

# 2022 Monitoring Report Key Points

July 2022

Certified Public Accountants and  
Auditing Oversight Board



# About the 2022 Monitoring Report

## Purpose of publication

- This report is aimed not only at audit and accounting specialists, but also market participants as well as ordinary readers such as students and working people. We have published it for the purpose of promoting understanding within society of the importance of audits by providing easy-to-understand and relevant information that is centered on the circumstances and results of the CPAAOB's monitoring activities but also encompasses the current state and changes in the environment surrounding the audit sector.

## Structure

- The Report comprises the following four sections (I-IV). In "I. Overview of the Audit Sector," we have added information. In "II. The CPAAOB monitoring", the report delivers the new wording of assessments related to the over rating of inspection results, and renews the recent trends with auditing, such as the impact and response to spread of COVID-19 and the responses to key audit matters (KAM), in "IV. Responses to Changes with Auditing."(main revisions for the 2021 edition)

### I. Overview of the Audit Sector

Describes the situation with regard to CPAs, audit firms, audited companies and audit of IPOs etc., and provides an overview of the audit sector as a whole

- Example content (1) Concentration of audit engagements at large sized audit firms (market share by type of audit firm [FY2020])

### II. CPAAOB's Monitoring

Describes the activities of the CPAAOB (overview of system and situation with examinations, collection of reports, and inspections)

- Example content (2) Situation with overall ratings

### III. Operation of Audit Firms

Describes the operation of audit firms as gleaned through monitoring conducted by the CPAAOB

- Example content (3) Initiatives based on The Audit Firm Governance Code
- Example content (4) Changes of Accounting Auditors

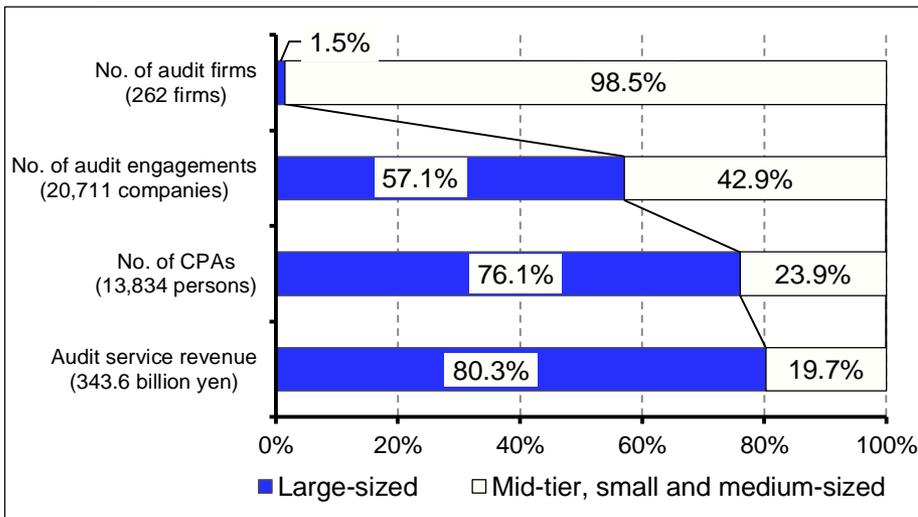
### IV. Responses to Changes with Auditing

