

July 14, 2023

Certified Public Accountants and Auditing Oversight Board

Basic Plan for Monitoring Audit Firms in Program Year 2023 (from July 2023 to June 2024)

To ensure audit quality and enhance the effectiveness of audits, the Certified Public Accountants and Auditing Oversight Board (the "CPA AOB") hereby establishes the Basic Plan for Monitoring Audit Firms in Program Year ("PY") 2023 (from July 2023 to June 2024) (the "Basic Plan 2023"), reflecting the perspectives and objectives stated in the Basic Policy for Monitoring Audit Firms (the "Basic Policy")¹ and the environment surrounding audit firms.

1. Environment surrounding audit firms

(1) Audit trends

a. Changes in auditors of listed companies

- Large-sized audit firms² have continuously accounted for an overwhelming share, above 90%, of audits of listed companies in Japan in terms of market capitalization. The annual number of changes in audit firms of listed Japanese companies surpassed 200 (excluding those resulting from audit firm mergers), as in the previous year. The change of large-sized firms to mid-tier or small and medium-sized ones remained remarkable.
- Factors behind the changes include audited companies' review of auditors from such viewpoints as audit fees, audit durations and these companies' business sizes. Among factors on the side of audit firms is large-sized firms' review of their client portfolios.
- While the range of listed company auditors has thus widened, there are

¹ It sets the standpoint, objectives, and basic policy for each term regarding monitoring implemented by the CPA AOB. The basic policy for the CPA AOB's seventh term (April 2022 to March 2025) was formulated and announced on May 20, 2022.

(<https://www.fsa.go.jp/cpaob/shinsakensa/kihonkeikaku/20220520/20220520.html>) (Available in Japanese)

² The CPA AOB classifies audit firms into the following three categories according to their sizes:

- Large-sized audit firms: Audit firms that audit about 100 or more listed companies in Japan and have at least 1,000 full-time audit practitioners. In this Basic Plan, they specifically refer to four firms: KPMG Azsa LLC, Deloitte Touche Tohmatsu LLC, Ernst & Young ShinNihon LLC and PricewaterhouseCoopers Aarata LLC.
- Mid-tier audit firms: Audit firms that are second only to large-sized firms in size. In this Basic Plan, they refer to five firms: Gyosei & Co., BDO Sanyu & Co., Grant Thornton Taiyo LLC, Crowe Toyo & Co. and PricewaterhouseCoopers Kyoto.
- Small and medium-sized audit firms: Audit firms other than large and mid-tier audit firms

concerns over the internal environments of some small and medium-sized audit firms that conduct audits of listed companies, such as the constant lack of full-time audit assistants. It is even more urgently required to secure and improve the quality of audits of the entirety of listed company auditors.

- When auditors are changed, the transition work from the previous auditors to the successors should be implemented appropriately according to Auditing Standards Committee Statements No. 900 "Change of Auditors."

b. Status of inappropriate accounting cases

- The annual number of listed companies that disclosed matters such as inappropriate accounting treatments in the timely disclosure of stock exchanges has continued to be above 50.
- Inappropriate accounting is attributable to dysfunctional corporate governance and internal control, including insufficient control on domestic and overseas group companies.
- It goes without saying that top company managers are responsible for the preparation of financial statements and the design/implementation of effective internal control systems. On the other hand, it has become increasingly important for audit firms to conduct audits based on their in-depth understanding of audited companies' business characteristics and environments when assessing such companies' internal control. Audit firms are required to inform audited companies in a timely manner when they have identified internal control deficiencies.

c. Accounting and disclosure trends

○ Review of quarterly disclosure

- In its report published in June 2022, the Financial System Council's Disclosure Working Group (the "DWG") presented the direction to abolish quarterly disclosure (for the first and third quarters) under the Financial Instruments and Exchange Act, while leaving quarterly disclosure under stock exchange rules (quarterly earnings reports). Additionally, the DWG made recommendations, in its report published in December 2022, concerning whether the submission of quarterly earnings reports should be required or not, the details to be disclosed in quarterly earnings reports, and whether auditors should review quarterly earnings reports or not.
- Based on the aforementioned recommendations, etc. in the DWG report, a draft amendment of the Financial Instruments and Exchange Act, which aims to abolish quarterly disclosure by listed companies and require them

to submit semiannual reports in lieu thereof, was submitted to the Diet (under continued deliberation as of the end of June 2023).

