

Report on the Working Group on Improving Internal Audits of Financial Institutions (2025)

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Financial Services Agency

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I. Introduction (Past initiatives by the FSA)

The Financial Services Agency (FSA) published the “Current Situation and Issues for Improving Internal Audits of Financial Institutions” (hereinafter referred to as “Current Situation and Issues”) in June 2019 to promote the improvement of internal audit at financial institutions. The “Current Situation and Issues” showed that it is possible to evaluate the level of internal audit in phases¹ and presented the direction that each financial institution should pursue in order to improve its internal audit. Subsequently, the FSA issued the “Progress Report for Improving Internal Audits of Financial Institutions (Interim Report)” (hereinafter referred to as “Interim Report 2023”) based on this “Current Situation and Issues” in October 2023. This outlined specific initiatives for improving the level of internal audits that are required of the management and other departments of the organization, known as “three issues²”. The FSA further published, in September 2024, the “Monitoring Report for Improving Internal Audits of Financial Institutions (2024)” (hereinafter referred to as “Monitoring Report 2024” and collectively as the “FSA Reports”). In this report, the FSA has provided a number of examples of specific initiatives taken in a wide range of business categories for each of the “three issues”, has indicated its awareness of the issues and expected levels, and has encouraged the further promotion of such initiatives.

The release of the Monitoring Report 2024 coincided with the period when many financial institutions were preparing to adopt the Global Internal Audit Standards (hereinafter referred to as “GIAS”), a set of international standards for internal audits, about four months before they came into effect. The Monitoring Report 2024 suggested that the FSA would continue to consider the necessity of updating the “Current Situation and Issues” (including whether or not to reconsider the evaluation of each phase of the (maturity) level of internal audits).

In January 2025, the FSA established the “Working Group on Improving Internal Audits of Financial Institutions” (hereinafter referred to as the “Working Group”), based on its belief that the updating of the “Current Situation and Issues” would be more effectively organized if it was undertaken with a broad range of financial institutions' efforts and the knowledge of experts in the field. The Working Group met five times until May of the same year, with the participation of a wide range of relevant organizations in the financial industry, including the asset management, money lending, payment, and crypto asset trading industries in addition to the deposit-taking financial institution, insurance, and securities industries to hear the request from and hold discussions based on the initiatives of each industry, identification of issues, and requests for clarification regarding each phase of the phased evaluation.

The Institute of Internal Auditors - Japan was invited to participate in the discussions to provide their views on the reconsideration of the evaluation of each phase, including the relationship with the GIAS, and to ensure consistency with the global standards. In addition, consulting firms were asked about key points in their own external evaluations and issues related to the reconsideration of the phased evaluation, and opinions were exchanged with them (see Reference 1 for an overview of the Working Group discussions).

Having summarized the results of the above discussions, the FSA has reviewed and reconsidered the phased evaluation in the “Current Situation and Issues”, including clarification of the content, and is now publishing it in the form of a report. Based on the report, the FSA will continue to review the internal audit system of the financial industry as a whole and promote its improvement. In doing so, this report is not intended to serve merely as a procedural checklist. We hope that this report will be widely referred to by non-financial companies, help raise the level of internal auditing in Japan, and also be used as a reference by financial supervisory authorities overseas.

¹ In addition to presenting three levels of internal audit maturity level for the current status of Japanese financial institutions (1st Phase (Administrative deficiency audit), 2nd Phase (Risk-based audit), and 3rd Phase (Management audit)), the report also presented the existence of a 4th level (Trusted advisor) based on examples of overseas initiatives.

² Issue 1: Support for the internal audit function by management teams, audit committee members, and corporate auditors

Issue 2: Improving the system and strengthening the infrastructure of the internal audit function

Issue 3: Understanding of internal audits for audited departments and fostering risk ownership

II. Main Opinions and Discussions of the Working Group

1. Purposes and themes of the Working Group

There were requests from the financial industry for the clarification of each phase of the phased evaluation and for specific measures to be taken in relation to the “three issues”, including examples of such measures, to improve the level of internal audits by financial institutions. The FSA held Working Group meetings to discuss the following topics, hearing opinions from various industry associations and other parties, in order to summarize the consensus of the financial industry and respond to these requests.

Topic of Working Group discussions

- Sense of the level of the phased evaluation (4 phases) [Chart 1] and practical issues
 - (1) Understanding of the level of each phase based on internal audit practice (including the image of the 4th phase)
 - (2) Relationship between the examples described in the FSA Reports and each phased evaluation
 - (3) Matters required to be addressed in the FSA Reports from the perspective of promoting efforts to improve internal audits.
- The phases that internal audit should aim for and points to keep in mind in order to achieve them
 - (1) The phases that internal audit should aim for based on the actual conditions of each industry and the current situation of practice
 - (2) Practical issues in realizing the 4th phase
 - (3) Items required to be addressed in the FSA Reports in order to achieve the desired phases

In addition, the Working Group heard opinions from The Institute of Internal Auditors - Japan on the compatibility between the purpose of the GIAS and the phased evaluation as well as the direction of clarification in order to enrich the discussion and to organize the issues appropriately in the Working Group. Furthermore, we heard opinions from five consulting firms³ on points to be considered when conducting external evaluations of internal audits, the relevance to each phased evaluation, and points to keep in mind when reconsidering them. [Chart 1] Sense of the level of the phased evaluation (4 phases) (Source: Monitoring Report 2024)

	1st phase (Ver. 1.0) (Administrative deficiency audit)	2nd phase (Ver. 2.0) (Risk-based audit)	3rd phase (Ver. 3.0) (Management audit)	4th phase (Ver. 4.0) (Trusted advisor)
Role & Mission	Exercising a check function on each business office by spotting administrative deficiencies, violation of rules, etc.	Raising issues for business processes in high-risk areas based on risk assessment	Providing assurances that contribute to management in response to internal and external environmental changes, etc.	In addition to providing assurances and resolving associated issues, providing advice that contributes to management strategies to management teams, other executives, and employees within the organization.

³ (in Japanese alphabetical order) KPMG AZSA LLC, EY Strategy & Consulting K.K., Deloitte Tohmatsu Risk Advisory LLC, PwC Japan LLC, Protiviti LLC

2. Key observations from the Working Group

The following is a summary of the main opinions and requests to the FSA from the Working Group.

(1) Opinions from industry associations, etc.

(i) Definition and concept of Evaluation Levels for the phased evaluation (4 phases)

- The relationship between the examples of initiatives for each of the “three issues” and corresponding phase is not clear.
- 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.

(ii) Concept of the aimed phases/issue recognition

- It should be recognized that the phased evaluation will be improved only when audit findings and recommendations lead to improvement and enhancement of corporate value.
- As smaller financial institutions with fewer officers and employees are struggling to secure resources, the first goal should be to achieve the 2nd phase (risk-based audit).

(iii) Positioning of the 4th phase (Trusted advisor)

- The 4th phase presents the best practices at the time, such as timely response to environmental changes. It is important to understand and disseminate these best practices within the internal audited organization.
- Insight and foresight⁴ require different qualities and also require a managerial perspective. Therefore, it is necessary to clarify the concept of mixed personnel in the internal audit function and their roles within the organization (matters mandated by the management team⁵).
- Internal audit is not a business consultant, therefore it does not directly evaluate the quality of the management strategy.

In addition, it is necessary to clarify the relationship and points to keep in mind between “advice that contributes to management strategy (execution)” and “the position of internal audit (independence)” (balancing between assurance⁶ and advice⁷ is important).

(iv) Request for reconsideration of the “Current Situation and Issues” (the phased evaluation), etc.

- It is preferable to be provided with more information on why certain initiatives were considered good practices, examples of how they have improved corporate value (e.g., audits of corporate culture and the use of DX, etc.), and information that contributes to the consideration of a roadmap by prioritizing initiatives.
- “A change in management's perception” is indispensable for developing into a higher phase, and it is preferable for the FSA to continue to send strong messages and provide case studies and information on an ongoing basis.

⁴ See “Glossary” No.1 at the end of this document.

⁵ See “Glossary” No.2 at the end of this document.

⁶ See “Glossary” No.3 at the end of this document.

⁷ See “Glossary” No.4 at the end of this document.

(2) Consulting firms' recognition of the phased evaluation

(i) Positioning of the phased evaluation

- The phased evaluation is the “roadmap for improving internal audits” (showing concept and direction for the improvement) and is not an evaluation criterion.
- The external evaluation to evaluate the implementation of the GIAS and the phased evaluation share the same expected areas of improvement in the internal audit function, and the direction to achieve the objectives is the same.
- Even if the organization evaluates itself as having reached the 3rd phase (management audit), the functions required for the administrative deficiency audit (1st phase) and the risk-based audit (2nd phase) are still necessary for the organization as a whole, and the 1st and 2nd phases are the foundation and basis for supporting the 3rd phase.
- The relationship between each phase is not a “graduation model” but an “accumulation approach” when considered as a whole. The functions required for “compliance audits (administrative deficiency audits)” should not be omitted even if the organization develops into a higher phase.
- Depending on the size and attributes of the company, it is possible to exercise the basic functions of internal audit (assurance and advice) in a necessary and sufficient manner even if the organization is still in the 2nd phase.
- When conducting self-assessment, it is necessary to evaluate not only whether an internal audit framework has been formally established, but also whether it is functioning effectively (the organization is evaluated as reaching a higher phase only when audit findings and recommendations actually lead to business improvement and enhancement of corporate value).

(ii) Points to note when reconsidering the phased evaluation

- By presenting specific items that need to be implemented in order for organizations to reach higher phases of the phased evaluation, issues to be addressed by the management team and the internal audit function would be clarified and further improvement would be promoted. On the other hand, it should be noted that the evaluation may be used in a formalistic manner as a checklist in self-evaluation, and effective measures may be affected.
- The following points could be clarified or added to the definition and concept of level for each phase.
 - 1st phase: Although compliance audits should essentially be conducted by the 1st and 2nd lines, it may be difficult to establish a “Three Lines Model” due to the size of the organization and business (number of employees, nature of business, etc.), especially for smaller financial institutions. In such cases, the 3rd line may take responsibility for the compliance audit in consideration of the overall optimization.⁸
 - 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 focus on “forward-looking” among the elements of “substantive, forward-looking and holistic,” the audit includes an audit of management strategy. In this case, rather than evaluating the adequacy of the management strategy itself, the audit is conducted to check for the existence of distortions and vulnerabilities arising from the management strategy and its execution from the perspective of risk

⁸ See “Glossary” No. 5 through No.8 at the end of this document for “Three Lines Model”.

management, control, and governance (e.g., conduct risk, material operational risk, etc.), and to provide assurance, advice, insight, and foresight.