Describes recent key trends with audit firms

# Example content (1) Concentration of audit engagements at large-sized audit firms

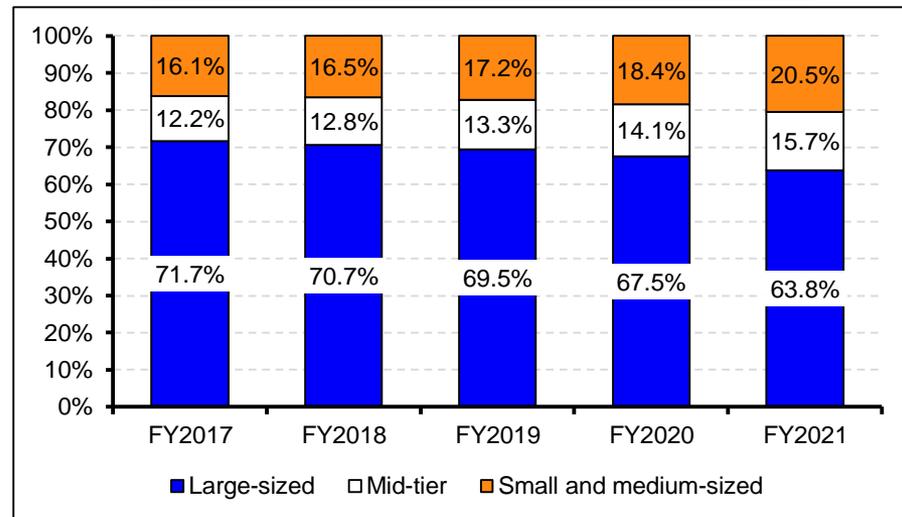
- Approximately 81% of audit service revenue is marked by large-sized audit firms (four firms).
- In recent years, the ratio of large-sized audit firms has been on a downward trend in the number of audit engagements, audit service revenue.
- The same oligopolistic tendency is also seen in the United States and the UK.

Market share by type of audit firm (FY2020)



(Note) Compiled based on FY2020 JICPA member data and operational reports submitted by audit firms.

Number of listed domestic companies by scale of accounting auditor



(Source) Prepared by the CPAAOB based on data from Quick and exchanges

## Big Four global networks' share of audit engagements for major listed companies (based on number of companies)

	Japan	United States	UK
Big Four global networks' share	97%	99%	93%

(Note) Shares were calculated based on the numbers of companies included in the following stock indexes:

Japan: Nikkei 225  
 United States: S&P 500  
 UK: FTSE 350

## Example content (2) Situation with overall ratings

- Based on inspection results, the operation of services of an audit firm is given one of five grades. This grade constitutes their overall rating, and the firm is notified of it. When this notification is made, the firm is required to disclose it to the audit and supervisory board members of the audited companies (from PY2016).
  - No audit firms qualified as “Satisfactory,” the highest rating in the overall rating scheme, so all audit firms were rated as “Generally satisfactory with minor deficiencies” or lower according to the status of their operation management.
  - Small and medium-sized audit firms, partnerships, and solo practitioners tended to have lower overall ratings than large-sized audit firms and second-tier audit firms. This is because the CPAAOB selects audit firms to be inspected on a risk basis

### Overall ratings (Covers inspections completed in PY2016-21)

Overall rating description	Details	Large audit firms, mid-tier audit firms	Small and medium-sized audit firms
Generally satisfactory	Given when operation of services is deemed to be satisfactory	-	-
Satisfactory with minor deficiencies	Given when there are issues needing to be fixed, but operation of services is deemed to be satisfactory on the whole	4	3
Unsatisfactory	Given when operation of services is deemed to be unsatisfactory	5	6
Unsatisfactory and in need of immediate remediation	Given when operation of services is deemed to be unsatisfactory and in need of immediate remediation	-	6
Extremely unsatisfactory	Material deficiencies with the quality control environment and audit engagements were identified and voluntary remediation cannot be expected to be implemented by the audit firm (recommendation is made to the FSA Commissioner)	-	8

(Note 1) Firms are notified of their overall ratings following regular inspections. Regular inspections take place once every two years in the case of large sized audit firms, once every three years in the case of second tier audit firms, and as necessary in the case of small and medium sized audit firms partnerships, and solo practitioners.

(Note 2) The CPAAOB will make the review of assessment result descriptions in overall ratings, starting with inspections to be launched in PY2021.