- Amendment of the Cabinet Office Order on Disclosure Concerning Sustainability Information Disclosure, etc.
 - In January 2023, the Cabinet Office Order for Partially Amending the Cabinet Office Order on Disclosure of Corporate Affairs and the Cabinet Office Order on Disclosure of Information on Regulated Securities was promulgated.
 - Based on the recommendations in the DWG report published in June 2022, the amendment aims to newly introduce the description column, "Approach to Sustainability and Sustainability-Related Efforts," in annual securities reports and enhance the content of disclosure regarding corporate governance.
 - The amended Cabinet Office Orders will start to be applied to annual securities reports for business years ending on or after March 31, 2023, and the disclosure of non-financial information, including sustainability information, is expected to be further promoted.

(2) Initiatives to ensure and enhance audit quality

a. Revision, etc. of the Quality Control Standards, etc.

- Revision of the Auditing Standards

Auditing Standards were revised in November 2020 to clarify auditors' procedures regarding "other information in documents" regarding non-financial information and started to be applied to audits of financial statements for the fiscal year that ended in March 2022. Additionally, the revision also enhanced the risk approaches regarding such information in audits, and this risk approach enhancement started to be applied to audits of financial statements for the fiscal year that ended in March 2023.

- Revision, etc. of the Quality Control Standards, etc.

- In November 2021, the Standards on Quality Control for Audits were revised. The revision includes the introduction of a quality control system based on risk approaches (a system under which an audit firm sets up its own quality goal, identifies and assesses risks that may hinder the achievement of the relevant quality goal, establishes policies or procedures for dealing with assessed risks, and implements those policies or procedures).

- In response to the revision of the aforementioned Quality Control Standards, the Quality Control Standards Committee Report No. 1 on quality management at audit firms and the Audit Standards Committee Report No. 220 on quality management in auditing were revised and the Quality Control Standards Committee Report No. 2 on audit engagement reviews were newly formulated.
 - Large audit corporations under the Certified Public Accountants Act³ are required to comply with the aforementioned standards from audits of financial statements for business years or accounting periods that start on or after July 1, 2023, and other audit firms are required to comply with them from audits of financial statements for business years or accounting periods that start on or after July 1, 2024.
- Revision of the Code of Ethics
- In response to the publication of the "International Code of Ethics for Professional Accountants (including International Independence Standards)" by the International Ethics Standards Board for Accountants, the Code of Ethics was revised in July 2022.
 - Through this revision, the Japanese Institute of Certified Public Accountants (JICPA) unified four independent rules/guidelines (Code of Ethics, Guidance on Independence, Guidance on Conflict of Interest, and Guidance on Response to Illegal Acts). In addition, provisions in the Code of Ethics regarding the dependence on audit fees and non-assurance services were revised and the rules on how to secure the objectivity of engagement quality reviewers were newly established.
 - The revised Code of Ethics started to be applied in April 2023, except for some provisions.
- Revision of the standards and practice standards concerning the Internal Control Report System
- Based on discussions at the Internal Control Committee of the Business Accounting Council since October 2022, the Standards and Practice Standards for Management Assessment and Audit concerning Internal Control Over Financial Reporting were revised in April 2023.
 - This revision aims to ensure appropriate risk approaches in evaluation of internal control by top management, improve disclosure of information

³ Audit corporations that audit a total of 100 or more listed companies, etc. in the latest accounting year. See Article 24 of the Regulations for Enforcement of the Certified Public Accountants Act.

relating to evaluation, and update the concept of internal control.

- The aforementioned revised standards will start to be applied in the business year that starts in or after April 2024.

b. Amendment of the Certified Public Accountants Act

- Introduction of a registration system for auditors of listed companies, etc.
 - Accompanying the enforcement of the Certified Public Accountants Act amended in May 2022 (the "amended CPA Act"), a legal registration system for auditors of listed companies, etc. was introduced in lieu of the registration system for audit firms of listed companies, which the JICPA had operated as a self-regulatory mechanism. The JICPA is expected to serve as the operator of this new registration system and check the eligibility of applicants for registration as listed company auditors, while referring to the grounds for refusal of registration prescribed in the CPA Act.
 - The amended CPA Act imposes the following requirements on registered listed company auditors: (i) requirement to develop a system to appropriately evaluate the status of service quality control and publish the evaluation results and grounds therefor etc. (Article 93 of the Regulations for Enforcement of the CPA Act); (ii) requirement to develop a system for having certified public accountants with sufficient knowledge and experience involved in audit and attestation services (Article 94 of the same Enforcement Regulations); (iii) requirement to develop a system for publishing the status of business management (Article 95 of the same Enforcement Regulations); and (iv) requirement to develop a system for conducting services in line with the principles for systematic management designated by the Commissioner of the Financial Services Agency⁴ and a system for publishing the application status of the relevant principles (Article 96 of the same Enforcement Regulations).
 - The JICPA will check the eligibility of applicants as registered listed company auditors through quality control reviews, etc., by examining the status of the development of the aforementioned systems and whether there are any grounds for refusal of registration.