4th phase: The concept of this phase differs from the 1st to 3rd phases in that it requires a state in which awareness is fostered throughout the organization with effectiveness being achieved. This cannot be achieved simply by formally adopting advanced methods.

In addition, 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.

(3) Clarifying the relationship with the Global Internal Audit Standards (GIAS) (Source: The Institute of Internal Auditors – Japan)

The summary of the opinions of The Institute of Internal Auditors - Japan at the Working Group discussions and the explanation of the relevance to the GIAS are as follows (see (Reference 2) for an overview of the GIAS):

- The GIAS states that the goal of internal audit is “Internal auditing strengthens the organization’s ability to create, protect, and sustain value by providing the board and management with independent, risk-based, and objective assurance, advice, insight, and foresight”. This is the same purpose, goal, and direction as that of the FSA’s phased evaluation.
- If reviewing the phased evaluation in terms of “basic concepts of financial administration (Inspection and Supervision Procedures)”⁹, as described in the “Current Situation and Issues”, the transition from the 1st phase to the 2nd phase is identified as “From form to substance”, the 2nd phase to the 3rd phase as “From element by element to holistic”, and the 3rd phase to the 4th phase is “(From the past) to the future, more strategic”. The criteria presented by the GIAS can be interpreted as an extension of the contents and main points of each phase, and can be considered consistent with each other [Figure 2].
- In addition, the “three issues” related to initiatives to improve internal audit correspond to each of the five domains and principles of the GIAS, and in this respect, the phased evaluation is consistent with the GIAS [Figure 3].
- The phased evaluation provides guidance as a basis for improvement of internal audit, and in light of the spirit of the GIAS, the definition and concept of the level of each phase will be clarified by explaining and considering the perspectives of (1) linkage with corporate value, (2) clarification of board of directors’ involvement, (3) emphasis on independence, and (4) the “Three Lines Model”.

In this report, the above points are discussed later in “III. Concepts for Promoting Initiatives to Improve Internal Audits at Financial Institutions”. Specifically, it mentions (i) Regarding the linkage with corporate value, the role and strategic positioning of internal audit should be clarified by recognizing that internal audit is linked to the creation, preservation, and maintenance of corporate value, (ii) Regarding the clarification of involvement of the board of directors, clarifying the relationship with the board of directors will establish the authority of internal audit and lead to rapid improvements throughout the organization, (iii) Regarding the emphasis on independence, ensuring “non-isolated independence” of the internal audit function will lead to effective internal audit, and (iv) Regarding the “Three Lines Model”, the development of a risk management system for the 1st and 2nd lines is indispensable for the improvement of internal audit.

⁹ “JFSA’s supervisory approaches (Replacing checklists with engagement)” (Released in June 2018)
(URL : https://www.fsa.go.jp/en/wp/supervisory_approaches_revised.pdf)

[Chart 2] Relationship between the phased evaluation of the FSA and the GIAS

Evaluation of each phase in "Current Situation and Issues"	1st phase (Ver. 1.0) (Administrative deficiency audit)	2nd phase (Ver. 2.0) (Risk-based audit)	3rd phase (Ver. 3.0) (Management audit)	4th phase (Ver. 4.0) (Trusted advisor)
Role & Mission	Exercising a check function on each business office by spotting administrative deficiencies, violation of rules, etc.	Raising issues for business processes in high-risk areas based on risk assessment	Providing assurances that contribute to management in response to internal and external environmental changes, etc.	In addition to providing assurances and resolving associated issues, providing advice that contributes to management strategies to management teams, other executives, and employees within the organization.
Basic concept of financial administration				More future-oriented, more strategic
			From element by element to holistic	
	From the form to the substance			
Specifically referenced GIAS standards	Standard 15.2 Confirming the Implementation of Recommendations or Action Plans Key points: What corrective measures, actions, and recurrence prevention measures should be taken in response to the identified administrative deficiencies?	Standard 9.1 Understanding Governance, Risk Management, and Control Processes Standard 9.3 Methodologies Standard 13.2 Engagement Risk Assessment Key points: Does the internal audit function have a system in place to understand the organization's risks and incorporate them into the audit planning, and are individual internal audits conducted in a risk-based manner?	Standard 6.3 Board and Senior Management Support Standard 7.1 Organizational Independence Key points: Is the positioning of the internal audit function within the organization clear?	Standard 11.1 Building Relationships and Communicating with Stakeholders Key points: Has the internal audit function gained the confidence of the management team, the board of directors, shareholders, authorities, etc. through a wide range of audit experience?

[Chart 3] Relationship between the FSA's "three issues" and the GIAS's five domains and principles and standards

Issue 1: Support for the internal audit function by management teams, audit committee members, and corporate auditors
[Domain III: Governing the Internal Audit Function] > Principle 6: Authorized by the Board (Standard 6.1 Internal Audit Mandate, Standard 6.2 Internal Audit Charter, Standard 6.3 Board and Senior Management Support) > Principle 7: Positioned Independently (Standard 7.1 Organizational Independence, Standard 7.2 Chief Audit Executive Qualifications) > Principle 8: Overseen by the Board (Standard 8.1 Board Interaction, Standard 8.2 Resources, Standard 8.3 Quality, Standard 8.4 External Quality Assessment)
Issue 2: Improving the system and strengthening the infrastructure of the internal audit function
[Domain II: Ethics and Professionalism] All internal auditors are required to conform with the standards of ethics and professionalism. [Domain IV: Managing the Internal Audit Function] > Principle 9: Plan Strategically (Standard 9.1 Understanding Governance, Risk Management, and Control Processes, Standard 9.2 Internal Audit Strategy, Standard 9.3 Methodologies, Standard 9.4 Internal Audit Plan, Standard 9.5 Coordination and Reliance) > Principle 10: Manage Resources (Standard 10.1 Financial Resource Management, Standard 10.2 Human Resources Management, Standard 10.3 Technological Resources) > Principle 12: Enhance Quality (Standard 12.1 Internal Quality Assessment, Standard 12.2 Performance Measurement, Standard 12.3 Oversee and Improve Engagement Performance) [Domain V: Performing Internal Audit Services] > Principle 13: Plan Engagements Effectively (Also related to issue 3) (Standard 13.1 Engagement Communication, Standard 13.2 Engagement Risk Assessment, Standard 13.3 Engagement Objectives and Scope, Standard 13.4 Evaluation Criteria, Standard 13.5 Engagement Resources, Standard 13.6 Work Program) > Principle 14: Conduct Engagement Work (Standard 14.1 Gathering Information for Analyses and Evaluation, Standard 14.2 Analyses and Potential Engagement Findings, Standard 14.3 Evaluation of Findings, Standard 14.4 Recommendations and Action Plans, Standard 14.5 Engagement Conclusions, Standard 14.6 Engagement Documentation) > Principle 15: Communicate Engagement Results and Monitor Action Plans (Also related to Issue 3)
Issue 3: Understanding of internal audits for audited departments and fostering risk ownership
[Domain IV: Managing the Internal Audit Function] > Principle 11: Communicate Effectively (Standard 11.1 Building Relationships and Communicating with Stakeholders, Standard 11.2 Effective Communication, Standard 11.3 Communicating Results, Standard 11.4 Errors and Omissions, Standard 11.5 Communicating the Acceptance of Risks) [Domain V: Performing Internal Audit Services] > Principle 13: Plan Engagements Effectively (Also related to Issue 2) > Principle 15: Communicate Engagement Results and Monitor Action Plans (Also related to Issue 2) (Standard 15.1 Final Engagement Communication, Standard 15.2 Confirming the Implementation of Recommendations or Action Plans)

*[Chart 2] and [Chart 3] show examples of principles and standards in the GIAS that are particularly relevant to each phase and issue.

Principles and standards not mentioned here are equally important for the improvement of internal audit, and initiatives toward conformity to the entire GIAS are desirable.

*For more information on the concept of risk-based internal audit of The Institute of Internal Auditors - Japan, see also "5.2 Planning Based on Risk Assessment of the Internal Audit Practice Guidelines" (released in March 2017).

(URL : <https://www.iaajapan.com/leg/pdf/guide/guideline5.2.pdf>)

3. Direction of reconsideration of the phased evaluation, etc. based on the Working Group discussions

The followings are the direction for reconsidering of the phased evaluation, etc., based on the opinions from the Working Group discussions:

(i) Definition and the concept of level of each phase evaluation

- There is no need to change the 4-phase classification for the maturity level of internal audit.
- However, among the definitions and the concept of the level for each phase, although the 1st phase to the 3rd phase is generally presented in “Current Situation and Issues”¹⁰, it is not clear what kind of function internal audit is expected to exercise in the 4th phase, so it should be redefined in relation to the functions of internal audit up to the 3rd phase and the position of internal audit in the organization as a whole.
- Considering the purpose and function of internal audit, advancement from the 1st phase to the 4th phase should be understood as a process of an Accumulation model, not a Graduation model, which should be clearly defined.
- To do this, in order to promote the improvement of internal audit with a guideline being the phased evaluation, it would be beneficial to organize the examples introduced in the FSA Reports in relation to the phased evaluation.

(ii) Presentation of concepts regarding the phase to which the internal audit should aim to achieve

- Basically, the phase that the company's internal audit should aim for should be determined by the management team based on the company's business situation. In order to achieve this, it is essential for the entire organization to take action, including the establishment of a three-line management system and the promotion of understanding among the management team and the audited department.
- What is essential for the internal audit function is to be able to constructively recommend “what improvements can be made to improve the organization,” and to see the results (i.e. the audit recommendations having a positive impact on organizational administration and business processes).
- It is natural that the state of internal audit systems differs from company to company depending on the size of the organization and business characteristics. Therefore, the FSA and industry associations cannot uniformly present the measures that can be taken to achieve the desired phase of maturity.
- Financial institutions with relatively small organizations have limited management resources that can be allocated to the internal audit function, making it difficult for them to take a wide range of actions. This is why the FSA is requested to provide information that will contribute to the development of the “roadmap for improving internal audit” at each financial institution, such as a ranking of the importance of the examples of initiatives introduced in the reports to date.

¹⁰ At the Work Group, there was a discussion on the contents of the 1st phase (Administrative deficiency audit) in the “Current Situation and Issues”, in terms of the position of compliance audit for the appropriate exercise of the function of the internal audit. In addition, there was a discussion on the definition and the concept of level of the 3rd phase in relation to the purpose and required functions of internal audit. See III 1 (2) below.

