairman of the Audit Committee in Toshiba Corporation as a representative of investors, and he participated in the meeting.

Past IFIAR plenary meetings

	Dates	Venue	Participating audit oversight authorities
First	March 22-23, 2007	Tokyo, Japan	22 jurisdictions
Second	September 24-25, 2007	Toronto, Canada	21 jurisdictions
Third	April 9-11, 2008	Oslo, Norway	22 jurisdictions
Fourth	September 22-24, 2008	Cape Town, South Africa	21 jurisdictions
Fifth	April 27-29, 2009	Basel, Switzerland	30 jurisdictions
Sixth	September 14-16, 2009	Singapore	29 jurisdictions
Seventh	March 22-24, 2010	Abu Dhabi, UAE	30 jurisdictions
Eighth	September 27-29, 2010	Madrid, Spain	37 jurisdictions
Ninth	April 11-13, 2011	Berlin, Germany	34 jurisdictions
Tenth	September 26-28, 2011	Bangkok, Thailand	29 jurisdictions
Eleventh	April 16-18, 2012	Pusan, South Korea	32 jurisdictions
Twelfth	October 1-3, 2012	London, UK	39 jurisdictions

Thirteenth	April 15-17, 2013	Noordwijk, the Netherlands	42 jurisdictions
Fourteenth	April 7-9, 2014	Washington, D.C., USA	44 jurisdictions

(ii) Interim Meeting

Since 2013, the frequency of the plenary meeting has been reduced to once a year. On the other hand, an Interim Meeting attended only by officers, members of the Advisory Council, and Working Groups Chairs, etc. has been held. At this Interim Meeting, high-level discussions on management, etc. of IFIAR's work are held (the Interim Meeting in 2014 was held in Toronto).

(iii) Global Public Policy Committee (GPPC) Working Group

Active discussions were held concerning audit firms' business models, including changes in their earnings structure, personnel strategy and global governance of networks of international audit firms. International joint inspections of member audit firms of leading networks were conducted for the first time by audit oversight authorities in different jurisdictions from the viewpoint of verifying the effectiveness of group audits of head offices of multinational enterprises and their overseas subsidiaries, etc. The international joint inspections were conducted under the initiative of Japan.

(iv) Inspection workshop

At the first IFIAR plenary meeting in Tokyo, it was agreed that the inspection workshop would be held, 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 provided by the Inspection Workshop Working Group.

This fiscal year, the workshop was held between March 2 and 4, 2015, and was hosted by the UK Financial Reporting Council (FRC). More than 140 inspectors and others participated from 37 jurisdictions, including Japan.

Past IFIAR inspection workshops

	Dates	Venue	Participating audit oversight authorities
First	May 30-31, 2007	Amsterdam, the Netherlands	22 jurisdictions
Second	January 29-30, 2008	Berlin, Germany	20 jurisdictions
Third	February 11-13, 2009	Stockholm, Sweden	25 jurisdictions
Fourth	February 9-12, 2010	Paris, France	31 jurisdictions
Fifth	February 23-25, 2011	Washington D.C.,USA,	30 jurisdictions
Sixth	March 5-7, 2012	Abu Dhabi, UAE	32 jurisdictions
Seventh	March 4-6, 2013	Zurich, Switzerland	38 jurisdictions
Eighth	March 10-12, 2014	Kuala Lumpur, Malaysia	36 jurisdictions
Ninth	March 2-4, 2015	London, UK	37 jurisdictions

3.2.3 *Situation for the hosting of a Permanent Secretariat*

In recent years, the IFIAR has been rapidly transformed from just a forum among members' jurisdictions to an organization conducting practical activities as an international organization. In addition, it is increasingly necessary for the IFIAR to enhance its relationships with other international organizations, including the Financial Stability Board (FSB), the International Organization of Securities Commissions (IOSCO) and the Basel Committee on Banking Supervision (BCBS). Under these circumstances, the establishment of a permanent secretariat was discussed at the Washington, D.C., plenary meeting in April 2014. Then, applications for the hosting of the permanent secretariat were invited from the IFIAR's member jurisdictions.

