
Case Report from
Audit Firm Inspection Results
summary
(Program Year 2024)

Main features of this Program Year

- In light of the importance of root cause analysis, "I. Operations Management System (Root Cause Analysis)" enhanced case studies of root cause analysis and root cause cases in recent inspections.
- "II. Quality Control System" and "III. Individual Audit Engagements" provide extensive coverage of the latest inspection cases, as well as examples of effective efforts being made by small and medium-sized audit firms to contribute to improvement.
- Notes on amendments of the Code of Ethics that have started to be applied and new standards that have not yet been applied (such as Auditing Standards Board Statement No. 600 and Auditing Standards Board Statement No. 1 on Financial Reporting) are provided as columns.
- The chart has been enhanced to assist in understanding the content described in "Required Actions" and "Points to Note".
- A "Summary of Inspection Results" and a "Summary Version" summarizing the "Inspection Results Summary" and "Required Actions" have been prepared and published together with this Case Report.

Outline of inspection results

I. Operations Management System (Root Cause Analysis)

Operations Management System (Root Cause Analysis)

Necessity of Root Cause Analysis

- As the scope of the quality control review and the CPAAOB inspection are highly limited, it is likely that, in addition to identified deficiencies, there remain undetected deficiencies with same root causes.
- Perfunctory improvement measures without root cause analysis would only increase ineffective and unnecessary tasks for audit frontline, which will not lead to fundamental improvement of the audit quality as a whole, but rather hinder the effective and efficient audit.
- Audit firms should recognize the importance of root cause analysis to realize substantial improvements of audit quality.

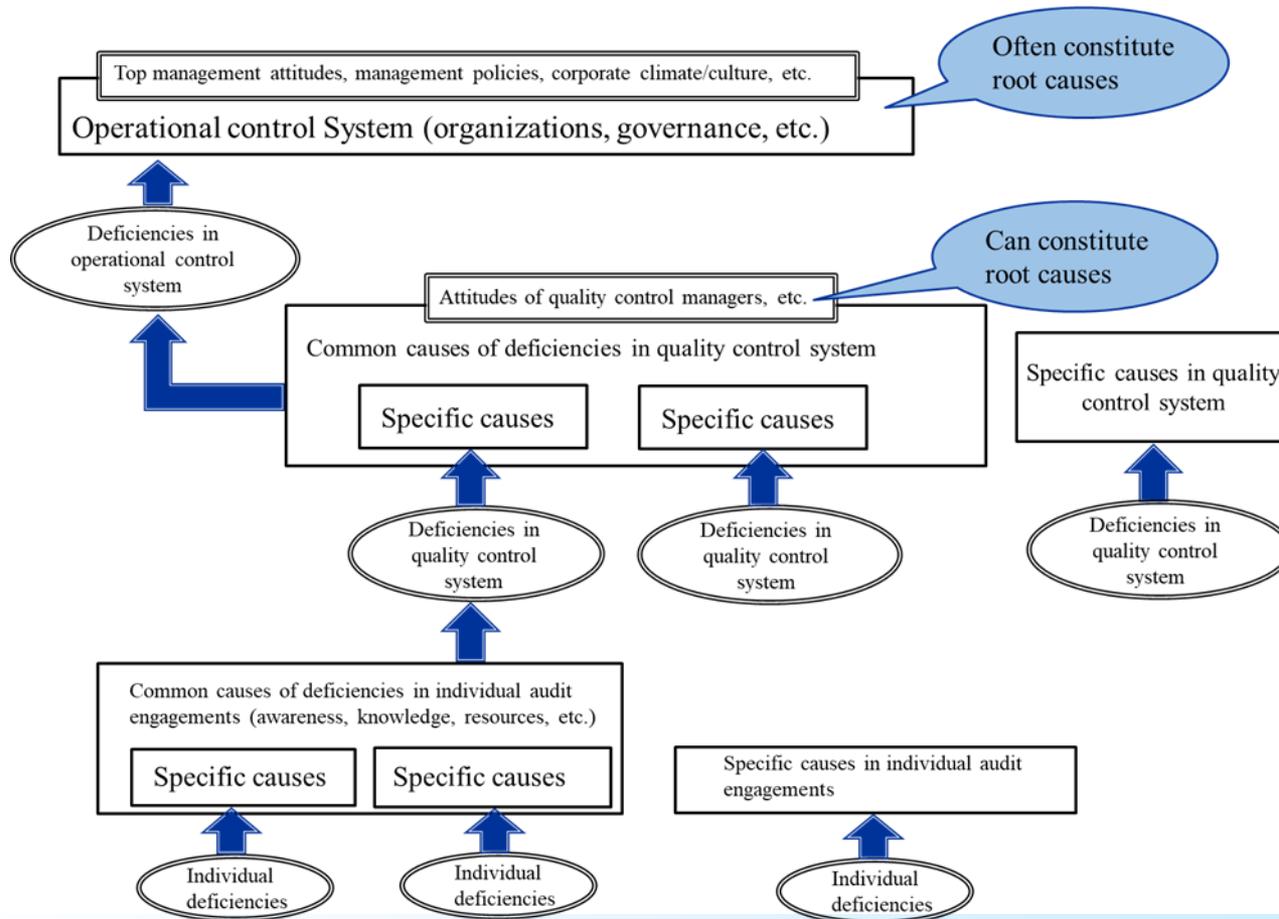
Operations Management System (Root Cause Analysis)