III. Concepts for Promoting Initiatives to Improve Internal Audits at Financial Institutions (redefinition and clarification)

Based on the opinions and discussions in the Working Group, it can be said that **“each phase in the phased evaluation indicates the direction and concept of realization of the purpose and exercise of the function of internal audit”**. The definition of each phase in the evaluation and its relevance to the concept of level and “three issues” are redefined and clarified as follows.

The ideas here are presented based on the current environment surrounding internal audit and relevant standards, etc., and may change with the development of internal audit technologies, etc. in the future. Therefore, it should be noted that their contents may need to be reviewed again in the future.

1. Redefinition of the phased evaluation and its relevance to the “three issues” and examples of initiatives

(1) Positioning of the phased evaluation

The FSA has presented the phased evaluation in the “Current Situations and Issues” and has encouraged financial institutions to improve their internal audits. This is based on the following considerations:

- In order for each financial institution to contribute to the stability of the financial system by building a sustainable business model and ensuring the operational appropriateness and financial soundness even in a changing environment, it is important that their governance is functioning effectively.
- To achieve this, the internal audit function should provide objective and independent assurance, advice, and insight into the effectiveness of organizational activities, etc., from a risk-based and forward-looking perspective, thereby enhancing and preserving the value of the entities, which is the mission of the internal audit¹¹.
- The internal audit system should be transformed from a ex-post check audit to a forward-looking audit (from the past to the future), from a compliance audit to a management audit (from form to substance), and from a partial audit to a holistic audit (from element by element to holistic). The evaluation should also have evaluation perspectives such as the development of an internal audit system to support these changes, and the coordination of the three types of audits¹² (internal audit, audit by corporate auditors, and external audit). Through dialogue with the internal audit function, etc., we will evaluate the overall level of internal audit at each financial institution and identify issues that need to be addressed in order to raise the level and improve their internal audit¹³, with the purpose of improving its effectiveness.

This view has been consistent since the publication of “Current Situation and Issues”.

Regarding the positioning of the phased evaluation, the opinions of the Working Group are described above in “II. Main Opinions and Discussions of the Working Group”. The GIAS defines the purpose of internal audit in “Domain I”, and states that the achievement of the criteria in Domain II through Domain V, which describes the qualities required of internal auditors, governance by the management team, and practices of the internal audit function, is aimed at achieving the purpose of “Domain I”¹⁴.

From this, it is clear that the importance lies in realizing the purpose and the exercise of the function of internal audit.

¹¹ The above two points are quoted from “1. Introduction” in “Current Situations and Issues”.

¹² See “Glossary” No.9 at the end of this document.

¹³ Quoted from “2. Monitoring Perspective (1) Internal Audit Evaluation” of the same.

¹⁴ See “Glossary” No.10 at the end of this document.

In view of the above, it can be summarized as:

“The phased evaluation is not a formal, quantitative evaluation, but rather a statement of the direction and approach to realizing the objectives of internal audit and exercise of its function. Advancement to higher phases is not in itself the goal”.

In other words, to understand the phased evaluation, the relationship to the purpose and function of internal audit should always be kept in mind. The management team and the internal audit function of a financial institution should recognize that unless the internal audit function is properly exercised and its purposes are realized, no matter how many different methods are used and how many actions are taken to achieve “improvement”, there is no hope for advancement to the higher phases.

(2) Definition and the concept of the level of each phase

The definition and the concept of the level of each phase can also be organized from the perspective of realizing the objectives and performing the functions of internal audit. The “Current Situation and Issues”, consistent with the basic concepts of financial administration, “From the past to the future”, “From form to substance”, and “From element by element to holistic” presented definitions and a concept of standards for the 1st through 3rd phases, in response to the improvement of the functions of internal audit. It then presented the existence of the 4th phase, “Trusted advisor”, beyond the 3rd phase, while introducing examples of advanced efforts overseas.

In the Working Group discussions, there were no particular objections to this alignment with the basic concept of financial administration. The Working Group also shared the view that unless the objectives and expected functions of internal audit within an organization transform significantly, such as a significant change in the corporate governance structure, there will not be a “5th phase” beyond the 4th phase, and that the current four phases can continue to be applied as a concept¹⁵.

The FSA Reports published to date show the examples of audit methods, etc. in relation to the self-assessment (phase) of financial institutions as a result of monitoring. This is largely because the definitions of the phased evaluation in the “Current Situation and Issues” refer to audit methodologies, human resources, and quality evaluation. The Monitoring Report 2024 in particular includes many examples of such initiatives.

In “Current Situation and Issues,” each phase is generally defined in terms of (i) Trust and expectations from the management team and its involvement, (ii) Audit methods, (iii) Securing human resources, and (iv) Quality evaluation. In the 3rd phase, the common situation is viewed in terms of (v) Effectiveness of audit results (assurance), root cause investigation, and response to business expansion [Chart 4]. Therefore, in subsequent dialogues with financial institutions, some have considered that they can reach that phase by taking the initiatives described in the case studies, and the Working Group has pointed out that such an understanding is a misinterpretation of the purpose of the phased evaluation.

To reiterate this point, although it is necessary to adopt appropriate methods to improve the function of internal audit, there is no single standard for what measures should be taken to realize the objectives and exercise of the function of internal audit, and each financial institution should take into account its

¹⁵ In the Quality Assessment Manual, which assesses the application level of internal audit with the GIAS, the “Optimization” (the highest level) in the (1) “Maturity Rating of Internal audit functions” is defined as (2) “Processes are measurably well optimized, with a focus on driving innovation, adding strategic value, and contributing to organizational success. Internal auditors are proactive in identifying emerging risks and providing forward-looking insights. The internal audit function is seen as a trusted advisor and partner in achieving organizational objectives”. In this regard, the current four-level classification with the “4th phase (Trusted advisor)” as the highest level is reasonable from the perspective of consistency with the GIAS.

own business environment and organizational structure, and take actions in its own originality and ingenuity.

Therefore, although the audit methods mentioned in “Current Situation and Issues” may be a part of the elements that explain the definition and the concept of level of the phased evaluation, they are not an indispensable element of definition and the concept of the level of the phased evaluation. This point will be discussed in “(4) Relationship with “three issues”” below.

Based on the foregoing (including II and III above), the definition and concept of the level of each phase in evaluation can be redefined as follows. This redefinition is not a modification of the contents presented in “Current Situation and Issues,” but rather a clarification through additions and supplements.

[Chart 4] Summary Definitions of Each Phase in “Current Situation and Issues”

	1st Phase	2nd Phase	3rd Phase
i) Trust and expectations from the management team and its involvement	The level of trust and expectations from the management team for the internal audit department and the level of understanding of audits by the management team are low, and the internal audit function is at a phase where its role is limited to superficial ex post facto checks of compliance with regulations, etc. The internal audit department is required to play the role of exercising a check function on business offices by discovering administrative deficiencies and violations of regulations.	The level of trust and expectations from the management team for the internal audit function and the level of understanding of audits by the management team are gradually increased, and in addition to the role of the 1st phase, the role of raising issues for business processes in high-risk areas is required based on risk assessment.	The level of trust and expectations from the management team for the internal audit department and the level of understanding of audits by the management team are further increased, and the internal audit is viewed as a useful department that can provide useful suggestions to the management team. In addition to the role of the 2nd phase, the internal audit role is required to assess the effectiveness and adequacy of the organization's governance, risk management, and control processes and proactively provide useful suggestions for improvement in these areas.
ii) Audit methods	Audit methods are not risk-based, but rely on the experience and intuition of the audit department staff and focus on indication through physical inspections of business offices.	Risk assessments based on the internal and external environments are conducted, the maintenance and operational status of business processes in high-risk areas are verified, audits not only of business offices but also of headquarters are conducted, and cross-departmental thematic audits are conducted.	The internal audit function has a management perspective and, from a more forward-looking perspective, provides assurance that contributes to management in response to changes in the internal and external environment, etc. Audits that focus on whether substantial high-quality financial services are being provided, audits that focus on changes in the business environment and the balance of profits, risks, and equity capital, and audits on the status of execution of management strategies are also conducted.
iii) Securing human resources	There is no medium-to long-term policy for the internal audit function, and personnel are assigned through normal personnel rotation.	The portfolio of audit personnel is managed from a medium-to long-term perspective, and personnel will be allocated with an awareness of their expertise in the business. Additionally, from the perspective of improving management skills at business offices, etc., there are moves to partially utilize internal audit functions, such as accepting short-term trainees from executive departments.	Personnel who understand the business and management strategy of the entire organization are strategically assigned. In addition, from the perspective of improving the status of the internal audit function and career development in the organization, there are career paths, after assigning young staff, department head candidates, or management candidates to the internal audit function to gain experience, and then returning them to the executive department in a managerial position.
iv) Quality evaluation	The PDCA cycle has not been established, such that quality evaluation of internal audits has not been conducted, or even if it is conducted, it is only a formality.	Initiatives are beginning to be seen to implement quality evaluations based on international standards for internal audits (IIA standards).	In addition to the IIA standards, some initiatives are made to conduct quality assessments based on relevant regulations and guidelines in regions where international business is conducted.
v) Effectiveness of audit results (assurance)			The above requires more forward-looking risk identification. In addition, the root causes of problems related to business models and governance are investigated. Furthermore, financial institutions that operate on a group/global basis establish internal audit systems on a group/global basis, such as reviewing the system for coordination and reporting with domestic and overseas internal audit bases and standardizing audit methods. The internal audit function's independence is strongly recognized for the management audit, and initiatives are being made to ensure direct instructions and reporting routes on duties to the board of directors, as well as instructions and reporting routes for departmental operations to the CEO to facilitate the day-to-day operations of the internal audit function. The management team recognizes the importance of the three lines of defense, with the internal audit department (3rd line) providing assurance in a position independent from the business department (1st line) and the management department (2nd line).

(i) 1st phase (Ver.1.0): Administrative deficiency audit (Audit of compliance and operational quality)

“Phase of verifying the operational status of regulations, administrative rules, etc.¹⁶”

The 1st phase is a 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.

- The internal audit function provides a certain level of assurance through various activities as to whether or not the financial institution's operational quality (especially the quality of services provided to customers) is at the level it expects to be.
- From the viewpoint of the so-called “Three Lines Model”, the compliance verification should essentially be conducted by the 1st line and the 2nd line in their own business operations, together with guidance and monitoring, in a PDCA cycle, and the 3rd line should verify the status of verification by the 1st line and the 2nd line and the adequacy of control based on the results from an independent and objective perspective.
- Financial institutions that are relatively small in terms of organizational size (number of employees, etc.) may find it difficult to establish a sufficient “Three Lines Model”, and there may be cases where the internal audit function is directly instructed by the management team to conduct compliance audits based on the characteristics of the business. In such cases, the 3rd line may take on some of the roles of the 2nd line, such as verification of compliance, from the perspective of overall optimization.