- Review of the CPAAOB's inspection authority, etc.

The amended CPA Act deleted the provisions to limit the inspection authority granted to the CPAAOB to the inspection of the status of business

⁴ The Commissioner of the Financial Services Agency designates the Effective Management of Audit Firms (the "Governance Code") as principles for systematic management.

operations of audit firms, etc. and the scope of the CPAAOB's authority to conduct inspection, etc. was expanded. Accordingly, the CPAAOB will exercise the expanded authority as necessary to enhance the effectiveness and efficiency of monitoring.

c. Governance systems of audit firms

- The "Principles for Effective Management of Audit Firms" (the "Governance Code") was revised in March 2023.
- The Governance Code was formulated in March 2017 to promote effective management functions at audit firms, and this is the first revision after its formulation.
- The revision aims to accommodate acceptance of small and medium-sized audit firms and promote external disclosure and enhance information disclosure in response to the globalization of audit firms. More specifically, the amended Governance Code incorporates the necessity for small and medium-sized audit firms to secure an effective management function even if they do not establish a management body in consideration of their sizes and characteristics, etc. and to utilize independent third parties even if they do not establish supervisory and assessing bodies. In relation to the latter point, the details concerning the enhancement of information disclosure, such as the relationship with and positioning of overseas networks (significance, purpose, risks, and contract outlines, etc.) are incorporated.

(3) Current state of quality control at audit firms

○ Outline of the overall inspection ratings

The CPAAOB has specified overall inspection ratings⁵ on a scale of five categories on inspected audit firms' business operations in inspection result notifications (excluding those for follow-up inspections) since PY2016 (July 2016-June 2017).

○ Distribution of overall inspection ratings

5 The "Key points" section of the inspection results notification contains an overview of deficiencies in operational management systems, quality control systems and individual audit engagements and gives one of the five overall inspection ratings based on the status of those areas. The five ratings are accompanied by the respective assessment comments as follows:

- (1) 1st-highest rating: "Favorable (Overall Rating 1)"
- (2) 2nd-highest rating: "Generally favorable with some deficiencies requiring remediation (Overall Rating 2)"
- (3) 3rd-highest rating: "Unfavorable with significant deficiencies requiring remediation (Overall Rating 3)"
- (4) 4th-highest rating: "Unfavorable with significant deficiencies with respect to operational management systems, etc. requiring immediate voluntary remediation (Overall Rating 4)"
- (5) 5th-highest (lowest) rating: "Extremely unacceptable (Overall Rating 5)"

- There are no audit firms that have been given the highest rating.
 - Large-sized audit firms were all given the second-highest rating.
 - Mid-tier audit firms were given the third or fourth rating.
 - Most of the inspected small and medium-sized audit firms were given third-highest or lower ratings as they were selected for inspections based on their risks.
- Challenges for large-sized audit firms

Large-sized audit firms tend to be shifting part of their quality control-related functions from head-office quality control departments to business units close to the audit frontline. Accordingly, the roles to be played by individual business units are increasing in spreading remedial measures to audit teams. Under such circumstances, ensuring sufficient cooperation between the head-office quality control departments and the business units and effective monitoring of the status of permeation of remedial measures among frontline auditors remain as their major challenges.
 - Challenges for mid-tier audit firms

Mid-tier audit firms are facing the following challenges: (i) the management including top management is not fully aware of the need to ensure and improve quality control and the importance of collaboration with quality control departments; (ii) communications between quality control departments and business units are insufficient; (iii) top management and quality control departments fail to sufficiently verify the effectiveness of remedial measures; (iv) supervisory and assessing bodies are not sufficiently fulfilling their functions; and (v) it is not sufficiently verified whether human and temporal resources are sufficient for each of the audit procedures in light of the actual conditions of the audit frontline. Furthermore, there are still personnel training challenges, including the growing utilization of non-CPA clerical employees.
 - Challenges for small and medium-sized audit firms

Challenges for small and medium-sized audit firms include the following: they have failed to exercise leadership in developing an organizational culture giving priority to compliance with professional ethics; top executives and personnel responsible for quality control are not aware of the fact that all auditors, including themselves, do not fully understand the current audit standards; and they do not understand the required levels of in-depth analyses of causes regarding inspection findings through quality control reviews, etc. for the

purpose of preventing the recurrence of deficiencies of the same type. There were also cases showing the lack of awareness regarding the importance of being honest and maintaining credibility as professionals (such as substituting audit documentation after an inspection notice is issued), the lack of an attitude to critically examine the audit quality of the firm as a whole (such as lacking the awareness to critically examine the quality of other staff members' individual audit work), the lack of the awareness to critically examine manager's views by demonstrating professional skepticism, and the lack of the awareness to carefully check whether sufficient and appropriate audit evidence has been obtained in response to audit risks.