Root Cause Analysis

- In root cause analysis, it is important to accurately identify the direct causes of deficiencies as a first step. In direct cause analysis, it is necessary not only to consider the knowledge, awareness, and experience of individual audit staffs, but also to consider other aspects of the audit, such as situation of the audit teams and the audited companies.
- Direct causes can be divided into "specific causes" which is unique to individual deficiencies, and "common causes" which is common to multiple deficiencies. Further analysis of common causes often leads to root causes of deficiencies.
- In the past inspections, the root causes were frequently related to “tone at the top”, “business strategy”, or “corporate culture” in the operations management system.

Operations Management System (Root Cause Analysis)

[Figure 1] Reference image: Identify deficiencies and root causes



Operations Management System (Root Cause Analysis)

Specific Examples of Root Causes(Large-sized Audit Firms)

- Large-sized audit firms often have issues in the operation of quality control system; for example, spreading improvement measures to individual engagement teams.
- In efforts to improve audit quality, there are cases where the firm's management have left the efforts to audit frontline, or cases where communication between the firm's management and the audit frontline has been insufficient.
- As a result, there are such issues that the actual situation of audit frontline has not been sufficiently understood, or the improvement measures have not been sufficiently monitored.

Operations Management System (Root Cause Analysis)

Specific Examples of Root (Mid-tier audit firms)

- It is recognized that mid-tier audit firms are making efforts to improve the quality control system, however, it is also recognized that enhancement of the headquarters function is insufficient.
- There are situations where top managements' awareness of the quality control has not caught up with the firms' growth, where firms are heavily dependent on part-time staffs and non-CPA assistants in the execution of audit engagements, and where a particular regional office has an audit quality issue.
- The root causes of deficiencies are different from firm to firm due to the difference in operations management systems, size of operations, and its history.

Operations Management System (Root Cause Analysis)

Specific Examples of Root (Small and medium-sized audit firms)

- Small and medium-sized audit firms are different in size and history, and the level of quality control systems differ from firm to firm. However, all of them have relatively small organizations, and it is difficult to provide audit teams with organizational support. The level of quality control is often affected by the abilities of the CEO and other individuals and their relationship.
- In recent inspections, "the CEO's insufficient demonstration of leadership toward quality improvement" and/or "failure to accurately grasp the level of audit quality at the firm " have often been identified as root cause.
- In the event of a significant change in the business environment, such as a merger, the CEO should demonstrate full leadership to appropriately update the quality control system in line with the change.