(ii) 2nd phase (Ver.2.0): Risk-based audit (Business process audit with the introduction of risk assessment)

“Phase of verify the appropriateness and validity of business processes within an organization on a risk basis.”

The 2nd phase is a risk-based phase that the operational status of each business area at sales offices and headquarters complies with the rules established by the financial institution (compliance verification) 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.

- The internal audit function provides assurance regarding the internal control system of their own financial institution by verifying the status of internal control and its implementation, and by raising internal control issues and problems as necessary.
- Business process audits should cover not only banks, securities, and insurance, but also money lending, money transfer, and virtual and crypto assets exchange businesses. The scope has become more diverse in recent years, as there are many financial institutions that have non-financial companies as their group companies. In addition, the extent and magnitude of risks inherent in their operations vary with changes in the environment surrounding financial institutions. Under these circumstances, it would be difficult to achieve an exhaustive verification of all the areas every fiscal year. In the 2nd phase, it is therefore important for financial institutions to establish a risk-based audit framework that prioritizes the areas to be audited and conducts verification in a sequential manner, so that audit resources can be

¹⁶ Considering also the purpose of the “Basic Policy for Compliance and Risk Management,” it includes a wide range of social norms and principles, as well as new social issues associated with changes in the domestic and international environment.

appropriately allocated to operations that are important to the financial institution and that require verification.

- It is also important to acquire IT knowledge and use digital data, not only to conduct audit activities efficiently, but also to digitize audit methods as a result of the rapid digitalization of the business operations to be audited.

(iii) 3rd phase (Ver.3.0) Management Audit (Audit contributing to business management decisions)

“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.”

The 3rd phase is the 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.

- The internal audit function focuses on distortions arising from management strategy and execution (such as conduct risk and significant operational risk) and provides assurance, advice, insight, and foresight into controls, risk management, governance, and other management systems and business operations.
- Some financial institutions have interpreted “management audit” as “an audit to evaluate the appropriateness of the management strategy itself”. In this respect, since the management strategy is a management decision, its adequacy and appropriateness are primarily subject to audits by audit committee members, corporate auditors, and auditors. Although the internal audit function may be involved in audits that evaluate the appropriateness of the management strategy itself in the context of cooperation with the audit committee and the board of auditors, it is not expected that it would proactively and directly conduct audits that evaluate the appropriateness of the management strategy itself.
- In the 3rd phase, the internal audit functions are required to be more responsive to management's requests. Although it is necessary to expand the scope and areas of internal audit, it will be even more important to conduct in-depth root cause analysis¹⁷ and to enhance improvement recommendations based on the results of such analyses. For this purpose, it is also important to improve audit accuracy by using information technology, such as statistical data analysis and text mining.
- The management team needs to establish a system in which the internal audit function can have a management perspective and identify and assess risks from a more forward-looking perspective by promptly recognizing changes in the internal and external environment in a timely manner. The management team also needs to communicate closely with the internal audit function to properly communicate their expectations and requests to internal audit, and to support the function in meeting those expectations and requests. Only the management team can improve its own corporate value. This attitude of the management team is also important in the 3rd phase.

¹⁷ See “Glossary” No.11 at the end of this document.

(iv) 4th phase (Ver.4.0): Trusted advisor

Although it is difficult to clearly define the 4th phase through Working Group discussions, there is still room for further discussion (see “Opinions from the Working Group, etc.” below). It can, however, be redefined as follows:

“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.”

The 4th phase is a 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.

- In the 4th phase, the understanding and dissemination of internal audits within the organization, particularly between the management team and the audited departments, will be more important than the internal audit function's own efforts. Commitment by the board of directors will be important in terms of the GIAS. This will lead to greater recognition of the internal audit function within the organization and foster an environment in which management and audited departments naturally seek and consult with the internal audit function.
- “Trusted advisors” does not mean “management consultants.” The management team and the internal audit function should understand the meaning of “advice on management strategy” (see Opinions from the Working Group, etc., below) and firmly and appropriately arrange the relationship between “advice that contributes to management strategy (execution)” and “internal audit position (independence)” and balance between assurance and advice to ensure effective internal auditing.
- In the 4th phase, the ability of the internal audit function is also important, and both insight and insight into the future (foresight) are required at a higher level. Furthermore, a managerial perspective is also required, and improvement of the organizational structure for internal audit is necessary, including the mix of personnel inside the internal audit function and the division of roles within the organization with an awareness of the “Three Lines Model”.

(Opinions from the Working Group, etc.)

- At the Working Group discussions, the vision of the 4th phase was shared as “a phase in which the internal audit function responds to the trust of the management by presenting useful information and recommendations, and in which the management trusts and further utilizes the internal audit function”.

However, some commented that the 4th phase is rather a positive evaluation of the presence of internal audit within the organization as a whole and that it can change depending on the current trends and environment, and can be positioned as a “TO-BE state” so to speak, as an “ultimate goal” that no financial institution can ever fully achieve. There was also an opinion that, depending on the characteristics of the business and the size of the organization, conducting risk-based audits could mean a “trusted advisor,” and that the 4th phase might not necessarily exist “beyond” the 3rd phase.

- The above issues should not be concluded too hastily, giving priority only to practical matters, but should be discussed more extensively, including the theoretical clarification. It is believed that a certain direction will emerge as various views are presented through more extensive discussions.
- For example, the purpose of internal audit function is “to contribute to the appropriate and smooth promotion of the organization's business operations with a forward-looking perspective by

providing assurance regarding the organization's past and current business operations.” However, if internal auditors are overly concerned with being advisors and seeking favor with the management team, the independence and objectivity of the audit will be undermined, hindering the objectives and functions of internal audits.

- The “advice” expected from the internal audit function does not mean directly evaluating management strategies, but rather, based on the results of verification and analysis of the status of business operations within the organization obtained through internal audit activities (by considering them as risk factors), providing useful information to the management team in a timely manner or recommending the need for review of management strategies and measures to be taken, in order to achieve the management strategies and goals.
- It is considered that the ideal state of a 4th phase internal audit would be that when a financial institution expands its business or changes its business model, the internal audit function is naturally asked to provide opinions.

(3) Relationships between the phases (“Accumulation model” is applied instead of the “Graduation model”)

As mentioned earlier, regarding relationships between the phases in the phased evaluation, not a small number of financial institutions regard it as the so-called “Graduation model,” where initiatives in previous phase(s) need not be repeated as the first phase advances to the second phase and then the second phase advances to the third phase. However, this interpretation does not necessarily reflect a correct understanding of the phased evaluation. The process must be understood as the so-called “Accumulation model” in that the process becomes increasingly multi-layered and obtains more depth as each phase advances to the next. This is in line with the definition and sense of level for each phase as described earlier (see Reference 3 for the image of each phase).

In addition, it was commonly acknowledged throughout the Working Group that the importance of the compliance verification function cannot be underestimated. This should be a matter of course, when considering the recent series of occurrences of misconduct at financial institutions, etc.

However, we must pay attention to the point that it does not mean the internal audit function should always be the main entity for implementing compliance audits.

Regarding this point, when talking about the positioning of audits for sales offices (as an example), audits for sales offices are not mere compliance audits from the perspective of realizing the objectives of internal auditing and performing its functions. It should be considered that audits for sales offices should lead to the measurement of the scale of risks that endanger the adequacy of their own business using the methods that can accurately grasp the business operation status in sales fields of their own financial institution (2nd phase); then, lead to root cause analysis based on the measured results as well as to considerations on recommendations for improvement (3rd phase).

Also, from the viewpoint of the above positioning as well as from the perspectives of “supervision of sales offices” and “ensuring accuracy and compliance of operational procedures,” we have sorted out the relationships as follows: As is shown in the afore-mentioned definition of the 1st phase, if originally the roles to be performed by the 1st line and the 2nd line functioned properly, necessary and sufficient prerequisite information could have been obtained through verifying the business process of the 1st line and the 2nd line, without any compliance audit directly carried out by the internal audit function targeting the sales offices in question. In addition, if there are any fields regarded by the internal audit

function as high-risk, more details of the reality, etc. can be obtained by using offsite examination and monitoring, or for example by implementing theme audits.

In this regard, the compliance verification function is also important, even if the level of internal auditing is 2nd phase or 3rd phase. As for the main actor for implementing a compliance verification function, it is not that all roles should be covered by the internal audit function, but that it is important to clarify the roles for respective parties from the perspective of the “Three Lines Model”. This is what must be considered by senior management based on their own organization, business, etc. In the case of financial institutions, each entity is required to improve various initiatives of previous phase(s) as the phase of internal auditing advances and make constant efforts to enhance the maturity level of the basic phase(s) as the endeavors of the whole organization.¹⁸

(4) Relationship with “three issues”

While the “three issues” indicate specific internal audit improvement initiatives that should be required of the senior management and each department within the organization, the “phased evaluation” conceptually indicates the degree of maturity in achieving the objective and performing the functions of the internal audit.

Therefore, we do not interpret that “implementation of certain efforts based on the three issues resulted in advancement to the higher phase” but interpret that such advance in the phased evaluation could occur only when certain results of initiatives meet the functional performance and objective realization in internal auditing.

Not to mention that the organization is required to pursue certain initiatives to enable functional performance and objective realization in internal auditing. Also, selection of methods for functional performance and objective realization in internal auditing is never stereotyped, but each financial institution is required to be creative based on its own business environment for implementing the selection.

There was an opinion which said various case examples based on the “three issues” had already been extracted and introduced in the Monitoring Report 2024. Another opinion said if case examples to be introduced include a description that summarizes the results/effects given to the organization, better understanding might be provided.

Given such opinions, we have created a correlational diagram for the case examples, etc. included in the FSA Reports with the “three issues” and the “phased evaluation” as [Chart 5]. We remind you that the case examples shown on [Chart 5] are what we have tried to sort out from relatively popular and characteristic initiatives for the financial institutions positioned in each phase; there also are other case examples not described on the Chart. Therefore, it is not that such case examples constitute the necessary conditions for respective phase. Also, attention must be paid to the fact that some case examples start somewhat earlier or later.

