

# **“Report on the Working Group on Improving Internal Audits of Financial Institutions (2025)” [Summary]**

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**June 20, 2025 (Friday)**

**Secretariat for the Working Group on  
Improving Internal Audits of Financial  
Institutions, Financial Services Agency**

# Measures by the Financial Services Agency for Improving Internal Audits of Financial Institutions

- ◆ Since 2019, the Financial Services Agency (FSA) has published various reports on internal audits to improve the internal audits of financial institutions.
- ◆ Following the publication of the “Monitoring Report for Improving Internal Audits of Financial Institutions (2024)” in September 2024 and in light of international trends (publication and implementation of the Global Internal Audit Standards (2024 edition)), the FSA decided that it would be appropriate to revisit the approach to internal audits at financial institutions, taking into account global standards and the perspectives of the broader financial industry and related experts. Therefore, the FSA has convened the “Working Group on Improving Internal Audits of Financial Institutions” since January 2025.

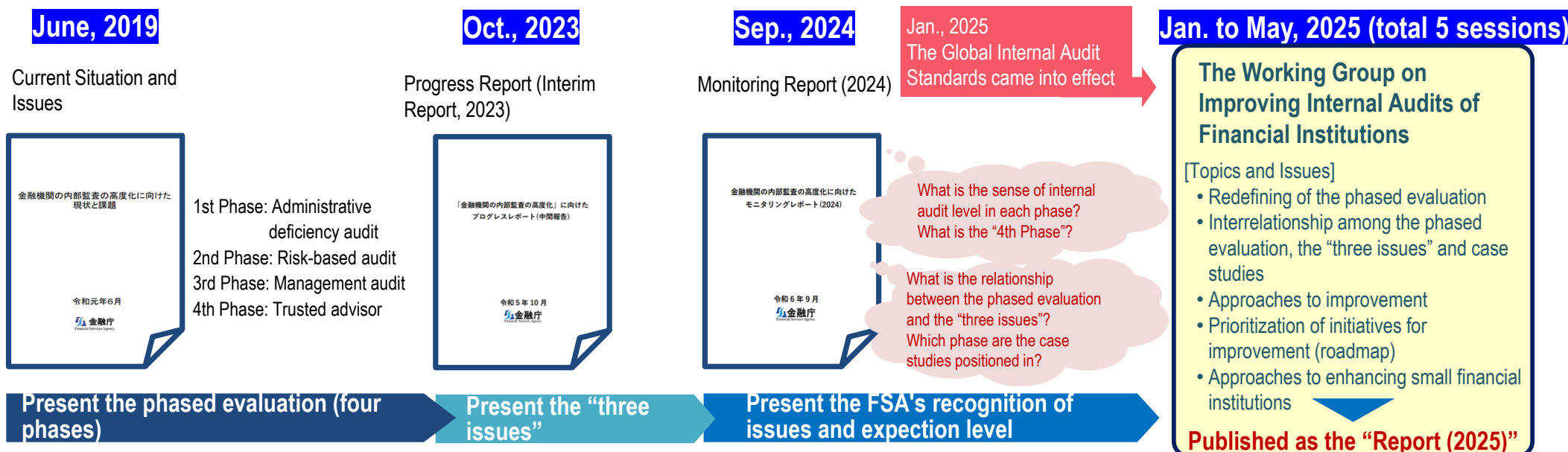
\* In the Monitoring Report (2024), the monitoring results based on the “three issues\*”, the Financial Services Agency’s “recognition of issues”, and “expectation level” were presented, and the necessity of updating the “Current Situation and Issues for Improving Internal Audits of Financial Institutions” (June 2019), including necessity of reconsideration of the phased evaluation was asserted.

\* Issue 1: Support for the internal audit functions by management teams, audit committee members, and corporate auditors  
Issue 2: Improving the system and strengthening the infrastructure of internal audit functions  
Issue 3: Understanding of internal audits for audited departments and fostering risk ownership

## [The Working Group on Improving Internal Audits of Financial Institutions]

The Working Group was held with the purpose of conducting discussions with financial industry organizations and experts in order to present viewpoints that encourage improvements in the internal audits of entire financial institutions and that secure trust in them from domestic and foreign stakeholders, and that are also utilized by non-financial institutions and overseas financial regulators.

- At the Working Group, in addition to industry organizations of deposit-taking financial institutions, securities companies and insurance companies, industry organizations of the asset management, money lending, payment services, and virtual and crypto assets exchange industries participated to assert their opinions. Furthermore, opinions were heard from external experts, including the Institute of Internal Auditors Japan and consulting firms. A total of five meetings were held with such financial industry organizations on topics including the sense of internal audit level and the attitude required of senior management.