II. Quality Control System

Implementation of Quality Control Operation

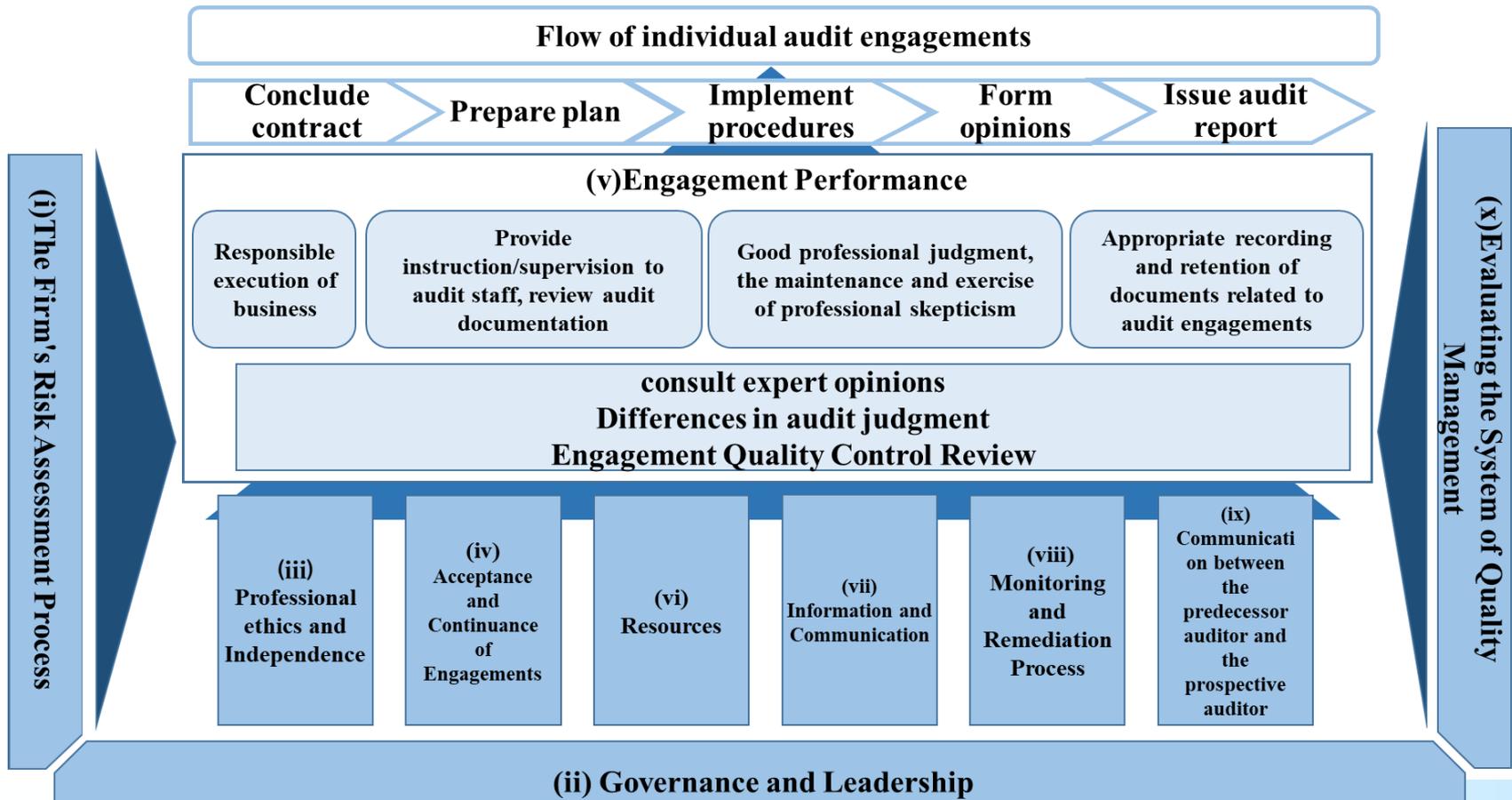
Relationship between quality control system and individual audit engagements

- Responses to requirements for QC systems under the audit standards vary from large-sized audit firms with several thousand members to relatively small-sized audit firms.
- Regardless of the size of an audit firm, the purpose of establishing and operating a quality control system is to reasonably ensure the quality of audit engagements performed by the audit firm as an organization.
- The Standard on Quality Control for Audits and Quality Control Standards Statements, etc. stipulate the quality control system required, and these have had a significant impact on the quality of individual audit engagements through the establishment and implementation of quality control system.