- Challenges in individual audit engagements

Irrespective of audit firms' sizes, deficiencies regarding audit procedures for accounting estimates and for fraud risks (including identification and assessment of fraud risks in revenue recognition and responses to fraud risks) have continuously been found in individual audit engagements. In addition, deficiencies have also been found in procedures relating to Key Audit Matters (KAM).

- Misstatements regarding certified public accountant qualifications

Since the summer of 2022, there have been cases where in statutory documents, such as annual securities reports, or materials submitted to audited companies, etc., multiple large-sized audit firms entered their staff members as certified public accountants although they had not been registered as such. Accordingly, the JICPA requested audit firms in charge of audits of listed companies to conduct self-inspection as to the occurrence of the same or similar cases, and announced that it received reports of similar misstatement cases from 18 audit firms.⁶

(4) Trends of international audit regulators

From the perspective of enhancing the international status of Japanese capital markets, the CPAAOB and the FSA support the International Forum of Independent Audit Regulators (IFIAR),⁷ with its permanent secretariat located in Tokyo. The

⁶ See reference materials for the Chairman's Statement, "Request for Appropriate Indication and Tabulation of Certified Public Accountants," dated December 26, 2022 (publication of the JICPA).

⁷ The IFIAR is an international organization established in 2006, consisting of independent audit regulators that inspect audit firms. Its permanent secretariat is located in Tokyo. It aims to improve audit quality globally through collaboration among authorities. As of the end of June 2023, the number of IFIAR member countries/regions totaled 54, including Japan.

IFIAR has long endeavored to ensure and improve audit quality globally through continuous dialogue with the six largest global networks⁸ and the publication of the "Survey of Inspection Findings 2022," which compiles findings in inspections by independent audit regulators, including the CPAAOB.

2. Concept of Basic Plan for Monitoring Audit Firms in PY2023

(1) Focus points of monitoring

Based on "1. Environment surrounding audit firms" above, the CPAAOB will monitor⁹ audit firms with a focus on the following points in PY2023.

a. Operational management systems

- Audit firm management's commitment to improving audit quality

To improve audit quality on an ongoing basis, top management leaders should take leadership to foster an organizational culture emphasizing audit quality and compliance with professional ethics and to develop organized and integrated operational management and quality control systems. Therefore, the CPAAOB will primarily evaluate whether management teams, including top management, recognize this point and reflect the recognition in specific measures.

- Effectiveness of operational management systems

The CPAAOB will primarily evaluate whether operational management systems are developed and implemented under effective governance and well-functioning management to ensure and enhance audit quality. In particular, regarding audit firms that audit listed companies, etc., the CPAAOB will primarily evaluate (i) whether they have an effective management function as an organization from the perspective of securing and sustainably improving their audit quality, and (ii) whether they are securing a function to supervise and assess the effectiveness of the management function from a standpoint independent of the firms' managements and a function to support the demonstration of the effectiveness through the supervision and assessment.

8 Out of all global networks of audit firms, the six largest global networks refer to Deloitte Touche Tohmatsu, Ernst & Young, KPMG, PricewaterhouseCoopers, BDO, and Grant Thornton.

9 Monitoring covers inspections and non-inspection monitoring. Non-inspection monitoring includes the collection of reports and interviews regarding audit firms and information gathering through the exchange of opinions and cooperation with relevant FSA divisions, the JICPA and other business organizations related to auditing, as well as dialogue with audit firms.

b. Quality control systems

○ Effectiveness of quality control systems

The CPAAOB will primarily evaluate not only whether audits by audit firms comply with audit standards in form, but also whether such audits demonstrate professional skepticism to find accounting fraud, and other points regarding whether quality control systems developed by audit firms are effective for ensuring and enhancing audit control.