From the viewpoint of the medium and long-term contribution to the IFIAR and improvement of Japan's presence, the CPAAOB and FSA ran for the election of the host country of the permanent secretariat to be established in Tokyo, and publicly announced our candidacy on its website in January 2015. Up to April 2015, a number of Japanese and overseas private sectors have issued press releases supporting the establishment of the permanent secretariat in Tokyo.

(Note) Private sectors which have issued press releases supporting the establishment of the permanent secretariat in Tokyo

The Japan Exchange Group, Inc. (JPX), Japanese Institute of Certified Public Accountants (JICPA), the Japanese Bankers Association (JBA), the Japan Business Federation (JBF), the Japan Association of Corporate Executives (JACE), the Japan Auditing Association, the International Bankers Association (IBA), the American Chamber of Commerce in Japan (ACCJ), the European Business Council (EBC), the U.S.-Japan Business Council, Inc. (USJBC) and the Japan-U.S. Business Council (JUSBC)

The CPAAOB and the FSA have been conducting activities to obtain support for the establishment of the permanent secretariat in Tokyo from parties concerned through enhanced contribution to discussions of the IFIAR's policy issues, request for support from IFIAR member jurisdictions, the holding of IFIAR-related meetings in Tokyo (scheduled for October 2015), etc.

3.3 Bilateral Cooperation

- *Exchange of views with foreign audit oversight authorities*

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, etc. has become indispensable for making audit oversight system globally efficient and effective. Through participation in the IFIAR plenary meeting and each working group, the CPAAOB is actively strengthening its cooperation and knowledge sharing with foreign audit oversight authorities. In addition to activities at the IFIAR, for the purpose of sharing information on international audit firms and audits and inspections' issues, the CPAAOB has been also constantly exchanging views with audit oversight authorities from various jurisdictions on a bilateral basis and has been striving to build and enhance its cooperative relationships with foreign audit oversight authorities.

The CPAAOB and the FSA also exchanged the letters on cooperation in the area of audit oversight with the Financial Reporting Council (FRC) on May 23, 2014. This exchange of letters has enabled them to exchange information for audit oversight more smoothly.

Based on the "A Framework for Inspection/Supervision of Foreign Audit Firms, etc." (Note) published by the FSA on September 14, 2009, the CPAAOB and the FSA on the

one side and the Netherlands Authority for the Financial Markets (AFM) on the other side agreed on mutual reliance, and the CPAAOB and the FSA announced on June 11 in 2014 that Japan and the Netherlands will rely, in principle, on the other party concerning audit and supervision of foreign audit firms, etc.

(Note) Provided that—(a) audit and public oversight systems in the firms’ home jurisdictions are equivalent to those of Japan, (b) necessary information can be provided from the foreign competent authorities through appropriate arrangements of information exchange, and (c) reciprocity is ensured, the CPAAOB and the FSA will, in principle, rely on such actions by the competent authorities of the firms’ home jurisdictions.

(Reference) Letters exchanged until FY2013

- (i) October 6, 2011: the U.S. Public Company Accounting Oversight Board (PCAOB)
- (ii) March 23, 2012: the Canadian Public Accountability Board (CPAB)
- (iii) October 3, 2012: the Audit Oversight Board of Malaysia (AOB)
- (iv) March 19, 2013: the Netherlands Authority for the Financial Markets (AFM)
- (v) August 2, 2013: the Commission de Surveillance du Secteur Financier (CSSF)

3.4 Holding of an International Conference for the 10th Anniversary of CPAAOB Japan

Since its foundation in April 2004, the CPAAOB has not only conducted an inspection of certified public accountants and audit firms but also actively participated in international discussions of the IFIAR, etc. As a part of these efforts, the CPAAOB held on March 12, 2015, an international conference for the 10th Anniversary of CPAAOB Japan which was attended by approximately 200 persons from 25 jurisdictions, including audit oversight authorities, securities authorities and international organizations, etc. in Asia, Europe, the U.S., etc.