On [Chart 5], each initiative case example is shown over multiple phases. It is shown so intentionally, in that obtainable results and effects differ depending on the depth of initiative, and the phased evaluation differs due to the results, etc. It is necessary to be aware that by evolving and deepening the initiatives one

¹⁸ There are some case examples with financial institutions where we have seen the following: audits for sales offices were transferred to the 2nd line based on the “Three Lines Model”; the transfer was done not necessarily clarifying the roles to be performed by the 1st line and the 2nd line; as a result, the internal audit function became unable to grasp the reality of business operations at sales offices in its monitoring process targeting the 2nd line; resulting in impaired effectiveness of internal auditing; so, coverage of audits for sales offices by the internal audit function was partially restored. As we can see from such case examples, constant efforts should be made not only by the internal audit function but also by the whole organization to enable the refinement of internal auditing.

by one, functionality of internal auditing can be further enhanced. Going forward, we would like to accumulate more case examples, deepen our scrutiny, and strive to provide easy-to-understand explanations.

Additionally, at the Working Group, many people said, “with only limited resources, we are struggling with how to distribute and allocate audit resources”. Also, some others said, “we want to receive certain information that could contribute to forming a roadmap for refinement” .

Based on these points, the FSA recognize the necessity to keep considering how to present specific initiative case examples. Looking forward, we will continue to perform the monitoring, grasp the initiative case examples of each financial institution, and consider easier ways to provide information.

[Chart 5] Main case examples included in the Monitoring Report 2024; relationships with each phase

Stage-specific evaluation			1st Phase	2nd phase	3rd phase	4th phase
Three discussion points						
[Discussion point 1] Support extended by senior management, audit committee members, and auditors to the internal audit unit	Communication with senior management, etc.		<ul style="list-style-type: none"> Mainly pursue scheduled and regular dialogue with management 		<ul style="list-style-type: none"> Conduct irregular dialogue as appropriate, too, in order to build a close relationship with management Based on audit results, consider amending business promotional measures and set goals at BoD meetings, etc. About TO-BE state of internal auditing, promote its understanding and strengthen relevant support through active 	
	Trust, expectations and involvement by senior management, etc. (As the unit that could provide management with useful suggestions, it receives expectations and support for realization from management)		<ul style="list-style-type: none"> Take measures for improvement at 		<ul style="list-style-type: none"> Ensure fast response under the initiative of management to the audit results for improvement Management extends proactive involvement to enhance importance and usefulness of internal audit Have outside officers strengthen their support in working with the audit committee 	
[Discussion point 2] Improvement initiatives at the internal audit unit	Improvement of audit system		<ul style="list-style-type: none"> Continue the past track records, reference the rule of thumb 		<ul style="list-style-type: none"> Ensure alignment with management on risk recognition to make the assessment more objective Based on the understood changes in risk, review the content of individual audits as necessary Ensure timely reviews for audit policy through regular discussion on risk assessment Deepen business process acknowledgement and understanding through offsite monitoring Ensure the monitoring of risk changes through allocating specific areas to the staff in charge or to each team Include strategic risk and conduct risk to each risk category 	
	Audit methods, etc.	Implement risk profiling and risk assessment (Identify and assess the risks based on internal and external environment)				
		Implement risk-based audits (formulate audit plans based on risk assessment results, note high-risk areas, improve operational processes, verify the operational status across the board, etc.)	<ul style="list-style-type: none"> Formulate a single-year plan Formulate an audit program based on an annual cycle Sales office audits Head office audits Enhance efficiency by using IT and data 		<ul style="list-style-type: none"> Formulate a mid-term audit plan based on MMP, set material items, etc. Analyze risk situation based on monitoring results, reflect them on the audit program Implement partial audits focusing on high-risk areas, in addition to general audits Complete timely audits through close dialogue with auditee units Implement audits as a long-term project advances Improve accuracy in audits using IT and related tech 	
		Strengthen root cause analysis and reporting based on audit results (implement root cause analysis, implement analysis across the organization, provide assurance, etc.)	<ul style="list-style-type: none"> Submit regular reports on facts Factor analysis to prevent recurrence incidents 		<ul style="list-style-type: none"> Create sense of acceptance by directly reporting to the officer in charge of the auditee unit on the results of analysis, etc. Ensure the sharing of risk recognition in business process through collaboration between the staff in charge of theme audits at head office and sales office audits Conduct root cause (common for individual audits) analysis, report the results Conduct root cause analysis based on the three-line management and management's posture Conduct analysis on behavioral causes including the factors of corporate culture 	
	Quality evaluation	Implement the PDCA cycle by using internal evaluation and external evaluation, etc.	<ul style="list-style-type: none"> Have the board of directors, etc. evaluate the audit results 		<ul style="list-style-type: none"> Implement and improve MMP-linked quality assessment Conduct post-event questionnaire surveys with auditee units to understand the sense of acceptance, communication level, feeling of burden, etc. Implement a unified external evaluation on the Group/global basis Implement the external evaluation not only from the viewpoint of compliance with international standards but also from the viewpoint of audit efficiency 	
		Strengthening audit base				
[Discussion point 3] Initiatives for auditee units	Securing and training personnel	Secure audit personnel from the mid- to long-term perspective, etc.	<ul style="list-style-type: none"> Implement a staffing for "waiting seats" Manage a trainee system, positioning it as a career path for young employees 		<ul style="list-style-type: none"> Proactively implement external recruitment as well as public recruitment inside the entity Have the same audit staffer take care of the monitoring and the individual audit to enable an in-depth audit Deepen the business understanding and improve the skills for the audit staff through monitoring operation Introduce an expert system to ensure know-how accumulation Implement overseas staff dispatch to train personnel for enabling a global integrated audit 	
		Secure personnel who can understand the business and business strategy of the whole organization and personnel who are versed in specific areas (personnel versed in market risk, anti-money laundering, etc.), etc.	<ul style="list-style-type: none"> Place seasoned business experts like a former branch general manager 	<ul style="list-style-type: none"> Use knowledgeable people in positions wearing two hats 	<ul style="list-style-type: none"> Implement mid-career recruitment for CIA (Certified Internal Auditor)-holders Introduce a system which could enable prolongation of the working period for qualification holders Create a set of skill sheets to help visualize the skills of audit staff and to help develop expert staff Install a dedicated team of data analysis experts Proactively use co-sourcing in highly professional areas 	
	Facilitate understanding of internal audit within auditee units, encourage the entity people to cultivate risk ownership, etc.				<ul style="list-style-type: none"> Proactively conduct internal PR on the roles, usefulness, etc. of internal auditing Share risk recognition through dialogue with GM of sales office, have dialogue towards autonomous management Make a shift to dialogue type audits, strengthen trust relationship through ensuring psychological safety for each auditee unit 	

*This Chart tried to position the main case examples included in the Monitoring Report 2024 (case examples introduced in the main text or on the charts thereof) in terms of how they are related to the “three issues” and the “phased evaluation” respectively, from such viewpoints as “Starting point,” “Maturity level” and “Direction of initiative.” Note that this does not show an absolute and complete form.

*Various reports released by the FSA are also useful as reference, when striving to improve audit methods, etc.

2. TO-BE stage for financial institutions and necessary system, etc.

(1) Posture required of senior management, etc.

① Clarify what is required of internal auditing

As objectives and functions of internal auditing, it “enhances and protects the value of an organization through providing objective and independent assurance, advice, and knowledge concerning the effectiveness, etc. of organizational activities,” as mentioned earlier. Then, internal auditing is positioned as part of business execution by management from the perspective of the so-called three-way audits.

Therefore, what is required of internal auditing for their own financial institutions should be determined by senior management primarily as a mandate to internal audit function, based on their own business situation. In other words, “when verifying and reporting business operation status of the organization as the eyes and ears of management, what needs to be implemented and to what extent” (the vision, so to say) for senior management is a matter of determination by senior management. This point could also be sorted out from the perspective of “business judgment principles¹⁹⁾” as well.

For example, at a financial institution where customer-oriented business operations are required extensively, it is necessary to provide products and services appropriately and timely and to ensure sound business operations that support the foregoing under the situation where customer needs and internal and external environment are getting diversified and more complicated. Given such a situation, senior management is required to make adequate judgments on what products and services are deployed in what methods by their own financial institution, and in the process, senior management should have necessary and sufficient information as a matter of course prerequisite. As to the information used as materials for such business judgments, timely and proper information provision by and reporting from related business units centered on the business unit supervising the business in question will be used as basic sources. However, when senior management judges whether what was intended has been realized in the actual fields or not, it is important to secure not only the information provision by and reporting from related business units but also the information from internal audit function to ensure more objectivity. It is so, because the roles of internal audit function are to grasp the business operation status of the organization and to provide necessary assurance from an independent and objective standpoint, and because these are the system and functions that enable the unit to perform the roles.

In this way, internal audit function serves as an important information source to ensure the adequacy of business judgments. To enable senior management to grasp the business operation status of the organization, communication with internal audit function could also be one of the important opportunities. The Monitoring Report 2024 also presented “grasping the risks faced by the entity itself timely, analyzing the risks from forward-looking perspective, and building a system for promoting business while adequately controlling the risks” as the objectives of internal auditing improvement; and this improvement of internal auditing may lead to strengthening important tools that provide validity of the judgments made by senior management.

② Clarify the mandate to internal audit function and its TO-BE phase

If a mandate to internal audit function is clarified by senior management, the TO-BE phase of internal auditing for their own financial institution as well can be clarified naturally.

¹⁹⁾ See “Glossary” No.12 at the end of this document.

When internal auditing is improved and each phase of the phased evaluation advances to a higher phase, challenges in terms of the risk management system for a financial institution can be resolved earlier and in a more constructive manner; and this way, the sustainability of the financial institution can be strengthened. This would eventually lead to an increased enterprise value for the financial institution and higher trust from stakeholders. As such, assurance provision by internal audit function has important implications and functions.

Regarding the setting of the TO-BE phase of internal auditing and the measures necessary to realize the aforementioned, senior management needs to consider and determine them while checking the organizational system and business situation of their own financial institution, based on good communication with internal audit function. In addition, if any goal or phase once set is reached, since business and internal and external environment are always changing, it must be assumed that the mandate to internal audit function continues to change naturally. Therefore, it is necessary to pay attention to the fact that any existing internal audit function cannot satisfy the wished objectives and functions eternally. In this sense too, senior management is required to make constant efforts to improve internal auditing.

③ Necessity of support from senior management, etc. to improve internal auditing

Regarding the “support for the internal audit function from senior management, audit and supervisory committee members, and auditors,” or one of the “three issues” towards internal auditing improvement, it is considered and implemented based on the thoughts of senior management, as previously discussed in ① and ②.