○ Evaluation of the status of the development and operation of quality control systems in compliance with the revised Quality Control Standards (for large-sized audit firms) / Confirmation of the status of responses to the revised Quality Control Standards (for other audit firms)

With regard to large-sized audit firms to which the revised Quality Control Standards are applied, the CPAAOB will primarily evaluate the status of the development and operation of their quality control systems based on risk approaches. For audit firms to which the revised Quality Control Standards are not applied (other than large-sized audit firms), the primary focus of checks will be the status of their responses to the revised Quality Control Standards.

○ Securement, training and distribution of audit resources

To ensure and enhance audit quality, it is vital for audit firms to secure, train and adequately distribute sufficient audit resources commensurate with the number of companies that they audit, as well as in consideration of audit risks. Given this, the CPAAOB will primarily evaluate the status of the securement, training and distribution of audit resources at audit firms, including the development of the work environment, initiatives to reduce the turnover rate and policies for audit fees.

○ Backgrounds on new client acceptance and cancellation

Based on the situation where a considerable number of audit firm changes are continuing for audits of listed companies, the CPAAOB will primarily evaluate the backgrounds of audit firms' new client acceptance and cancellation with listed companies (including details about the new client acceptance with large listed companies or listed companies suspected of having high audit risks), the adequacy of risk assessment for the new client acceptance and processes for determining audit fees, the development of

auditing arrangements and details of contract takeovers.

- Compliance with the revised Code of Ethics

The revised Code of Ethics started to be applied in April 2023, except for some provisions. Therefore, the CPAAOB will primarily evaluate the status of compliance with the revised Code of Ethics (provisions regarding the dependence on audit fees, non-assurance services, and the rules on how to secure the objectivity of engagement quality reviewers).

- Introduction of audit tools leveraging digital technologies (including cybersecurity measures)

Considering that progress in the digitalization of audits is expected to enhance the effectiveness of audit procedures for detecting fraud and realize the effective and efficient distribution of audit resources, the CPAAOB will continue to grasp audit firms' development and introduction of audit tools leveraging digital technologies. The CPAAOB will also check if audit firms have taken adequate cybersecurity measures according to the advancement of cyberattacks.

- c. Individual engagements

- Implementation of audits regarding fraud risks

Considering the status of the occurrence of inappropriate accounting treatments, the CPAAOB will primarily evaluate how audits on fraud risks are implemented (whether auditors take special care to fully demonstrate their professional skepticism in order to identify fraud risk factors, including incentives and pressure to commit fraud, and events and conditions that provide opportunities to commit fraud, and also in order to assess the risks of material misstatement, and whether auditors appropriately develop and implement audit procedures in response to identified and assessed risks).

- Implementation of audits regarding revenue recognition

Considering the status of deficiencies being found in audits regarding revenue recognition, the CPAAOB will primarily evaluate how audits on revenue recognition are implemented (whether auditors develop and implement audit procedures responding appropriately to identified and assessed fraud risks after appropriately judging the type of revenue, transactions or assertions linked to the generation of fraud risks based on the presumption that revenue recognition poses fraud risks).

- Implementation of audits regarding accounting estimates

Considering the status of deficiencies being found in audits regarding accounting estimates, the CPAAOB will primarily evaluate whether audit firms consider the extent of uncertainty about estimates, appropriately identify and assess risks of material misstatement regarding accounting estimates, take note of the rationality of managers' assumptions and implement audit procedures that respond appropriately to the risks.

- Procedures for making decisions on KAM and descriptions and implementation of audit responses

Considering the status of deficiencies being found in procedures concerning KAM, the CPAAOB will primarily evaluate procedures for making decisions on KAM (whether audit firms proactively communicate with managers and audit committee members of audited companies when making decisions, and whether audit firms prepare audit reports with the same content as those for the previous term (including reports prepared by the predecessors) without conducting special deliberations), descriptions of audit responses (whether procedures conforming to factors described in reasons for decisions on KAM or audit approaches are specifically described), and the implementation status regarding audit responses (whether procedures described as audit responses are properly implemented).

- Implementation of procedures regarding "other information in documents"

In consideration of the recent moves to enhance the disclosure of non-financial information, the CPAAOB will primarily evaluate the implementation of procedures regarding "other information in documents" (through reading of other information in documents, consideration and assessment of other information in documents, etc.).

d. Others

- Effectiveness of quality control reviews

Accompanying the introduction of a registration system for auditors of listed companies, etc., the importance of quality control reviews is increasing as a means to check the eligibility of registered listed company auditors, etc. Given this fact, the CPAAOB will primarily evaluate the effectiveness of quality control reviews.