Under the conference’s theme of “Audit Quality and the Role of Auditors for Enhanced Corporate Governance and the Financial System Stability,” three panel discussions were held concerning—(1) the role of external audits for enhanced corporate governance; (2) the role of external audit for the Financial System Stability; and (3) global efforts for enhanced audit quality by audit market oversight bodies and useful discussions to improve the audit quality were held.

3.5 Future challenges

(1) Strengthening cooperation with foreign audit oversight authorities

Given that the globalization of corporate activities has resulted in the advance of cross-border audit services, such as using the audit results of overseas audit firms in the audit of consolidated financial statements of internationally active enterprises, ensuring the global audit quality is a challenge. Under these circumstances, special attention also needs to be paid to the quality control method in the whole network of international audit firms, the introduction of the data analysis method in audits, and the effects that the global economic and financial situation, etc. has on the audit quality.

Based on such perspectives, multilateral cooperation at meetings, etc. of the IFIAR, etc. and bilateral cooperation with foreign audit oversight authorities are becoming increasingly important. Therefore, the CPAAOB needs to not only continue to actively participate in the IFIAR activities, but also to use international conferences, etc. to actively exchange views regarding our concerns and those of foreign audit oversight authorities, to share knowledge which the CPAAOB obtains from its activities, etc. with foreign audit oversight authorities, and to exchange opinions concerning global challenges with them on a bilateral basis in order to take the same stance on common issues. In particular, since many Japanese companies have been currently doing business in Asia, it is a challenge of the CPAAOB to enhance cooperation with the relevant authorities of Asian countries, including prospective member countries of the IFIAR from the viewpoint of verifying group audits, etc.

It is also necessary to promptly share the results of those exchanges, etc. with parties concerned and actively use such results in the work of the CPAAOB.

While actively proceeding with negotiations toward developing frameworks for the exchange of information between audit oversight authorities, the CPAAOB believes that an important issue is to strengthen cooperation further by communicating closely with foreign authorities to utilize developed frameworks.

(2) Response to international trends in accounting and audit systems

Regarding international trends in discussion on accounting and audit systems, the CPAAOB needs to pay particular attention to discussions at international organizations, etc., and collect and promptly share information in a timely manner, through cooperation, with a wide range of relevant organizations, including the FSA divisions concerned, JICPA, and the stock exchanges. The CPAAOB also believes it important to take necessary action properly in a timely manner,

including analyzing and considering the potential impact of discussion on audit firm activities and the CPAAOB operations, and measures to be taken, and translating such results into off-site and on-site monitoring on audit firms.

(3) Activities to obtain support for the establishment of IFIAR's permanent secretariat in Tokyo

In Asia where capital markets and economies have steadily grown in the recent past and are expected to further grow in the future, there are many prospective authorities. However, it can be said that the establishment of the permanent secretariat in Tokyo would encourage Asian audit oversight authorities to become members of the IFIAR, help improve the presence of Asian audit oversight authorities in international audit-related discussions, and contribute to Tokyo becoming an international financial center as indicated in the "Japan Revitalization Strategy."

In view of the above, it remains important for Japan to continue making efforts to obtain support for the establishment of IFIAR's permanent secretariat in Tokyo from IFIAR members, elaborate Japan's proposal, and hold meetings with related organizations.

4 Efforts to Enhance the Attractiveness of the Qualification of Certified Public Accountant (CPA)

4.1 Outline

CPAs are expected to play an active part not only in the audit industry but also in various other sectors, including the business community. Based on this concept, the relevant law was revised in 2003 in order to secure a number of qualified personnel by diversifying types of applicants and increasing the number of applicants. A new examination system was introduced from 2006. The number of successful applicants tentatively increased after the shift to the new examination system. However, the number of persons recruited by the audit industry significantly decreased due to the deterioration in economic conditions, etc. As a result, many persons who have passed the CPA examination could not obtain a position and became so-called “persons on waiting list.”

Since then, the employment situation at audit firms has improved and the issue of “persons on waiting list” has calmed down recently. On the other hand, the new challenges have occurred: the number of applicants for the CPA examination has tended to decrease; and audit fees have also tended to decrease.