Implementation of Quality Control Operation

[Figure 2] Reference Image:

Relationship between Quality Control System and Individual Audit Engagements



Implementation of Quality Control Operation

Analysis of deficiencies that occurred (Large-sized audit firms)

- Deficiencies related to the design of a quality control system have seldom been identified in recent years.
- Operation-related deficiencies have been identified in areas such as reviews of audit work papers, engagement quality control reviews and periodic inspections.
- Furthermore, with regard to deficiencies in individual audit engagements that were identified by the CPAAOB inspections and quality control reviews in the past, adequate verification was not conducted as to whether improvement measures had taken hold and how effective they were. As a result, the same or similar deficiencies have been identified in other individual audit engagements. In such cases, it may be deemed that efforts to improve quality control operations are insufficient.

Implementation of Quality Control Operation

Analysis of deficiencies that occurred (Mid-tier audit firms and small and medium-sized audit firms)

- Deficiencies have been identified in a broad range of areas in terms of both the establishment and implementation of the quality control system.
- The reasons for this include: the CEO's lack of awareness and knowledge of quality control operations; insufficient understanding of the depth and methods of analyzing the causes of deficiencies; insufficient investment of management resources in the design and operation of the quality control system; and a lack of awareness of the need to verify the effectiveness of measures, believing that if they were made known through training, etc., partners would respond appropriately.
- There are also cases in which the development of quality control system functions has not kept pace with expansion in scale due to mergers or the acquisition of new audited companies.

1. Efforts to Improve Operation

[Large-sized audit firms]

(Outline of inspection results)

- In many cases, improvement measures for deficiencies are planned under the initiative of the quality control division at the headquarters, etc., and communicated to each engagement team through training and notifications, and each engagement team reviews the actual audit procedures.
- There is a tendency to build up a quality control environment not only at the headquarters but also at divisions closer to the audit frontline in order to further disseminate improvement efforts.
- the CPAAOB inspection identified that organizational improvement measures were not necessarily sufficient at different levels within the firm, including divisions and partners.
 - ✓ Cooperation between the headquarters and divisions was inadequate
 - ✓ There were lacks of organizational support from the headquarters and audit service divisions concerning the response
 - ✓ Efforts to make operational improvements had not sufficiently taken hold at divisions and regional offices where staff assignment is not flexible due

1. Efforts to Improve Operation

[Large-sized audit firms]

(Expected response)

- In order to disseminate improvement measures planned by headquarters to the entire organization and achieve sufficient effects as a response intended to improve operation, it is deemed that the entire firm, which means not only limited divisions such as the quality control division but also whole personnel including division heads etc., should understand the importance of quality control management and collaborate.
- Should establish an effective system to monitor improvement and promptly take appropriate remedial actions in case a problem related to the status of dissemination or effectiveness of improvement measures has been recognized as a result of verification.
- It is important to carry out moderated and effective measures, such as fully analyzing the tendency and causes of the identified deficiencies to specify the target areas for operational improvement and focusing on effective improvement measures that suit such target areas.

1. Efforts to Improve Operation

[Mid-tier Audit Firms and Small and Medium-sized Audit Firms] (Outline of inspection results)

- At some audit firms, initiatives to improve the deficiencies identified in the QC review were not fully implemented, and over multiple deficiencies, improvement measures were not implemented or insufficient.
- In many cases, engagement partners responsible for reviewing audit documentation, EQC reviewers, and persons in charge of periodic inspections completed their work by superficially reviewing audit documentation and filling out checklists as a matter of formality because they did not sufficiently understand the purpose of their own tasks.
- The audit firm left acquisition of knowledge related to audit to the discretion of audit team members themselves instead of proactively maintaining and improving the aptitude and capabilities of the staff. Therefore, engagement teams did not sufficiently understand the level of procedures required under audit standards such as the Auditing Standards Statement.