- Status of assurance on non-financial information

Given that non-financial information assurance needs and hopes with respect to CPAs' engagement with such assurance are growing, the CPAAOB will check the status of non-financial information assurance at audit firms.

- Provision of auditing services for companies preparing for IPOs

From the perspective of whether efforts are promoted to pave the way for IPO-seeking companies to undergo appropriate audits according to their growth stages, the CPAAOB will check the status of audit firms' provision of auditing services to companies preparing for IPOs.

- Introduction and implementation of measures to prevent misstatements regarding certified public accountant qualifications

Considering the occurrence of misstatements regarding certified public accountant qualifications, the CPAAOB will check and evaluate the introduction and implementation of preventive measures.

(2) Monitoring methods

- Since PY2020, the CPAAOB has utilized online approaches such as borrowing laptops from audit firms to browse audit working papers and holding interviews using a web-based video conferencing system, in addition to traditional face-to-face inspections.
- The CPAAOB will continue to conduct inspections using both of the above methods and consider even better methods through dialogue with audit firms.

3. Basic plan for non-inspection monitoring

(1) Verification of JICPA quality control review reports and cooperation with JICPA

- Accompanying the introduction of a registration system for auditors of listed companies, etc., the JICPA has introduced a review of the registration screening, in addition to conventional regular reviews and special reviews, and has reconsidered its internal structure, by methods including the establishment of a listed company auditor registration screening board. The JICPA is also considering placing more importance on reviews of small and medium-sized audit firms and examination of the effectiveness of quality control systems as its

future policy for quality control reviews.

- The CPAAOB has encouraged the JICPA to ensure and enhance audit quality through opinion exchange, etc., but considering that quality control reviews are expected to play even more important roles as a means to check the eligibility of registered listed company auditors, the CPAAOB will have in-depth discussions with the JICPA to further strengthen systems for conducting quality control reviews. Regarding the results of the verification of the effectiveness of quality control reviews, which is cited as one of the focus points of monitoring, the CPAAOB will share relevant information on a timely basis to encourage the JICPA to further enhance the effectiveness of its reviews. Additionally, the CPAAOB and the JICPA will continuously discuss the respective roles of CPAAOB inspections and JICPA quality control reviews and their cooperation based thereon, and the JICPA's enhancement of instruction and supervision of small and medium-sized audit firms.

(2) Collection of reports

a. Basic concept

- To encourage all of Japan's audit firms to ensure and enhance audit quality and each audit firm to develop appropriate operational management and quality control systems, the CPAAOB will appropriately grasp the status of audit firms and risks regarding individual audit engagements in a timely manner. The CPAAOB will also collect reports effectively on the design and implementation of operational management and quality control systems at audit firms (including the implementation of remedial measures). To collect reports efficiently, the CPAAOB will utilize information gained through inspections and dialogue with audit firms, considering the workload on audit firms.
- To efficiently inspect large-sized and mid-tier audit firms, the CPAAOB will regularly collect and analyze quantitative and qualitative information from them on operational management systems.
- From small and medium-sized audit firms, the CPAAOB will collect and analyze information in a timely manner according to their sizes and characteristics, considering the results of JICPA audit quality reviews and audit risks regarding audited listed companies. When encouraging small and medium-sized audit firms to spontaneously ensure and enhance audit quality, the CPAAOB will hold interviews on their reports to secure effects similar to those of inspections.
- The CPAAOB will collect reports from small and medium-sized audit firms

to ascertain their responses to issues identified in inspection results after a lapse of certain period time from the notification of inspection results, and encourage them to spontaneously improve their practices.

- From audit firms that are rated unfavorable with significant deficiencies with respect to operational management systems and are required to improve their practices immediately, the CPAAOB will collect reports when notifying them of inspection results and encourage them to quickly improve their practices.

b. Focus points of reports for collection

Based on "1. Environment surrounding audit firms," common focus points of reports for collection are as follows.

- (i) Audit firm management's commitment to enhancing audit quality
- (ii) Effectiveness of operational management systems (including top managers' policies, and revenue and financial structure)
- (iii) Effectiveness of quality control systems
- (iv) Development and operation of quality control systems in compliance with the revised Quality Control Standards (for large-sized audit firms) / Status of responses to the revised Quality Control Standards (for other audit firms)
- (v) Compliance with the revised Code of Ethics
- (vi) Securement, training and distribution of audit resources (including the development of the work environment and initiatives to reduce the turnover rate)
- (vii) Backgrounds to new client acceptance and cancellation of audit contracts
- (viii) Introduction and implementation of measures to prevent misstatements regarding certified public accountant qualifications
- (ix) Introduction of audit tools leveraging digital technologies (including the implementation of cybersecurity measures)
- (x) Non-financial information assurance
- (xi) Provision of auditing services for companies preparing for IPOs

(3) Collection and analysis of information regarding audit firms

a. Dialogue with audit firms

- The CPAAOB will continue to conduct periodic dialogue with top and other managers of large-sized and mid-tier audit firms in order to collect information about the latest operational management systems at the firms, ascertain the problems that audit firms and the audit industry are facing and share problem awareness with them.