4.2 Current Efforts

Accounting and auditing are an important part of the infrastructure in financial and capital markets. CPAs who are experts in accounting and auditing are required to play an important role in broad sectors of the economy as “public property” in financial and capital markets.

The CPAAOB revised the action plan in cooperation with the FSA, the JICPA, etc. In addition, the CPAAOB provides enterprises, market participants, etc. with information necessary for making them well aware of the role of accounting and audit, and conducts enhanced publicity activities targeting young persons, including high school students, in consideration of the declining number of applicants for the CPA examination.

4.3 Future challenges

The proposal to accelerate activities to make the certified public accountant qualification more appealing is made in the “Follow-up and Further Recommendations

for Vitalizing Financial and Capital Markets” released by the Panel for Vitalizing Financial and Capital Markets on June 12, 2014, and the “Japan Revitalization Strategy Revised in 2014—Japan’s Challenge for the Future—” approved by the Cabinet on June 24, 2014.

Based on the above-mentioned proposal, the CPAAOB needs to continue to provide enterprises, market participants, etc. with information necessary for making them well aware of the role of accounting and audit, and conduct enhanced publicity activities targeting young persons, including high school students. In addition, the CPAAOB needs to take effective measures, in future, to further improve the attractiveness of the qualification of CPA in close cooperation with the FSA, JICPA, the economic community, and market players, etc.

**List of Members of the Fourth
Certified Public Accountants and Auditing Oversight Board
(CPAFOB)
(As of April 1, 2014)**

Annex 1

Chairperson (full-time)	Kunio Chiyoda	Former Professor, Graduate School of Accountancy, Waseda University
Commissioner (full-time)	Toshiro Hiromoto	Former Professor, Graduate School of Commerce and Management, Hitotsubashi University
Commissioner (part-time)	Yasuyoshi Ichikawa	Partner, Deloitte Touche Tohmatsu LLC
Commissioner (part-time)	Akiko Kimura	Of Counsel, Anderson Mori & Tomotsune Outside Corporate Auditor, Fuji Electric Co., Ltd.
Commissioner (part-time)	Michiyoshi Sakamoto	Certified Public Accountant, Corporate Auditor (Full-Time), Bank of Tokyo-Mitsubishi UFJ, Ltd.
Commissioner (part-time)	Hisakatsu Sakurai	Professor, Graduate School of Business Administration, Kobe University
Commissioner (part-time)	Yoshiko Sato	Secretary General, Chief Research Fellow, Japan Investor Relations Association,
Commissioner (part-time)	Yasuyuki Fuchita	Executive Fellow, Nomura Institute of Capital Markets Research
Commissioner (part-time)	Keiko Mizuguchi	Chief Analyst & General Manager of Rating Planning Department, Japan Credit Rating Agency, Ltd.
Commissioner (part-time)	Kazunori Yagi	Advisor, Yokogawa Electric Corporation Outside Corporate Auditor, Yokogawa Bridge Holdings Corp. Outside Director, JSR Corporation Outside Corporate Auditor, TDK Corporation Outside Director, OYO Corporation

Case Reports from the Results of Audit Firm Inspections

1. Introduction

From the viewpoint of maintaining and improving the quality of audits in Japan, ensuring public interest and protecting investors, the CPAAOB inspects audit firms and identifies a variety of deficiencies in matters relating to quality control of audits. Main cases of deficiencies in inspections are compiled in the “Case Reports from the Results of Audit Firm Inspections.” These Case Reports have been publicized every fiscal year.

In the case of the Case Reports publicized on July 14, 2014, the text is divided into quality control and individual audit services sections as the previous year’s one. The contents of the Case Reports are as follows.

- ▶ In the quality control section, for each quality control item, “inspection standpoints,” “summarized inspection results” (“commendable efforts,” “summary of deficiencies” and “cause analysis of deficiencies), and “actions to be taken” by audit firms are stated, and then particulars of cases of deficiencies are introduced. For the “operation control system” in particular, root causes of deficiencies related to the quality control system of audit firms (including the system for individual audit services) are analyzed in consideration of direct causes, and their results are stated.