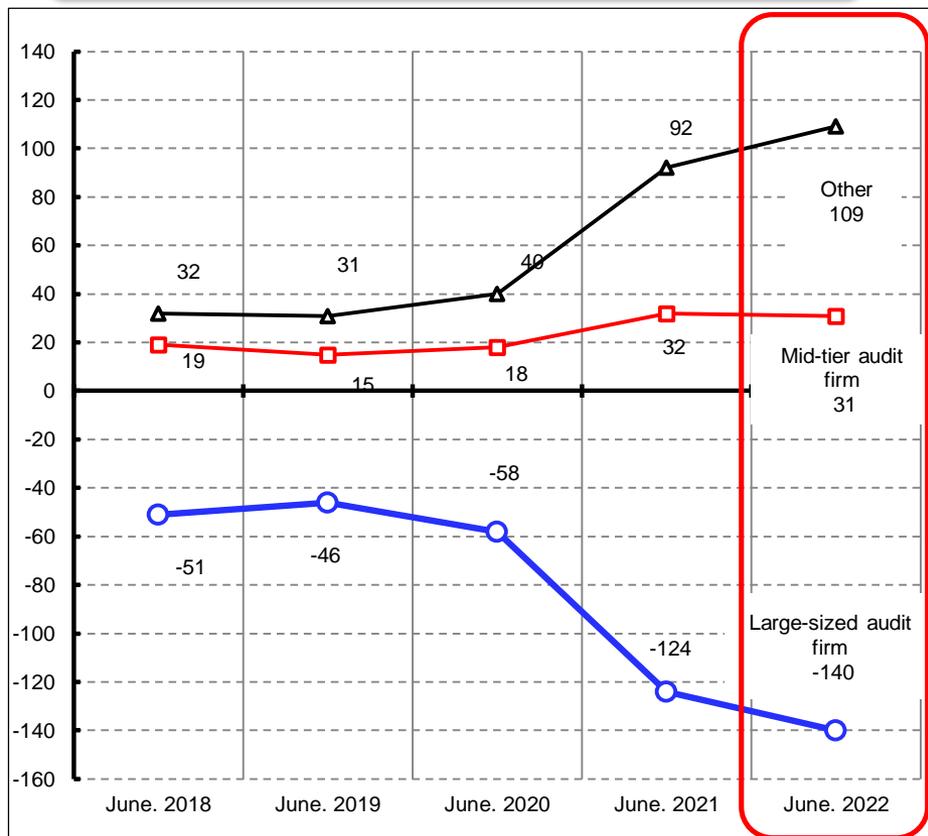
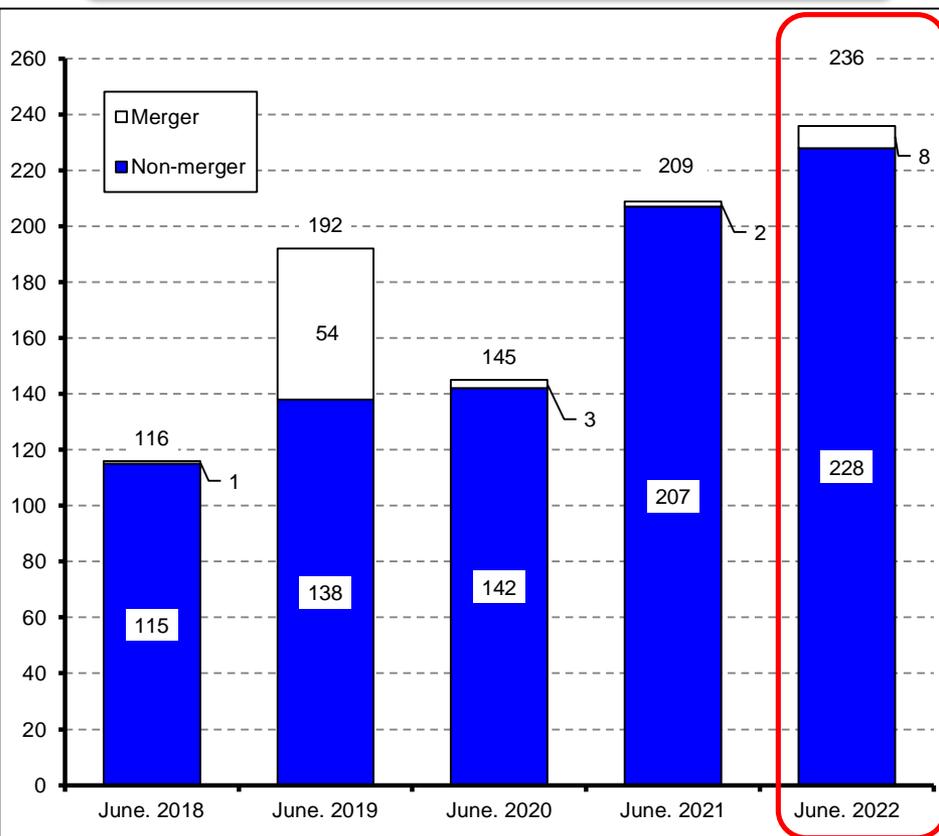
(Note 3) For audit firms that underwent regular inspections multiple times during the relevant period, results of the latest inspection are tabulated.