## 1. Sense of level for the phased evaluation (four phases)

- ✓ The relationships between each phase are not a "graduation model" but an "accumulation model," therefore "compliance audits" should not be neglected as the phases progress.
- ✓ The relationships between initiatives for each of the "three issues" and each phase are not organized. It is necessary to describe the reasons why those initiatives are selected as good practices and examples of how they contributed to improving corporate value.
- ✓ It is necessary to differentiate the evaluation perspectives for audit systems (methods and quality) and maturity levels, as well as to present examples of initiatives and sense of level corresponding to the scale of operations and business characteristics.
- ✓ It is necessary to enrich information contributing to the consideration of a roadmap based on prioritization of initiatives (⇒ providing useful examples for stepping up with limited resources).
- ✓ The positioning of the "Global Internal Audit Standards™" and "Internal Control – Integrated Framework" in phased evaluation should be organized.

## 2. Concept of the "aimed phase" of internal audits

- ✓ By addressing the "three issues," audit findings and recommendations contribute to improved corporate value, which ultimately leads to better phased evaluation.
- ✓ The goal is to achieve "the audit that contributes to the establishment of robust governance," which is recognized as a prerequisite for the 4th phase (trusted advisor).
- ✓ Small financial institutions are struggling to secure resources; therefore, they should first aim for the 2nd phase (risk-based audit) (⇒ The 3rd phase (management audit) is difficult and requires cooperation within the industry).

## 3. Recognition of issues toward the "aimed phase" of internal audits

- ✓ "Revolution in senior management's awareness" is essential for stepping up (strong messages from the FSA are also desirable).
- ✓ Continuous information provision on such topics as the three lines management system and the necessity of risk ownership in the first and second lines (including outreach to audited departments), are desirable.
- ✓ Criticizing the audited department or individuals should be avoided in internal audits ⇒ It is necessary to analyze and discuss issues that seriously affect the organization and business operations."
- ✓ Keeping small financial institutions with limited resources in mind, the feasibility and concept of utilizing the audit functions of the group headquarters or external organizations shall be organized.

## 4. Clarifying the 4th phase (trusted advisors)

- ✓ The phased evaluation is a relative evaluation, and the 4th phase presents best practices such as timely response to environmental changes and also clearly indicates the importance of disseminating understanding of internal audits within the organization (⇒ Initiatives by the internal audit function alone are limited to the 3rd phase, and the entire organization must be involved to reach the 4th phase).
- ✓ Insight and foresight require different skills. Therefore, it is necessary to organize the human resources of the internal audit department (including securing and training specialists in laws and regulations, IT, data utilization, etc.) and the division of roles and cooperation within the organization, because senior managements' perspective and expertise are also necessary.
- ✓ Internal audits are not business consulting; it consists of assurance and advice; furthermore, maintaining a balance between them is important.
- ✓ The relationship and concerns regarding the "advice contributing to management strategy (execution)" and the "position of the internal audit (independence)" (⇒ Organizing assurance and recommendations for business management strategy, etc.)
- ✓ Specific cases of improvement and evaluation perspectives should be presented (⇒ Audits for corporate culture and utilization of DX, etc.)
- ✓ Organizing of concept and provision of their specific cases on securing financial resources for utilizing external personnel and co-sourcing the external specialized organization are desirable.

## ➤ Issues to be considered based on the Global Internal Audit Standards (as explained by the Institute of Internal Auditors Japan)

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| ① Linkage with corporate value                               | ⇒ Recognition of the linkage between internal audits and the creation and preservation of corporate value clarifies the role and strategic positioning of the internal audits.  |
| ② Clarification of the involvement of the Board of Directors | ⇒ Clarifying the relationship between the internal audits and the board of directors leads to the establishment of authority and rapid improvement throughout the organization. |
| ③ Emphasis on independence                                   | ⇒ Ensuring the "non-isolated independence" of the internal audit function leads to realizing the effective internal audit.  |
| ④ Explanation of the three-line model                        | ⇒ Establishing risk management systems in the first and second lines is essential for improving internal audits.  |

# Main Opinions Presented by Consulting Firms at the 3rd and 4th Working Group Meetings (Summary)

## Recognition of the “phased evaluation”

This page is a compilation of points that appear to be common among the explanations from each consulting firm, as organized by the Secretariat. External evaluations conducted by each consulting firm are based on their own criteria and may not necessarily align with the content presented here.