1. Efforts to Improve Operation

[Mid-tier Audit Firms and Small and Medium-sized Audit Firms]
(Expected response)

- It is important for CEO to take a leadership, analyze root causes of the deficiencies, and formulate effective improvement measures to resolve the causes.
- At the implementation stage of the improvement measures, it is important to make the entire organization understand correctly details of the improvement measures.
- Audit firms should not only check the individual audit engagement where the deficiency was identified, but also check whether other engagements had the same or similar situations as the identified deficiency, and fully check whether the improvement measures developed have been properly implemented. Thus, the firm must take measures to improve all audit engagements of the audit firm.

2. Establishment/Implementation of Internal Rules and Compliance with Laws, Regulations, and Professional Standards

Establishment/Implementation of Internal Rules

(Outline of inspection results)

- There are deficiencies not only in the operation of internal rules but also in designs of them.
- Causes of the deficiencies include insufficient understanding of applicable laws and regulations and standards, and the use of templates provided by the Japanese Institute of Certified Public Accountants (hereinafter referred to as the "JICPA") as they are.

(Expected response)

- Audit firms should re-examine whether their internal rules comply with laws, regulations and professional standards and are in line with the actual situation of each audit firm, and review the internal rules when necessary.
- In addition, it is necessary to establish operations management environment for appropriate design, dissemination, and operation of internal rules.

2. Establishment/Implementation of Internal Rules and Compliance with Laws, Regulations, and Professional Standards

Compliance with Laws, Regulations, and Professional Standards

(Outline of inspection results)

- In addition to deficiencies in the rules for non-competition compliance among partners, deficiencies in the rotation of key personnel in charge of audit engagements, inappropriate responses to inspections, and false statements regarding CPA qualifications were identified.
- Causes of the deficiencies include a lack of sufficient understanding of laws, regulations and standards, lack of personnel in charge of checking the status of compliance, and a lack of business flow.

(Expected response)

- An audit firm should be aware of their duties and responsibilities of certified public accountants at all times and should foster an organizational culture under which laws, regulations, and professional standards are observed. Moreover, an audit firm should establish an appropriate operations management system to ensure compliance with laws, regulations, and professional standards by identifying operations which necessitate checking the status of compliance with laws, regulations, and professional standards, and by assigning persons to be responsible for those operations.

2. Establishment/Implementation of Internal Rules and Compliance with Laws, Regulations, and Professional Standards

Information Security

(Outline of inspection results)

- The engagement team did not appropriately implement information leakage prevention measures, there were deficiencies in the operation of information security rules for part-time staff, and there were deficiencies in the confidentiality of personal information in audit documentation.
- Causes of the deficiencies include: the information security manager's insufficient understanding of the importance of information management; overreliance on professional staff's compliance with rules; and failure to implement measures to understand the operational status.

(Expected response)

- It is necessary to establish and operate appropriate information security systems that reflect the actual use of information devices at each audit firm, while fully recognizing that information leakage could have a serious impact on the operation of audit firms. In addition, it is necessary to steadily strengthen cybersecurity in line with the advancement of IT.

2. Establishment/Implementation of Internal Rules and Compliance with Laws, Regulations, and Professional Standards

Prevention of Insider Trading

(Outline of inspection results)

- Although internal rules have been implemented, operational deficiencies were identified, such as the failure to confirm the status of compliance.
- The causes of the deficiencies included not having a comprehensive understanding of the anti-insider trading measures that should be implemented by the responsible person and being convinced that the members of the office were appropriately compliant.

(Expected response)

- It is necessary to take appropriate measures, such as considering the necessity of strengthening the anti-insider trading system, while reaffirming that society in general is increasingly aware of the negative impact of insider trading on capital markets.

3. Professional Ethics and Independence

(Outline of inspection results)

- There are deficiencies such as confirmation of independence as a formality and conclusion that there is no problem easily, or failure to respond to amendments to laws and regulations related to independence.
- Causes of the deficiencies include a lack of specific procedures for implementing independence checks, the timing of implementation, and the personnel in charge of implementation.

(Expected response)

- It is necessary to establish an appropriate operations management environment by complying with the basic principles of the "Code of Ethics" published by the JICPA and applying the conceptual framework.
- When identifying, assessing and addressing threats to independence, careful consideration needs to be given to the actual situation.

