

## General Statement

- ✓ The credibility of audits is very important as it affects not only individual companies, but also the whole market, as well as the Japanese economy.
- ✓ In order to secure the credibility of audits and protect investors, it is important that auditors, audit clients and shareholders function as a whole.
- ✓ When auditors fail to detect systematic fraud involving the management of a company, it can be viewed as the failure of the auditors to take responsibility.
- ✓ An auditor can function as a bulwark to fraud involving the management of a company, and play the role of an anchor or a last resort in the audit.
- ✓ The current auditing standards, including the Standards to Address Risks of Fraud in an Audit and the internal control report system, are already reasonably established, and it is important to check whether current practices are adequately in accordance with the standards.
- ✓ If we discuss the amendment of the current system, it is essential to take into account the cost and benefit equation.

## Competence of Accountants

- ✓ There are auditors who rightly bring up accounting concerns to audit clients. There are also auditors who focus on matters which they consider material and highly risky.
- ✓ The focus of the debate should be on the reasons why auditors are unable to properly express their opinions to audit clients and the management and make the audit system work appropriately.
- ✓ It is difficult to understand why auditors cannot detect a fraud even when the transactions are obviously unnatural.
- ✓ Auditors should be able to anticipate fraud when it is conducted through traditional approaches.
- ✓ The key to the audit process is to recognize crucial areas within the whole picture of the audited target, based on the risk of fraud, and this is the area where auditors have to make more efforts.

- ✓ The important point is how to cultivate and secure auditors who have broad experience and knowledge, and high spirits for squarely facing the management.

### Management of Audit Firms

- ✓ It is necessary to conduct an audit from the audit planning stage in a more adept and varied manner.
- ✓ From the viewpoint of audit firms exercising proper professional skepticism and securing an audit by focusing on the truly risky areas, it is necessary to promote the fostering of a culture wherein each audit firm exercises leadership through the management of audit firms and the education and evaluation of human resources.
- ✓ From the viewpoints mentioned above, one idea would be to consider the drafting of a governance code for audit firms.

### Auditing Methodologies

- ✓ In order to enable the listing and verification of every transaction on an equal level, auditing methodologies that utilize IT are being researched overseas. Japan will also need to consider such methods.

### Viewpoints of Third Parties

- ✓ When an audit firm engages with a certain company for a lengthy period, the methodology of the audit tends to be fixed, even if they rotate engagement partners.
- ✓ It has been pointed out that, while audit firm rotation aims at strengthening the independence of the auditor and improving the audit quality, it also incurs costs for changing audit clients and brings down the audit quality, especially immediately after the rotation. In addition, audit firm rotation is practically difficult, considering the scarcity of large audit firms. Both the pros and cons of audit firm rotation should be taken into consideration accordingly
- ✓ Ten years have already passed since the Certified Public Accountants Act was amended. Therefore, we should discuss audit firm rotation in response to the change in situation.

- ✓ A whole change in the engagement team of an audit firm could be an option for rotation: however, like audit firm rotation, the whole change of the engagement team interrupts the accumulation of knowledge and experience.
- ✓ The inspection of audit firms conducted by the Certified Public Accountants and Auditing Oversight Board should be enabled to be operated more flexibly.

### Corporate Governance of Audit Clients

- ✓ There are companies whose *kansayaku* or audit committee members discuss with auditors when the auditors recognize an audit risk.
- ✓ In order to secure a proper audit, it is necessary that the audit clients support auditors, such as *kansayaku* or audit committee members, and participate more actively in the recognition of risks and audit planning

### Standards and Practical Guidances

- Accounting Standards
  - ✓ There have been more and more estimates in current accounting standards, which could make audits more difficult.
  - ✓ The estimates necessary to disclose facts should be treated separately from those necessary to forecast future performance. In considering accounting standards, it is important to examine whether the estimates are required for the disclosing of facts, as well as whether the estimates can be audited.
  
- Auditing Standards (including Quality Control Standards for Audits and Standards to Address Risks of Fraud in an Audit)
  - ✓ Audit standards have come to a saturation point, and the burden for auditors at the end of the financial year has become considerable.
  - ✓ Young auditors are forced to take time to avoid any holes in audit documentation in order to respond to various quality control reviews.

- ✓ Based on the current situations mentioned above, we should prompt auditors to concentrate on truly risky areas while appropriately understanding the business model and business risks of the audit client. To that end, it is necessary to establish an audit environment more thoroughly focused on a risk-based approach.
  - ✓ The Standards to Address Risks of Fraud in an Audit involve detailed provisions; however, it seems that audit practices are not entrenched enough and that practitioners are not thoroughly implementing these Standards.
- Standards for Management Assessment and Audit Concerning Internal Control over Financial Reporting
- ✓ The internal control report system is designed to involve a supervisory function over both the board of directors and *kansayaku*, who are appointed to supervise the management and prevent the management's override of internal control.
  - ✓ Traditional frauds should be detectable if an internal control is properly set up and assessed, and if an audit is appropriately conducted.
  - ✓ Inspection is required as to the reasons why an internal control system cannot deter fraud in spite of the above.

#### Others

- ✓ Tighter sanctions on both the management and the company are necessary in order to deter systematic fraud involving the management.
- ✓ From the viewpoint of turning out competent accountants, the role of a qualification examination system would be an important issue to address.