- ✓ The phased evaluation is the “roadmap for improving internal audits” (showing concept and direction for the improvement) and is not an evaluation criterion. When conducting external evaluations, consulting firms use their own evaluation items, criteria and perspectives to evaluate, and they do not directly match each phase of the phased evaluation. (In external evaluations, based on the purpose of the phased evaluation, specific initiatives are recommended.)
- ✓ The “phased evaluation” by the FSA and the “external evaluation” by consulting firms which evaluates the compliance with “Global Internal Audit Standards” share common areas of expected improvement of internal audit function and aim for the same outcomes.
- ✓ In phased evaluation, specifying initiatives to take for advancing to the next phase clarifies the issues that senior management and internal audit function should address, thereby promoting further improvement. However, it should be noted that if evaluation criteria and perspectives are incorporated into the phased evaluation, there may be risks that the phased evaluation would be treated as a checklist in self-evaluation, thereby undermining effective measures.

## Points requiring additional description or clarification in the “phased evaluation”

- ✓ Clarify the importance of establishing three lines management system (three lines model), which shall be a prerequisite for the effective internal audit function. Overall, from the perspective of the structure of the entire organization in consideration of the three lines model, the first and second lines should conduct guidance and monitoring, while the third line should independently verify performance status by the first and second lines and the appropriateness of the controls based on the results of it.
- ✓ Although the entire organization has reached the 3rd phase (management audit), administrative deficiency audit (1st phase) and risk-based audit (2nd phase) are still necessary as the foundation supporting the 3rd phase.
  - ① As a whole, the relationship between each phase is not a “graduation system” but rather an “accumulation system”, and “compliance audits” should not be neglected as the phases progress.
  - ② Depending on the size and characteristics of the company, it is possible to perform basic internal audit functions even at the “risk-based audit” phase.
- ✓ Clarify and add the following points regarding the definitions and sense of level in each phase.
 

1st phase: If it is difficult to establish three lines management system due to the size of the company (number of employees, business content, etc.), consider the total optimization and do not reject the idea that the third line conducts “compliance audits.”

2nd phase: Focusing on “substantive, forward-looking and holistic,” perform audits and provide assurance with executing risk assessments (identification and evaluation of risks and evaluation of control status) for each business and other activities regarding the “establishment and operational status of internal control.”

3rd phase: With a strong focus on “substantive, forward-looking and holistic” (particularly from the perspective of “forward-looking”), rather than performing “audits relevant to management strategies”, evaluate the existence of distortions (conduct risk, significant operational risk, etc.) and vulnerabilities arising from management strategies and their execution from the perspectives of risk management, control, and governance, as well as provide assurance, advice and insights.

4th phase: The phase is conceptually different from the 1st to 3rd phases, and it can not be achieved by simply adopting advanced methods as a formality.  
As a result of trust in internal audits, the senior management and audited departments come to actively request insights and advice from the internal audit function.
- ✓ When performing self-evaluation based on the phased evaluation, evaluation should be incorporated with effectiveness, not merely judged by formalities and procedures.  
⇒ Audit findings and recommendations will only be evaluated at higher phases if they lead to business improvements and, ultimately, to an increase in corporate value.

# Relationship between “Redefining Phased Evaluation” and the “Three Issues”

- ◆ Based on discussions at the Working Group meetings, the definition of the phased evaluation presented in “Current Situation and Issues” have been re-organized in the “Report (2025)” .
- Phased evaluation is not based on the formal and quantitative evaluation perspective but shows the direction and approach for achieving the objectives and performing the functions of internal audit entrusted by senior management. It is not intended to lead to advancement to a higher level.
- There is no uniform approach to achieving the objectives and performing the functions of the internal audits. Each financial institution should respond creatively, taking into account its own business environment and organizational structure.
- Even as the phases of internal audits have evolved, continuous efforts are required to enhance the various initiatives that have been implemented up to that point and increase the level of maturity at the basic phase (multi-layered initiatives). (Not a “graduation model” but an “accumulation model”).
- The “three issues” indicate specific internal audit improvement initiatives that should be required of the senior management and each department within the organization. “Phased evaluation” conceptually indicates the degree of maturity in achieving the objective and performing the functions of the internal audit.