Given the understanding that the phased evaluation advances with the “Accumulation model,” further depth will be required in the roles and functions to be performed by internal audit function in more diverse fields, when aiming to realize the TO-BE phase, particularly the 4th phase, as mentioned earlier. If senior management aims for the 4th phase, it is necessary to establish an internal audit function that can perform those functions. In the process, management is expected to refer to example cases on strengthening audit foundations presented in the FSA Reports, 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.

Support for improving internal audit by senior management is not limited to the internal audit function. It must be recognized that it is important to engage with the entire organization including raising awareness among audited departments.

Such support from senior management primarily includes securing de facto independence for internal audit function. As objectives and functions of internal auditing, it “enhances and protects the value of an organization through providing objective and independent assurance, advice, and knowledge concerning the effectiveness, etc. of organizational activities.” For its adequate realization, it is necessary to give internal audit function a position not affected by other business execution units. If internal audit function is positioned in an environment where it needs to pay too much attention, it would be only detrimental to the objectivity and independence the unit must maintain. In GIAS also²⁰, it is recognized that the board of directors should ensure the exclusion of

²⁰ See the “Glossary” №13 at the end of the document.

Some financial institutions are emerging where internal audit function is set as a direct report to the board of directors, or it is set as a direct

such hindering factors. It is a matter that senior management must handle adequately to enable internal auditing to be properly functional.

Another point is improving the “Three Lines Model”. As already seen in the definition and sense of the level of the 1st phase (compliance, operational quality auditing), the compliance verification function should have been originally covered by the 1st line itself as the risk owner when considering from the “Three Lines Model” perspective; in other words, it should have been performed by the 1st line in line with the guidance and monitoring by the 2nd line to or for the 1st line, or should have been implemented by them within the framework of the PDCA cycle. This means that if a proper “Three Lines Model” is established within the organization, internal audit function no longer needs to perform unnecessary operations given the resource allocation in the entire organization, enabling effective and efficient internal auditing.

Senior management is required to help internal audit function concentrate on internal auditing operations and help it improve operational efficiency and proficiency level, through clarifying role division between the 1st line, 2nd line, and 3rd line, etc.²¹

In addition, through establishing a “Three Lines Model” like this, senior management should cultivate and strengthen the sense of risk ownership at the auditee business unit; also, senior management should understand and recognize that it might be possible to realize further improvement in enterprise value if more meaningful dialogue is enabled between internal audit function and the auditee business unit. Additionally, those initiative examples for promoting the relevant understanding among senior management and auditee business units, presented in the FSA Reports, might also be helpful.

(2) Items required of Internal audit function

From the viewpoint of objectives and functions of internal auditing, the following points are indispensable for internal audit function: ability to present constructive proposals for possible improvements for the organization; and tangible materialization of such proposals in terms of positive impact on organizational operations and business processes, and harvests (results) for the organization.

From such viewpoints, Internal audit function of each financial institution is making constant efforts to upgrade the audit systems. This point is clearly shown in that the Monitoring Report 2024 contains over 70 initiative case examples (about 100 case examples if including the case examples about advanced initiatives aiming for the 4th phase), concerning “Discussion point 2: Sophistication initiatives for Internal audit function.” In addition, it is not that a uniform method is used for realizing the TO-BE phase, but that each financial institution is showing unique creativity in methodology. This fact is highly commendable.

report to both the board of directors and to audit and the supervisory committee or the board of auditors or the board of supervisors (double reporting line). However, there are many entities, in particular regional financial institutions, where the internal audit function is set as a direct report to President or Chairman as the “chief business execution officer.” Relevant entities are expected to make further efforts for improving internal auditing, to also make governance effective, while referencing the GIAS trends and the initiatives of other financial institutions, too.

²¹ “Once a “Three Lines Model” is built, the 3rd line is no longer allowed to perform any roles of the 1st line nor the 2nd line” - this interpretation is a short circuit. As mentioned earlier, role division between the 1st line, 2nd line, and 3rd line at each financial institution is what must be determined by respective financial institutions based on the situation given to the respective financial institutions (see the case examples in Note 17 too). What is important is whether role division is properly done or not between the units that mainly cover the 1st line, the 2nd line, and the 3rd line respectively, from the viewpoint of overall optimization for ensuring business continuity while the organization is properly managing the risks. This point, too, needs to be reviewed in a timely and appropriate fashion within the PDCA cycle, because its evaluation should be noted as subject to change, as the internal and external environments change.

Going forward, not only for efficiently implementing audit operation, but also because digitalization in audit target operations is advancing rapidly, digitalization of audit methods as well should become mandatory. Therefore, it is important to further promote the utilization of data and IT.

On the other hand, whether such various initiatives can really be effective or not for realizing the objectives of internal auditing and for truly performing its functions, we have not necessarily been able to say there is a clear recognition of that in the organization.

When pursuing certain measures to improve internal auditing at a financial institution, if you consider the realization of purposes of internal auditing versus the use of certain functions, the item for consideration items might include the perspective of quality evaluation in internal auditing, the performance element prioritized among the KPI items for internal audit function, etc.²² In addition, along the process, you must be aware of whether the performance aspects that match the items expected by senior management are prioritized or not.

3. Attention points that align with organizational scale and business characteristics (direction of sophistication measures at small-sized financial institutions)

The FSA has been sorting out monitoring results concerning internal audit improvement centered on deposit-taking financial institutions, major securities firms and insurance companies, etc. In this Working Group, we recently collected opinions from industrial associations for organizationally small financial institutions (hereinafter “small-sized financial institutions”) including money lending operators, funds transfer business operators, virtual and crypto assets exchange industries, and asset managers, etc., as well. We learned about certain worries peculiar to such industries simply because they are small-sized financial institutions, as follows: there are no people who can sufficiently understand the phased evaluation, they are unable to allocate enough manpower to internal audit function, and so on.

Specifically, there have been many issues that require senior management involvement or consideration across the entire organization: that is, how to allocate limited resources; how to promote the sophistication measures at what priority setting; the full field of internal audit function needs to be covered by themselves, etc.; we heard many concerns and opinions that they faced resource limits at the current moment, it would take a long time until it is resolved, etc. This point is also a reason for stating “If it is hard to build a “Three Lines Model” due to the scale of financial institution, coverage by the third line as well will not be denied from the viewpoint of overall optimization” in 1 (2) ① (compliance, definition and sense of level for operational quality auditing). It is also clear that this is not a challenge that can be resolved immediately.

On the other hand, among small-sized financial institutions, there are some entities of relatively larger business scale (transaction volume, business volume) especially funds transfer business operators, and virtual and crypto assets exchange industries, etc. At such financial institutions, there might arise significant impact on their own entity and their stakeholders when risks become apparent. Therefore, they need to pay attention to the fact that they are required to improve their respective internal audit system depending on the business features of each entity, including transaction scale.

Many of the senior management personnel of small-sized financial institutions recognize that it is apparent that the internal audit function is important for ensuring business adequacy and for maintaining/improving their enterprise value, and that it is indispensable to improve the internal audit system to ensuring the sustainability of their financial institution. On the other hand, there are some

²² Performance of the internal audit unit is considered important in the GIAS, as shown in previous Note 15.

entities that lower the priority of updating efforts citing “lack of resources” as their reason. Admittedly, it might be difficult to newly secure human resources, but senior management members are not allowed to stop the initiatives for improvements.

On the contrary, it can be considered that the distance between senior management and internal audit function is shorter among small-sized financial institutions, so that smoother communication is possible. About the depth of root cause analysis where causes are analyzed more deeply from verified results, some say that it is a different matter from the quantity of human resources, or that if involving senior management, more in-depth discussions and considerations might be possible.

Also, instead of deploring that it is difficult for a small-sized financial institution to pursue initiatives alone, we could expect that if such an entity belongs to a major financial group (centered around a major bank, or a major securities company, or a major insurance company), the entity may be able to use the extensive audit resources and knowledge held by the core company of the group in an integrated manner. In addition, among the financial institutions of the same business category, which may share similar risk profiles, we could expect their joint response through “horizontal collaboration” such as information exchange among these types of financial institutions.²³

Furthermore, it can be said that internal audit function is a field shared commonly irrespective of the business category, so multiple entities could respond jointly through pursuing a certain collaboration system or building a consortium. Regarding such responses required of an organization, respective mandatory items are sorted out in “Domain II” through “Domain V” of the GIAS. They are useful as a reference.

Therefore, we believe there should be significant room for creative ideas even at small-sized financial institutions with limited resources. The FSA will further collect such initiative case examples at small-sized financial institutions, consider adequate actions, and provide them with necessary information.

²³ In the labor bank industry and in the other industries where an “authorization association” or a “self-regulatory organization” (like Japan Securities Dealers Association, Japan Financial Service Association, etc.) exists, we can see their initiatives to improve the internal auditing at respective member financial institutions through conducting association audits, etc. In other industries as well, if collaboration is pursued voluntarily between financial institutions, or if certain initiatives are conducted by respective industrial association as a hub to contribute to internal auditing sophistication at the member financial institutions, we can expect sophistication in internal auditing throughout respective industries.

IV. Conclusion (Direction of monitoring and the role of this report for the FSA)

Since the publication of “Current Situation and Issues” by the FSA, each financial institution has been steadily making efforts to improve internal auditing. In the process, the concept of the phased evaluation, which was presented in the “Current Situation and Issues”, together with the “three issues” presented thereafter, was useful for them as a reference when considering the direction to promote their initiatives: we have heard such comments from monitored financial institutions to date.

At the same time, we received multiple requests to clarify a specific image of the 4th phase, defining the phased evaluation, sharing case examples more extensively, etc. Therefore, it had become a challenge for us to present the concept of the phased evaluation in an easier-to-understand manner, to further help financial institutions upgrade their internal auditing.

As part of the response to such challenges, the FSA set up the Working Group, and we have had in-depth discussions through it. This report is its outcome. Each financial institution is required to build a sustainable business model while maintaining operational appropriateness and financial soundness; looking forward, they will need to pursue proper measures for helping internal audit function effectively depending on the TO-BE phase of business at each entity. Each financial institution is expected to make creative efforts constantly towards updating respective corporate management systems, etc., including not only internal auditing but also internal control, while referencing this report and considering its own surrounding environment as well as the business operational status of their own organization.

Based on this report, the FSA will keep striving to maintain good communication with internal audit function of financial institutions which are our important partners. We will determine the target areas and depth of monitoring depending on the level of respective internal audit, while appropriately grasping and analyzing the challenges inherent in each financial institution and respective situation. Thereupon, we plan to urge each financial institution to take adequate measures for building an appropriate risk management system and promoting improvement.