- ▶ In the individual audit services section, headings similar to those included in the report of the Audit Standards Committee are used. However, separate headings are used for the audit of the accounting estimate in which deficiencies are concentrated, the audit of financial institutions for which a priority in industry-classified audit is placed, malpractice in the audit of financial statements for which future actions of audit firms must be watched, and audit of internal control over financial reporting to which a standard different from that applicable to the financial statement audit was applied. Then, under each heading, “inspection standpoints,” “summarized inspection results” and “actions to be taken” by audit firms are stated, and depending on the contents, etc. of cases of deficiencies, “matters to be noted” in performing audit procedures are stated, in addition to the introduction of cases of deficiencies, to help improve deficiencies common to cases of deficiencies.

The CPAAOB expects each audit firm to inspect their quality control system, including

individual audit services, with reference to cases of deficiencies and their causes, etc. introduced in the Case Reports, and if any deficiency is detected in the quality control system, for each audit firm not only to remedy the deficiency but also to investigate and remove its root causes.

In particular, top management, the quality control manager, etc. should be primarily responsible for any deficiencies detected in the quality control system, including individual audit services. However, it is often observed that the root or essential causes can be attributed to audit firms' business management systems, business policy or business models, etc. Remembering that the maintenance and operation of the quality control system should not be handled only on the individual responsibility of top management, the quality control manager, etc. but should be handled by all employees responsible for management of audit firms, because this is a challenge for business management, employees of audit firms are required to identify the root causes which may cause deficiencies in the quality control system and take organizational measures to rectify such deficiencies.

An overview of parts of the quality control section in the Case Reports are as follows.

*For the full text of the Case Reports, please visit the CPAAOB website:

<http://www.fsa.go.jp/cpaaob/english/oversight/20141121.pdf>

2. Overview of Inspection Results

(1) Operation control systems

(i) Quality control system

At large audit firms, the quality control department is mainly involved in maintaining and improving the quality control system. Some small and mid-sized audit firms make positive efforts to maintain and improve their quality control by nominating a dedicated quality control manager, for example.

On the other hand, in the case of some audit firms (mainly small and mid-sized ones), their efforts to maintain and operate the quality control system are insufficient, while there are some audit firms (mainly small and mid-sized ones), where top management, the quality control manager, etc. do not fulfill their responsibilities for quality control acceptably.

There are some audit firms whose efforts to improve deficiencies detected in quality control reviews conducted by the CPAAOB or JICPA are insufficient, and other audit firms whose audit services continue to have deficiencies. In some situations, it is quite difficult to say that audit services are properly provided by persons having a professional awareness of audit risks.

Root causes of cases of deficiencies are issues relating to the following:

- a. Audit firms' business management system, business policy or business models;
- b. Efforts of top management, etc. in quality control; and
- c. Each employee's recognition of his/her job responsibility, mutual checks and balances among employees, etc.

The details are as follows.

a. Example of causes attributable to audit firms' business management system, business policy or business models:

- Top management places a higher priority on business expansion than on audit quality control, and reflects sales achievement in employees' performance evaluation and compensation but doesn't reflect the quality of audit services and compliance with professional ethics in employees' performance evaluation. As a result, all employees of the audit firm tend to make light of quality management.

- Profit management, the determinant of employee compensation, etc. is independently made by each regional audit office and the headquarters are not involved in the business operations of each regional audit office. In other words, the audit firm doesn't conduct integrated business operations.

- As dual employment is permitted for employees and staff, many employees and staff spend more time in the business of their individual firms than in the business of the audit firm. Therefore, the governance of the firm by top management, etc. doesn't work sufficiently.

b. Example of causes attributable to the efforts of top management, etc. in quality control:

- Top management and the quality control manager don't understand the level of the quality management system which is required in the practical guidelines, etc. Therefore, the audit firm misunderstands that their efforts to improve the quality management system are sufficient.

- Despite the fact that deficiencies in the audit firm's quality control system are repeatedly detected by the CPAAOB inspection and quality control reviews conducted by JICPA, top management, etc. fail to recognize that the audit firm's quality control system has serious problems.