Phase	Matured level of Internal Audit (from the “Current Situation and Issues”)	Redefinition in “Report (2025)” <small>* Addition and supplement to the content presented in the “Current Situation and Issues”</small>
<b>1st Phase</b> Administrative deficiency audit	Exercise a check functions on each department by discovering administrative deficiencies, violations of regulations, etc.	✓ <b><u>Phase of verifying the operational status of regulations, administrative rules, etc.</u></b> Phase in which financial institutions verify that their operations comply with the regulations and administrative rules currently in place, particularly regarding the first-line operations.
<b>2nd phase</b> Risk-based audit	Based on risk assessment, raise issues for business processes in high-risk areas.	✓ <b><u>Phase of verifying the appropriateness and validity of business processes within an organization on a risk basis</u></b> Phase of verifying that the operational status of each business area at sales offices and headquarters complies with the rules established by the financial institution (1st phase) as well as verifying that the rules themselves are appropriate on a risk basis, considering the environment surrounding the financial institution and the status of its business operations.
<b>3rd Phase</b> Management audit	Provide assurance that contributes to management in response to changes in the internal and external environment.	✓ <b><u>Phase of flexibly verifying business operation status across the organization based on the management strategy, providing information required by senior management in a timely manner, and providing assurance to the business processes.</u></b> Phase of revealing the root causes of issues and problems related to the company-wide system for business models and governance, as well as recommending (i.e., management recommendations) for resolving those issues and problems, assuming that compliance verification and business process verification functions are effective throughout the organization.
<b>4th Phase</b> Trusted advisor	Going beyond providing assurance and solving related issues, provide advice that contributes to management strategy to the management team and other officers and employees within the organization.	✓ <b><u>Phase of becoming the function which is trusted by the entire organization and sought for advice by senior management and audited departments, as well as contributing to the continuous improvement of corporate value (with room for further consideration in the future)</u></b> Phase where the mindset and system which the internal audits' initiatives and advices are actively established by the senior management and audited departments as the result of the trust in the internal audit function, in addition to the implementation of 1st to 3rd phases.



**The FSA plans to continue to conduct in-depth monitoring and promote the improvement of internal audits of financial institutions.**

# Phases to be Targeted and Necessary Structure, etc. for Financial Institutions

## Attitude required of the senior management of financial institutions

### ① Clarification of the matters entrusted to the internal audit function

- ✓ Requirement for the internal audits of the financial institutions should be clearly determined by the senior management of the financial institutions based on their business status, as entrusted matters to their internal audit function.

### ② Clarification of the phases to be targeted by the internal audit function

- ✓ The senior management should consider and determine on the necessary structure for the internal audit function to respond to its entrusted matters assuming good mutual communication between internal audit function and senior management.

### ③ Necessity of support for the improvement of internal audits by senior management, etc.

- ✓ Referring to example cases on strengthening audit foundations presented in the FSA's report, actively participating in and supporting considerations regarding the allocation of management resources (securing and expanding audit personnel, etc.), the introduction of human resource development systems, and the effective use of co-sourcing, while communicating with the internal audit function, and working on these matters in a planned and continuous manner.
- ✓ Acknowledging that support for improving internal audit by senior management is not limited to the internal audit function, but that it is important to engage with the entire organization including raising awareness among audited departments.

## Status of internal audits at small financial institutions and direction for improving their internal audits

### Status of internal audits at small financial institutions

- In industries such as cooperative financial institutions, money lending, payment services, and virtual and crypto assets exchange industries, there are small-scale organizational structures and insufficient human resources in their internal audit functions (some institutions state that the entire organization has a very small number of employees and it is difficult to allocate personnel\*).
- On the other hand, some fund transfer service providers and crypto asset exchange operators have a small number of employees but a large volume of business (volume of transactions), therefore their vulnerable internal governance may have a significant impact on their operations.

\* There are many issues that need to be considered by their senior management and the entire organization, such as the allocation of limited resources, prioritization of initiatives for improving and the necessity of covering all areas of internal audits by themselves. At present, there are limitations to cope with, and this takes time.

### Possible direction of response

- If such institutions belong to major financial groups, integrated initiatives that utilize the extensive audit resources and expertise of the core companies can be expected. In addition, the possibility of "horizontal collaboration," such as information exchange between financial institutions with similar business types can also be expected.
- Furthermore, internal audit functions can be considered as common to all business types, and it may be an option to establish a certain coordination structure or consortium to cope with. Utilizing the audit functions of self-regulatory organizations (associations) is also possible.

➡ **The FSA plans to collect reference cases of initiatives, including those of small financial institutions, and give back the necessary information.**