In addition, seizing adequate opportunities going forward, the FSA will continue to provide case examples, etc. grasped through monitoring that could contribute to improving internal auditing at financial institutions; and also aims to provide guidelines for updating internal auditing at non-financial companies or for improving supervision by overseas financial regulators as well, not limited to financial institutions.

Note that this report shows what we have sorted out at this moment in time. It is our policy at the FSA that we will revise the content as necessary to reflect changes in the environment that surrounds financial institutions, such as domestic and international financial, economic and social situations, changes in international regulations, etc., progress in technology used in internal auditing (utilization of generative AI) and so forth.

(Glossary)

See the following table for how the terms are defined in this report, unless otherwise described in the main text.²⁴

No	Term	Definition, etc.
1	Insight and foresight	<p>[Insight] Clearly identify the apparent risks and potential risks based on the facts grasped as the results of verification, and analyze occurrence causes and magnitude of impact on the organization.</p> <p>[Foresight] Create an outlook on the TO-BE risk management from now, assuming future changes in the situation of the organization as well as in the environment surrounding the organization, based on the insight results and the implementation of recommended improvements.</p>
2	Senior management	<p>In the case of a kabushiki kaisha (a limited company), its scope includes not only directors, auditors, audit and supervisory committee members, but also those who cover monitoring of corporate management or business execution such as members of the organization to determine business execution (execution managers or executive officers). Also, in the case of a financial institution of cooperative structure, senior management represents directors and auditors.</p> <p>When used in a caption, etc., there are redundant indication cases for clarifying the subjects (for instance, senior management, auditors, audit committee members).</p> <p>As to the governance form in Japan, institutional design includes companies with a board of directors, companies with an audit and supervisory committee, etc. One of the features here is that both the monitoring function for corporate management and the execution function are given to the board of directors or the directors.</p>
3	Assurance	<p>For each of such processes as risk management, control, and governance relating to audit targets, make a judgment on the adequacy in accordance with the established standards (regulations, rules, etc.) and express the results (including recommendations for improvement).</p>
4	Advisor	<p>Separately from proper operations of audit or as a derivative from them, in response to a request from a business execution unit, etc., make advice that should contribute to making judgments for the unit, based on the knowledge accumulated through internal auditing.</p>
5	“Three Lines Model”	<p>A system to ensure the management and operations for the whole organization, where each of the units (business execution unit, management unit, internal audit function) is given respective roles, and mutual interaction is ensured among them, for achieving corporate goals while properly managing organizational risks.</p>

²⁴ This definition was compiled by referencing The Institute of Internal Auditors (IIA) “Global Internal Audit Standards™,” “Quality Evaluation Manual (Quality Assessment Manual)” and “The IIA’s Three Lines Model,” JPX “Corporate Governance Code”

No	Term	Definition, etc.
		Note that in the management system by the first, second and third lines, there exists a group that governs the whole organization (board of directors, etc.).
6	1st line	Perform the roles to provide products and services to customers of the organization. It is mainly covered by the business execution unit or the business unit, such as the departments responsible for sales fields (sales offices, etc.), the Head Office departments that supervise or support the sales fields, etc.
7	2nd line	Perform the roles to provide support to the 1st line and supervise them, through providing expert knowledge from the viewpoints of compliance, internal control, and various types of risk management as well as through ensuring the monitoring. Mainly covered by the management unit.
8	3rd line	Perform the roles to provide independent and objective assurance and to provide relevant advice concerning the validity and effectiveness in governance and risk management. It is covered by internal audit function.
9	Three-way audits	Three-way audits refer to the three types of audit: namely, “internal auditing” where business operation status is audited as requested by senior management and the board of directors; “audits by audit and supervisory committee members and auditors” where legality and validity is verified by audit and supervisory committee members and auditors concerning the business execution performed by directors and execution managers; and “external audits” where accounting legality and validity is verified by accounting auditors. All these three-way audits share one common factor in that they are the functions to “raise and protect the organizational value.” On the other hand, internal auditing is different from the other two types, in that they are the audits implemented by corporate insiders under the supervision of corporate insiders (senior management, board of directors, etc.).
10	Content of each Domain in the GIAS	Regarding the objectives of internal auditing, “Domain I” of the GIAS prescribes that “Internal auditing strengthens the organization’s ability to create, protect, and sustain value by providing the board and senior management with independent, risk-based, and objective assurance, advice, insight, and foresight,” saying they also “strengthen the corporate ability to contribute to public benefits.” Standard 12.2 “Performance measurement” in “Domain IV” says performance goal measurement is quite important to determine whether Internal audit function has met <<Global Internal Audit Standards>>, satisfied the expected items, and achieved improvements in line with the strategies of the business unit or not. In addition, in the “Quality Evaluation Manual” (to ensure the level of internal auditing satisfies the standards) as well, the status of how Internal audit function is performing for realizing the above objectives is treated as an element in the evaluation.

№	Term	Definition, etc.
11	Root cause analysis	Analyze the root cause for problematic events. In this process, it is expected to avoid or prevent occurrence of risk events that share common underlying causes, not only through analyzing the background of audit findings and situation of the auditee department, but also through performing in-depth analysis about internal management, control environment, corporate strategy on operational situation, etc. targeting the entire organization.
12	Business judgment principles	Generally, business judgment principles refer to the “bylaw to determine acceptable or not, when a duty of care breach is questioned concerning a business execution by a director, etc.” In short, it is recognized that “duty of care has been duly performed, if the following three conditions are met: ① examination and consideration necessary for fact authorization have been properly and sufficiently implemented, ② there is no visibly irrational point in the fact authorization based on ①, and ③ there is no visibly irrational point in the inference process and judgmental content based on ②.”
13	Required items in Domain III	It is clearly stated that the “Board of directors is responsible for realizing the independence of the Internal audit function” as “Principle 7: Positioned independently” that constitutes Domain III “Governance for Internal audit function.” Then, after clarifying that “Independence means no existence of the state that hinders the ability of the Internal audit function to perform the responsibilities of internal auditing in a fair and unbiased manner,” in “Standard 7.1 Organizational independence,” the following descriptions are shown: mandatory requirement for the board of directors is to “establish direct instruction and reporting relationships with the head of internal audit function and internal audit function for enabling internal audit function to perform the items expected in internal auditing,” etc.; and also the mandatory requirement for senior management is to “position internal audit function at an adequate level in the organization for enabling it to perform its operations and responsibilities under the instructions from the board of directors and without any external intervention,” etc.

(Reference 1) Overview of the Working Group on Improving Internal Auditing of Financial Institutions

[Participating entities, etc.]

(General incorporated association) Japanese Bankers Association

(General incorporated association) Regional Banks Association of Japan

(General incorporated association) The Second Association of Regional Banks

(General incorporated association) The National Association of Shinkin Banks

(General incorporated association) National Central Society of Credit Cooperatives

(General incorporated association) National Association of Labour Banks

(General incorporated association) The Life Insurance Association of Japan

(General incorporated association) The General Insurance Association of Japan

(General incorporated association) Japan Small-Amount and Short-Term Insurance Association

Japan Securities Dealers Association

(General incorporated association) Investment Trust Association

Japan Financial Service Association

(General incorporated association) Japan Payment Service Association

(General incorporated association) Japan Virtual and Crypto assets Exchange Association

(General incorporated association) The Institute of Internal Auditors Japan

(General incorporated association) International Bankers Association

Bank of Japan

(Consulting firms)

KPMG AZSA LLC

EY Strategy and Consulting Co., Ltd.

Deloitte Tohmatsu Risk Advisory LLC

PricewaterhouseCoopers Japan LLC

Protiviti LLC

[Date and agenda of each Working Group meeting, etc.]

First (1/23), Second (2/19)

Interviewed industrial associations on how the each phase evaluation is felt among the industry and briefed on practical challenges.

Third (3/19), Fourth (4/10)

Interviewed consulting firms on how to revise the each phase evaluation.

Fifth (5/21)

Discussed the essence (draft) of the Working Group report.

*Refer to the FSA website for more details.

(URL: <https://www.fsa.go.jp/singi/naibukansa/index.html>)

(Reference 2) Overview of the “Global Internal Audit Standards TM,” etc.

“Global Internal Audit Standards™,” formulated by The Institute of Internal Auditors (IIA), provides the international standard framework for internal auditing. It consists of the following five Domains:

- **Domain I: Purpose of internal auditing**

Purpose statement: Internal auditing strengthens the organization’s ability to create, protect, and sustain value by providing the board and senior management with independent, risk-based, and objective assurance, advice, insight, and foresight.

- **Domain II: Ethics and professionalism**

- **Domain III: Governing the internal audit function**

- **Domain IV: Managing the internal audit function**

- **Domain V: Performing internal audit services**



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➤ Domain II ~ V include the following element:

Principle (there are 15 Principles): Each Principle describes relevant required items and the items to be considered.

Standard (there are 52 Standards):

- Required items: Practical items indispensable to perform internal auditing.
- Items to be considered in implementation: General and desirable items in practice that should be considered when implementing the required items.
- Compliant evidence examples: Method to show that the required items in the “Global Internal Audit Standards” are being implemented.