- Additionally, in the same manner as in the previous program year, the CPAAOB will also have dialogue with managers at relatively larger firms among the small and medium-sized audit firms that audit listed companies, as necessary.
- b. Cooperation with relevant organizations at home and abroad
- The CPAAOB will enhance the exchange of opinions and cooperation with relevant FSA divisions, the JICPA, financial instruments exchanges and the Japan Audit & Supervisory Board Members Association, as well as the IFIAR, foreign audit regulators and global audit firm networks. The CPAAOB will proactively utilize information gained through the exchange of opinions and cooperation for monitoring and endeavor to collect and analyze various documents and information according to risks at audit firms. The CPAAOB will also continue to promote personnel who can analyze domestic and foreign information, the internationalization of accounting practices and Japanese audit firm systems, and take appropriate actions, and those who can provide guidance for efficient and effective monitoring. The CPAAOB will promote the fostering of personnel through their proactive participation in international meetings.

4. Basic Inspection Plan

(1) Common points

a. Common focus points

Based on "1. (3) Current state of quality control at audit firms," common focus points for evaluation in inspections are as follows.

- (i) Audit firm management's commitment to enhancing audit quality
- (ii) Effectiveness of operational management systems
- (iii) Effectiveness of quality control systems
- (iv) Development and operation of quality control systems in compliance with the revised Quality Control Standards (for large-sized audit firms) / Status of responses to the revised Quality Control Standards (for other audit firms)
- (v) Diffusion and adoption of quality control measures (including remedial measures for findings through quality control reviews and CPAAOB inspections) at the audit frontline
- (vi) Securement, training and distribution of audit resources
- (vii) Compliance with the revised Code of Ethics

- (viii) Backgrounds to new client acceptance and cancellation of audit contracts (including the adequacy of risk assessment for concluding new contracts, the development of audit performance systems and the implementation of takeover procedures)
- (ix) Implementation of audits regarding fraud risks
- (x) Implementation of audits regarding revenue recognition
- (xi) Implementation of audits regarding accounting estimates
- (xii) Procedures for making decisions on KAM and descriptions and implementation of audit responses
- (xiii) Implementation of discussions with managers and communications with auditing committee members
- (xiv) Implementation of procedures regarding "other information in documents"
- (xv) Introduction and implementation of measures to prevent misstatements regarding certified public accountant qualifications

b. Inspection methods

Based on the status of the introduction of electronic audit documentation at audit firms and their requests, the CPAAOB will continue to conduct inspections using both online methods (inspections through browsing audit working papers and holding interviews with partners and employees online) and face-to-face methods.

(2) Inspections of large-sized audit firms

a. Inspection frequency, etc.

- Given that large-sized audit firms fulfill an important role in the capital markets, the CPAAOB in principle inspects them every year (with regular and follow-up inspections being conducted alternately).
- When conducting follow-up inspections, the CPAAOB will give consideration to the workload of audit firms, refrain from evaluating individual audits in principle, and evaluate remedial measures taken to address issues detected in the previous regular inspections. In addition, the CPAAOB may collect reports to confirm remedial measures instead of conducting an inspection.
- If a serious accounting problem at an audited company having a material impact on markets is detected or suspected and the CPAAOB finds it necessary to immediately confirm the status of the quality control systems of the audit firm accountable for audit procedures, the CPAAOB will perform inspections expeditiously without being bound by the abovementioned principle.

b. Focus points

Based on the current state of quality control at large-sized audit firms (see "1. (3) Current state of quality control at audit firms"), the CPAAOB will pay particular attention to the following focus points for evaluation in inspections for the current program year.

- (i) Implementation of functions by the management, including the top leader, and the quality control department to check the audit frontline (business units, etc.) to ensure and enhance audit quality
- (ii) Monitoring by the quality control department on individual audits
- (iii) Audit procedure deficiencies for cases where inappropriate accounting treatments are found at audited companies, evaluation of root causes of such deficiencies, and implementation of remedial measures

(3) Inspections of mid-tier audit firms

a. Inspection frequency, etc.