# Example content (4) Changes of accounting auditors (1/2)

- Even if changes due to merger are excluded, the number of changes of accounting auditors is at its highest level in five years.
- Breaking things down by size of audit firm reveals an ongoing shift from large-sized audit firms to a smaller audit firms.

Number of listed domestic companies that changed audit firms (unit: companies)

Changes by size of audit firm (unit: companies)



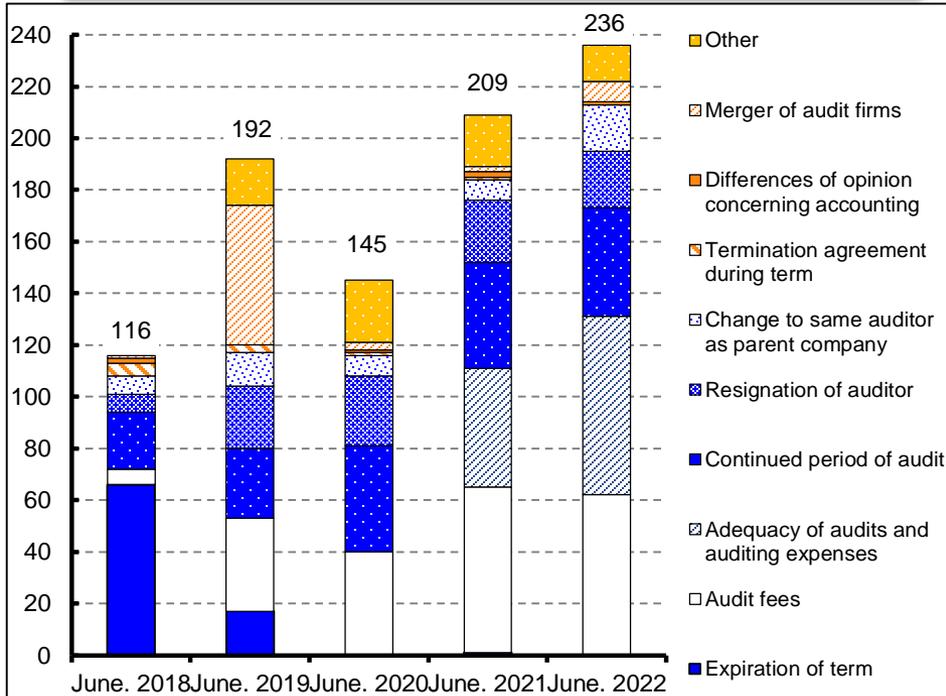
(Note) The figures above show the number of companies that had decided on an incoming auditor by the end of June of each period, based on timely disclosures of listed domestic companies