Domain I: Purpose of internal auditing

Domain II: Ethics and professionalism

Principle 1 Demonstrate integrity:

Standard 1.1 Honesty and professional courage, Standard 1.2 Organization’s ethical expectations, Standard 1.3 Legal and ethical behavior

Principle 2 Maintain objectivity:

Standard 2.1 Individual objectivity, Standard 2.2 Safeguarding objectivity, Standard 2.3 Disclosing impairments to objectivity

Principle 3 Demonstrate competency:

Standard 3.1 Competency, Standard 3.2 Continuing professional development

Principle 4 Exercise due professional care:

Standard 4.1 Conformance with the Global Internal Audit Standards, Standard 4.2 Due professional care, Standard 4.3 Professional skepticism

Principle 5 Maintain confidentiality:

Standard 5.1 Use of information, Standard 5.2 Protection of information

Domain III: Governing the internal audit function

Principle 6 Authorized by the board:

Standard 6.1 Internal audit mandate, Standard 6.2 Internal audit charter, Standard 6.3 Board and senior management support

Principle 7 Positioned independently:

Standard 7.1 Organizational independence, Standard 7.2 Chief audit executive qualifications

Principle 8 Overseen by the board:

Standard 8.1 Board interaction, Standard 8.2 Audit resources, Standard 8.3 Quality, Standard 8.4 External quality assessment

Domain IV: Managing the internal audit function

Principle 9 Plan strategically:

Standard 9.1 Understanding governance, risk management, and control processes, Standard 9.2 Internal audit strategy, Standard 9.3 Methodologies, Standard 9.4 Internal audit plan, Standard 9.5 Coordination and reliance

Principle 10 Manage audit resources:

Standard 10.1 Financial resource management, Standard 10.2 Human resources management, Standard 10.3 Technological resources

Principle 11 Communicate effectively:

Standard 11.1 Building relationships and communicating with stakeholders, Standard 11.2 Effective communication, Standard 11.3 Communicating results, Standard 11.4 Errors and omissions, Standard 11.5 Communicating the acceptance of risks

Principle 12 Enhance quality:

Standard 12.1 Internal quality assessment, Standard 12.2 Performance measurement, Standard 12.3 Oversee and improve engagement performance

Domain V: Performing internal audit services

Principle 13 Plan engagements effectively:

Standard 13.1 Engagement communication, Standard 13.2 Engagement risk assessment, Standard 13.3 Engagement objectives and scope, Standard 13.4 Evaluation criteria, Standard 13.5 Engagement resources, Standard 13.6 Audit work program

Principle 14 Conduct engagement work:

Standard 14.1 Gathering information for analyses and evaluation, Standard 14.2 Analyses and potential engagement findings, Standard 14.3 Evaluation of findings, Standard 14.4 Recommendations and action plans, Standard 14.5 Engagement conclusions, Standard 14.6 Engagement documentation

Principle 15 Communicate engagement results and monitor action plans:

Standard 15.1 Final engagement communication, Standard 15.2 Confirming the implementation of recommendations or action plans

*See the website of (General incorporated association) The Institute of Internal Auditors Japan for more details.
(URL: https://www.iiajapan.com/leg/iaa/info/2024/20240705_global_ia_std.html)

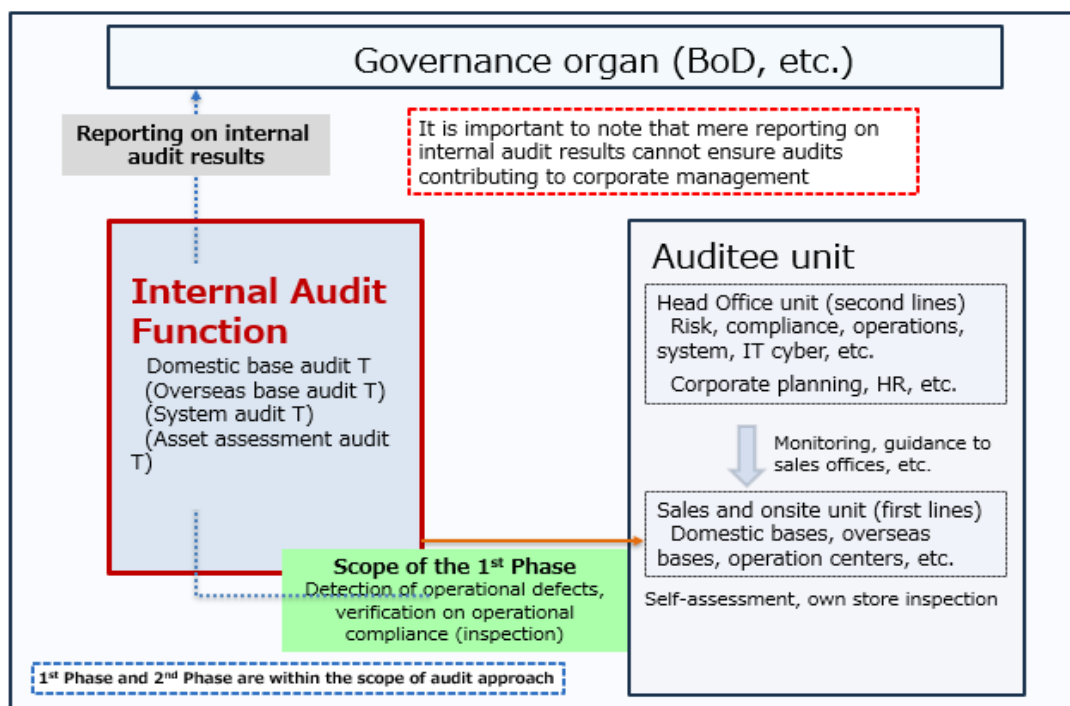
(Reference 3) Envisaged each phase evaluation

*A kabushiki kaisha organization is illustrated around Internal audit function, in a simplified manner.
(Basically the same structure is applied to a cooperative-type financial institution.)

[1st phase] Operational mistake auditing (compliance, operational quality auditing)

In this phase, application status for regulations, operational rules, etc. is verified.

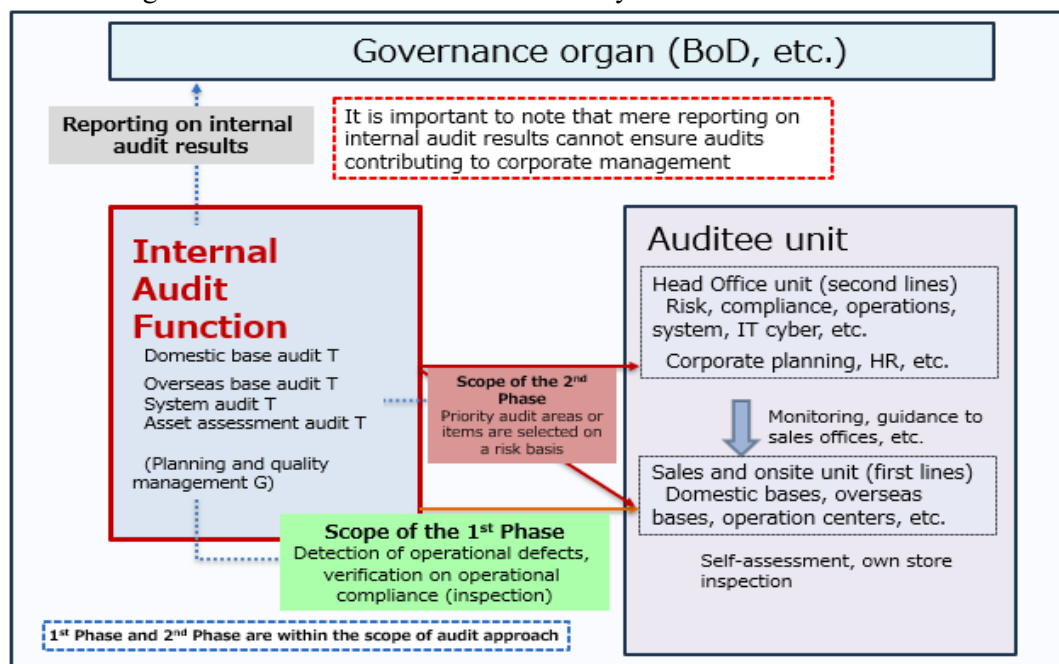
Whether operational quality of their own financial institution keeps the level assumed by their own financial institution or not is verified and the results are reported to senior management.



[2nd phase] Risk-based auditing (business process auditing by introducing risk assessment)

In this phase, risk-based adequacy and validity of business process is verified.

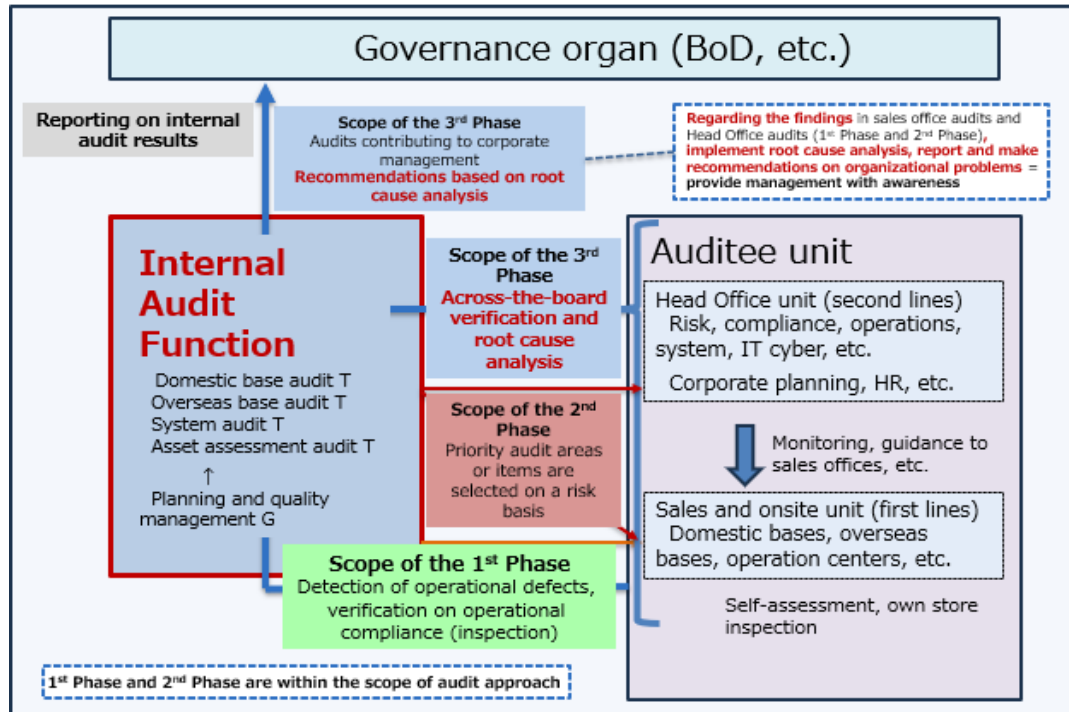
Risk-based verification is performed for the establishment and operation status of internal control at their own financial institution, on the priorities set. Results are reported to senior management and issues are raised as necessary.



[3rd phase] Corporate management auditing (auditing to contribute to business judgment)

In this phase, business operation status is verified across the organization based on its corporate strategy, key information is provided to senior management, and assurance is given to the business process.

Along with the result reporting of compliance audit and business process auditing, root causes of issues or weaknesses in the overall organizational framework of the financial institution are clarified, and recommendations are made to resolve those problems.



[4th phase] Trusted advisor

In this phase, auditors are trusted by the whole organization, are requested by senior management and respective auditee business unit to provide them with advice, and keep contributing to raising enterprise value (best practice of internal auditing).

By practicing the 1st phase~3rd phase, trust in internal audit function is created. As a result, an environment is cultivated where "internal auditing is naturally requested" by senior management and respective auditee business unit.