- Although top management, etc. recognize that audit controllers are divided over the necessity to maintain and improve the quality of audits and there are gaps between levels of audit quality of different audit services, they fail to implement activities necessary for maintaining and improving the quality of audits all over the firm.

- Although top management, etc. recognize that the ratio of certified public accountants having

extensive audit experience is low, they don't fully examine measures necessary for securing auditors who have appropriate capabilities.

- The employees engaged in the management of the audit firm such as top management, etc. fail to have a specific sense of crisis over the quality of audits of the audit firm, and therefore they have not established and/or implemented measures to rapidly improve the audit quality of all audit services to be provided by the audit firm to a certain level or higher.

c. Example of causes attributable to each employee's recognition of his/her job responsibility, mutual checks and balances among employees, etc.

- Under the circumstances that the ratio of less-experienced and newly-qualified certified public accountants exceeds the ratio of experienced certified public accountants, each employee believes that the quality management issue of the audit firm should be left to top management or quality managers, and they fail to recognize that they should fulfill their job responsibilities and roles to maintain and improve the quality of all audits of the firm.

- Employees have no willingness to critically monitor and verify, on an equal footing, the quality of audits conducted by other employees as audit controller.

- Employees have no discussions over the necessity or significance of systemic audits, and therefore they fail to share the recognition of the necessity to conduct systemic audits.

(ii) Efforts to improve business

Some audit firms (mainly small and mid-sized ones) have not fully implemented measures to remedy the deficiencies identified in quality control reviews conducted by the JICPA and have failed to implement measures to improve deficiencies or the level of improvement is insufficient. Causes of deficiencies may be attributed to the fact that quality control managers, etc. recognize that deficiencies detected in quality control reviews occur under special circumstances specific to audit services and therefore they have not verified the root causes, etc. of deficiencies, or that quality control managers, etc., with respect to deficiencies detected in quality control reviews, only superficially agreed based on the checklist describing deficiencies and corresponding improvement measures and each audit controller and each person in charge of risk assessment, with respect to audit services in which they are involved, has not checked the status of improvement in full consideration of the intent to detect deficiencies.

(iii) Establishment, notification and operation of internal rules

In the case of some audit firms (mainly small and mid-sized ones), cases of defects are detected in the establishment, notification or operation of internal rules. One of the causes of such defects may be attributed to the fact that a form of the audit quality control regulations publicized by the JICPA is adopted as internal rules without amending them to fit the actual conditions, etc. at the

audit firm.

(iv) Compliance with laws and regulations and various standards

In the case of some audit firms (mainly small and mid-sized ones), cases of defects are detected in relation to prohibition of competitive work for employees, particulars of entries in business reports and notifications of changes in the articles of incorporation, etc. These cases are due to the fact that the quality control manager, etc. has not clarified the person in charge of verifying that the services comply with laws and regulations and various standards, or has not specified the work flow.

(v) Information management

Cases of defects are detected for some audit firms (mainly small and mid-sized ones) where information leakage prevention measures specified in their internal information security rules are not implemented in a proper manner, or their internal information security rules are not distributed to auditors. This is due to the fact that the persons, etc. responsible for information management only establish the internal information security rules for form's sake, and leave the enforcement of those rules to auditors using PCs, etc. (including part-time auditors), or that the persons, etc. responsible for information management misunderstand that auditors comply with the internal information security rules and fail to implement measures to check the actual conditions of operation of the internal rules at their audit firms.

(vi) Preventing insider trading

Cases of defects are detected for some audit firms (mainly small and mid-sized ones) where the internal rules are established with reference to the form of the insider trading prevention regulations but measures to prevent insider trading as specified in the rules are not implemented. These are due to the fact that the persons, etc. in charge of preventing insider trading have not completely recognized the measures that should be implemented based on the internal rules, or the persons, etc. in charge of preventing insider trading simply assume that the employees of their audit firms properly comply with the rules concerned without verifying the status of compliance with internal trading prevention measures by the employees.