(Note 1) Net increases/decreases in the number of changes

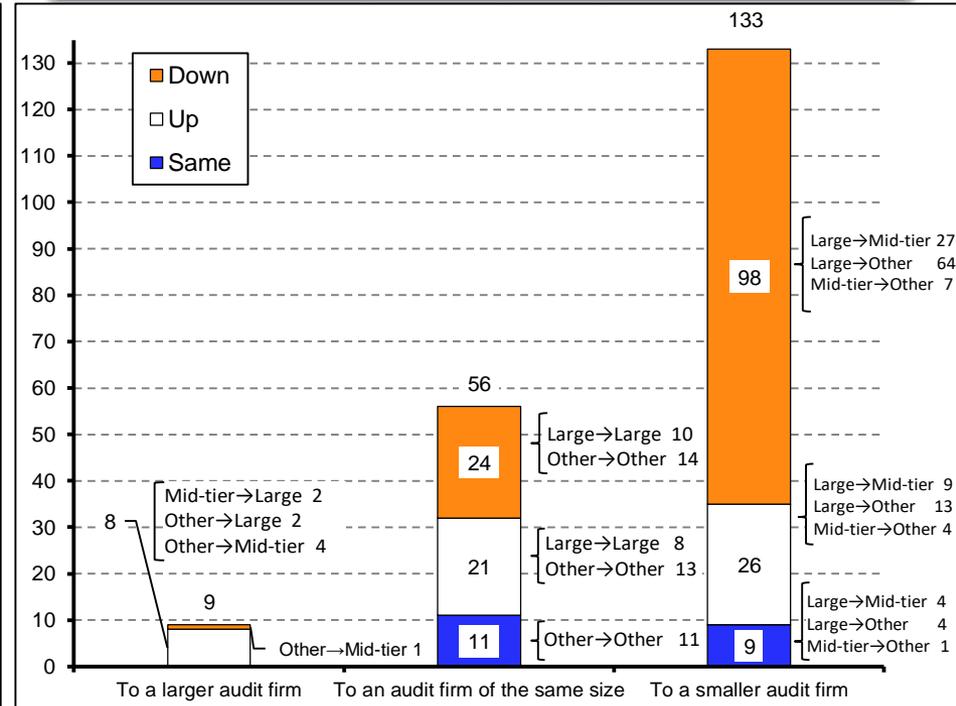
# Example content (4) Changes of accounting auditors (2/2)

- Cases in changes of accounting auditors solely based on expiration of term have been decreasing sharply since June 2019. In the year ending June 30 ,2022, there are many cases in which audit fee hike proposal and prolongation of continuous audit terms are cited as reason. Additionally, in many cases , companies cited that consideration of the audit service adequate for their business scale and suitability of audit fees through comparison with other audit firms resulted in changes of auditors.
- Regarding audit fees before and after changes, approximately 70% of changes to a smaller audit firm resulted in lower fees. Among these, changes from a large-sized audit firm to a small and medium-sized audit firm, partnership, or solo practitioner saw fees drop in over 80% of cases.

Reasons for changes in accounting auditors by listed domestic companies (unit: companies)



Audit fees following changes in accounting auditors (unit: companies)



(Note 1) Compiled by the CPAAOB based on timely disclosures by listed domestic companies choosing new auditors by the end of June each year.  
 (Note 2) In the case of two or more reasons disclosed, the classification was made based on principal reasons.  
 (Note 3) Prior to the year to June 2020, the "adequacy of audits and auditing expenses" was included in "others." While there was no reference to it in the year to June 2018, it was mentioned in four cases in the year to June 2019 and eight in the year to June 2020.

(Note 1) Based on changes in accounting auditors between July 2021 and June 2022 where the audit fees before and after the changes were publicly disclosed  
 (Note 2) Breakdowns of these changes are shown in the graph  
 (Note 3) "Other" in the figure refers to small and medium-sized audit firms, partnerships and solo practitioners.  
 (Sources) Prepared by the CPAAOB based on timely disclosures of changes in accounting auditors securities reports submitted by June 2022