

## **Study and Evaluation of the Quality Control Review of JICPA (Outline)**

### **Introduction**

The Certified Public Accountants and Auditing Oversight Board (“CPAAOB”) was established on April 1, 2004, and subsequently published its “Oversight Policy and Plan” on June 29, 2004. In accordance with this “Oversight Policy and Plan,” CPAAOB has conducted a study and evaluation of the quality control reviews performed by Japanese Institute of Certified Public Accountants (“JICPA”) in the past five years. Under its self regulatory system, JICPA has performed quality control reviews of auditors and audit firms (“audit firms”) that have engaged in audits of listed companies.

CPAAOB has undertaken this study and evaluation in order to gain a full understanding of the actual conditions of JICPA’s quality control reviews, and to identify areas that need to be improved, in order to protect the public interest and ensure the fairness, neutrality and effectiveness of audits. This study and evaluation process aims to improve JICPA’s quality control reviews and the quality and effectiveness of audits, and to enhance the credibility of financial information.

CPAAOB concluded that JICPA’s quality control reviews have played an important role in promoting the improvement of the quality and effectiveness of audits by monitoring the quality control practices of audit firms, and by issuing recommendations to audit firms that they perform proper audit practices, such as using a risk based approach methodology, auditing significant estimates, and performing an independent concurring review. However, CPAAOB also identified issues in the quality control review process that JICPA needs to improve.

### **Recommendations**

Through this study and evaluation, CPAAOB has made various recommendations to JICPA to further enhance the functioning of its quality control review.

The following are the main recommendations that should be improved to best safeguard the public interest.

1. On the system and structure of the quality control review, JICPA should:
  - strengthen the human resources of the quality control review team.
  - improve the transparency of the decision making process of the Quality Control Committee in JICPA.
  - consider the basic concept and principles for evaluating the sufficiency and appropriateness of both evidence used in audits and the decision-making process followed in forming audit opinions, which are needed to protect the public interest and to ensure the reliability and effectiveness of the quality control reviews.
  - actively disclose the contents of the quality control review process, along with the results and actions stemming from this process.
  
2. On standards and procedures of the quality control review, JICPA should:
  - establish clear guidelines for making fair judgments and reaching conclusions in the quality control review process.
  - ensure that audit firms implement an independent concurring review, especially in the case of small audit firms.
  
3. On implementation of the quality control review, JICPA should:
  - properly evaluate compliance with professional standards and regulatory and legal requirements related to audit engagements.
  - properly evaluate implementation of risk based approach methodologies in audit practices, as well as whether audit firms document sufficient and appropriate evidence in their working papers (i.e. audit planning; work program; the nature, timing and extent of audit procedures performed; conclusions reached based on audit works).
  - properly select audit engagements for the quality control review.
  - improve the quality control review procedures used to evaluate the sufficiency and appropriateness of audit procedures, as well those used to evaluate the audit evidence documented for expressing an audit opinion; and also to document clearly the process and results of the quality control review.
  - study, in cooperation with related authorities, the timing of the independent concurring review, which should be performed before expressing an audit

- opinion, in order to ensure the effectiveness of audits.
- establish proper organizational measures to perform timely and effectively follow-up on the recommendations from the prior quality control review of each audit firm.
4. On ensuring auditor's independence, JICPA should:
- develop quality control review procedures and tools relating to auditor's independence in both fact and appearance, to accomplish the goals below:
    - to properly evaluate an auditor's independence, especially with regard to the rotation of a sole practitioner or senior audit personnel in small firms.
    - to evaluate the financial independence of audit firms when the total fee from certain audit client represents a large proportion of the firm's total fees.
5. JICPA should improve the communication and cooperation between its Quality Control Committee and other related committees within JICPA that have useful information relating to quality control in cases of improper audits, in order to enhance the effectiveness of the quality control review.

## **Conclusion**

Through this study and evaluation, CPAAOB was able to analyze generally the actual conditions of audits by audit firms, and the JICPA quality control review process, in the past and present, and to identify specific areas in JICPA's quality control review that are in need of improvement. We expect that JICPA will implement our recommendations and take remedial action without delay to enhance its quality control review and improve the quality and effectiveness of audits.

In closing, we would like to note that we could not have accomplished this study and evaluation without the voluntary and positive cooperation of JICPA.