(2) Concluding new contracts and renewing contracts

Although the conclusion or renewal of new or existing audit contracts constitutes a part of business judgement of the audit firms, cases of defects are detected for some audit firms (mainly

small and mid-sized ones) where check marks are only placed in the check boxes according to the internal rules to indicate that there are no problems and no careful risk assessment is made before the conclusion or renewal of new or existing audit contracts.

This is due to the fact that audit controllers, etc. (appointed persons) put priority on early conclusion of audit contracts and early commencement of the audit procedures instead of on implementing careful risk assessment, or on implementing measures to resolve problems in a timely and appropriate manner, or that audit controllers, etc. (appointed persons) have less experience in making proper judgment concerning management fraud, audit of internal control and accounting estimate, etc. and therefore they cannot properly identify or evaluate the risk of concluding an audit contract based on the facts obtained from preliminary investigations, the transfer of audit services, etc., or that employees other than audit controllers, etc. (appointed persons) become less willing to critically examine the audit business which other employees obtained from customers when they discuss the acceptability or non-acceptability of the audit contract.

(3) Risk Assessment of audit services

There are cases of defects where auditors have not conducted careful risk assessment with respect to the necessity, sufficiency and judgment process of audit procedures of important audit items and the enhancement of the audit system continues to be an important challenge. Furthermore, there are cases of defects where reviewers appropriate for the audit risks involved are not appointed, or where the effectiveness of audits is not secured for the reason that auditors have not conducted risk assessment from the critical viewpoint or for other reasons.

These deficiencies are attributed to the following causes.

- Although audit services involve high risks, reviewers appropriate for such audit risks are not appointed.
- Reviewers excessively rely on audit controllers, etc. and therefore simply assumes that the audit team has performed the audit procedures in a sufficient and proper manner.
- The audit team doesn't inform reviewers (including contracted reviewers) of the conditions of audited companies and the particulars of important matters to be examined, and as a result risk recognition is not shared by the audit team and reviewers.

- Audit teams being reviewed don't understand that they must receive an objective appraisal from reviewers not only for their judgment on important accounting procedures but also for the sufficiency and appropriateness of the audit procedures performed by the auditors.
- In the situation where the business operations of some audit firms (mainly small and mid-sized

ones) are conducted by a small number of employees, reviewers place priority on their own audit services and don't spend enough time on reviews.

- In the situation where some audit firms (mainly small and mid-sized ones) do not have a sufficient number of employees, etc. having the adequate and sufficient knowledge and experience needed to carry out a review, such audit firms have not taken measures to employ and develop persons having the qualification of reviewer.

(4) Cooperation with audit & supervisory board members, etc.

(i) Cooperation with accounting auditors and audit & supervisory board members, etc.

There are cases where the necessity of cooperation between accounting auditors and audit & supervisory board members, etc. is increasingly recognized by the parties concerned and communications are made on a regular basis between them, although the degree of cooperation between them differs case by case.

However, verification of the contents of notifications concerning quality control reviews sent by audit firms subject to quality control reviews to audit & supervisory board members, etc. revealed that in many cases, such audit firms notified audit & supervisory board members, etc., orally instead of in writing, of only the conclusion to the effect that "important deficiencies are not detected in quality control reviews," although they have received recommendations for improvement, but for the reason that qualified conclusions are not made.

On the other hand, there still are some audit firms which don't give any notification about quality control reviews to audit & supervisory board members, claiming that "any deficiencies identified in the quality control review are insignificant and there is no need to inform the audit & supervisory board members of the fact," or that "they have not received a request for disclosure or questions from audit & supervisory board members."

(ii) Responding when fraudulent or illegal acts have been detected

Commendable efforts of audit firms are that after the introduction of the provisions concerning responses to the detection of legal violations, etc. in the Financial Instruments and Exchange Act, they made the details of the law fully known to their employees, etc. by notifying them of examples of notifications to audit & supervisory board members of audited companies, in the case that legal violations, etc. are detected.

There are cases where, if an audit firm determines that an issue could influence the perceived correctness of the financial statements, the audit firm gave a notification to the audited company pursuant to Article 193-3 of the Financial Instruments and Exchange Act, and as a result the audited company amended the quarterly report and enhanced their disclosure system.