- Considering that mid-tier audit firms' roles as listed company auditors are increasing, the CPAAOB will increase the frequency of inspections of mid-tier audit firms from once in three years in principle to once in two years in principle. Specifically, the CPAAOB will conduct inspections targeting all mid-tier audit firms within PY2023 and PY2024, and thereafter, it will conduct inspections for individual audit firms once every two years, in principle.
- However, if the CPAAOB finds it necessary to immediately confirm the quality control systems of a mid-tier audit firm accountable for audit procedures for a company where a serious accounting problem is detected or suspected, the CPAAOB expeditiously inspects the audit firm.

b. Focus point

Based on the current state of quality control at mid-tier audit firms (see "1. (3) Current state of quality control at audit firms"), the CPAAOB will pay particular attention to the following focus points for evaluation in inspections for the current program year.

- (i) Initiatives by the management, including the top management, to develop an organizational culture emphasizing audit quality
- (ii) Cooperation between the quality control departments and the audit frontline (business units, etc.)
- (iii) Monitoring by the quality control department on individual audits

(4) Inspections of small and medium-sized audit firms

a. Inspection frequency, etc.

- As for small and medium-sized audit firms, the CPAAOB considers the need for confirming their quality control systems immediately, based on the JICPA's quality control review results and the extent of risks regarding their operational management systems and the listed companies they audit.
- Considering that they are playing greater roles in auditing listed companies and that a registration system for auditors of listed companies, etc. was introduced, the CPAAOB will give greater priority to inspections of small and medium-sized audit firms this program year as well.

b. Focus point

Based on the current state of quality control at small and medium-sized audit firms (see "1. (3) Current state of quality control at audit firms"), the CPAAOB will pay particular attention to the following focus points for evaluation in inspections for the current program year.

- (i) Top and other managers' recognition of quality control
- (ii) Initiatives to develop an organizational culture emphasizing compliance with laws and professional ethics
- (iii) Development and operation of organized quality control systems covering local offices
- (iv) Partners' and employees' recognition of professional ethics, independence and compliance with laws
- (v) Management of audit working papers (including the prevention of inappropriate correction, etc. of working papers)

5. Provision of monitoring information

To ensure and enhance audit quality, it is important to adequately convey the results of inspections to audit firms and the audit committee members of audited companies and disseminate information on the monitoring results to the public so as to spur interest in and awareness of audits. From that viewpoint, the CPAAOB gives consideration to the following points on the occasion of monitoring information provision.

a. Conveyance of inspection results to audit committee members

The CPAAOB endeavors to enhance descriptions of inspection results so as to

accurately convey inspection findings to audit firms and their quality control levels, inspection findings on operational management systems and other findings to audit committee members at audited companies. The CPAAOB also confirms whether audit firms appropriately convey the results of inspections to audit committee members at audited companies.

b. Monitoring Report

To contribute to furthering market participants' understanding of audits, the CPAAOB has published the annual Monitoring Report,¹⁰ compiling monitoring results and insights, since 2016. The CPAAOB will strive to further enhance its contents and dissemination with the needs of readers in mind. The CPAAOB will also endeavor to disseminate the Monitoring Report to foreign readers by translating it into English.

c. Case Report from Audit Firm Inspection Results

In order to encourage audit firms to ensure and enhance audit quality, the CPAAOB has published the annual Case Report from Audit Firm Inspection Results,¹¹ compiling specific cases identified through inspections, since 2008. The CPAAOB will continue to enhance the report by replacing cases with new ones to make the report a useful reference for audit firms' improvement initiatives. The CPAAOB will also continue to hold lectures and briefings on the Case Report at each branch of the JICPA nationwide, proactively disseminate the report to market participants and translate it into English to provide relevant information to foreign readers.

10 In the "2023 Monitoring Report" (<https://www.fsa.go.jp/cpaaob/shinsakensa/kouhyou/20230714/20230714-1.html>) (Available in Japanese), more detailed information is provided regarding "1. (1) Audit trend" and "1. (2) Initiatives to ensure and enhance audit quality" in this Basic Plan. Please refer to them.

11 In the "Case Report from Audit Firm Inspection Results (PY2023)" (<https://www.fsa.go.jp/cpaaob/shinsakensa/kouhyou/20230714/20230714-2.html>) (Available in Japanese), more detailed information is provided regarding "1. (1) Audit trend" and "1. (2) Initiatives to ensure and enhance audit quality" in this Basic Plan. Please refer to them.