4. Acceptance and continuance of audit engagements

Assessment of risks associated with the acceptance and continuance of audit engagements

(Outline of inspection results)

- The engagement team did not share information on the audit engagement risks, such as the integrity of the audited company involved, with the person authorized to approve the conclusion of the contract, so that appropriate risk assessment was not performed. The engagement team also did not sufficiently consider the audit resources needed to conclude the contract.
- The causes of the deficiencies include giving priority to concluding contracts over risk assessment and failing to implement appropriate acceptance procedures due to lack of experience in acceptance.

(Expected response)

- Audit firms should keep in mind that the acceptance and continuance of audit engagements are core management decisions at audit firms.
- With regard to procedures for engagement risk assessment, etc., audit firms need to identify engagement risks and consider measures to address them based on the integrity of the audited company and information on the audited company's risks.

4. Acceptance and continuance of audit engagements

Communication between the predecessor auditor and the prospective auditor

(Outline of inspection results)

- Deficiencies such as the failure to appropriately ask inquiries to the predecessor auditor and the failure of the predecessor auditor to correctly convey the management's views on integrity to the prospective auditor, were identified.
- Causes of the deficiencies include the priority given to early acceptance of audit engagements and the belief that the engagement team would comply with and appropriately operate rules, etc. concerning the handover of audit engagements if such rules, etc. were established.

(Expected response)

- The predecessor auditor needs to understand that it is necessary to sufficiently and clearly communicate to the prospective auditor information regarding the audit risks, etc. of the audited company that was obtained in the course of performing the audit.
- The prospective auditor needs to appropriately document information on the risks, etc. of the audited company that was obtained in the process of handover from the predecessor auditor, etc., and establish a system that enables full use of such information in the course of audit engagements.

5. Recruitment, Education and Training; Evaluation and Assignment

Recruitment, Education and Training

(Outline of inspection results)

The following deficiencies were identified:

- Recruitment was not appropriate for the audit firm as a whole because emphasis was placed on the operation of the audit division rather than the operation of the audit firm as a whole.
- Effective education and training for professional staff is not provided, and the audit firm has failed to provide education and training opportunities in areas that require expert knowledge.
- The firm tracks the number of employees who have not taken the requisite training, but does not let them take the training within the training period stipulated by the firm.
- Causes of the deficiencies include leaving the acquisition of knowledge, etc. related to audit engagements entirely to the audit frontline, not recognizing the need to confirm that required training had been received, and lack of awareness of the need to establish appropriate education and training systems as an audit firm.

5. Recruitment, Education and Training; Evaluation and Assignment

Recruitment, Education and Training

(Expected response)

- When hiring professional staff, it is necessary to appropriately estimate the number of personnel required based on factors such as the current volume of audit engagements, the likelihood of new contracts being signed in the future, and the likelihood of professional staff retiring.
- When providing education and training to professional staff, it is necessary to accurately identify audit areas in which professional staff (including part-time professional staff and unqualified professional staff) lack sufficient understanding, and formulate and implement training programs that fully take into account the knowledge, skills, and experience of each professional staff, in order to maintain and improve their skills.
- Effective measures need to be taken to steadily encourage audit firms to participate in mandatory training, such as following up on whether audit firms are appropriately participating in the mandatory training programs they have designated.
- It is important to make education and training more effective so that the content and issues conveyed in the training are fully utilized in the actual audit frontline through the review of audit documentation, etc.

5. Recruitment, Education and Training; Evaluation and Assignment

Evaluation, Compensation, and Promotion

(Outline of inspection results)

- There were deficiencies such as failure to perform evaluations based on the abilities of professional experts (especially abilities related to quality control) and the status of compliance with professional ethics.
- The background to this deficiency was the CEO's subjectivity in determining the remuneration of partners, etc.

(Expected response)

- It is necessary to establish and implement policies and procedures for evaluating the competence of professional experts (especially competence in quality control) and the status of compliance with professional ethics, while taking into account the size and personnel structure, etc.
- In addition, the results of evaluation should be appropriately reflected in compensation, promotion, and composition of engagement teams.

5. Recruitment, Education and Training; Evaluation and Assignment

Assignment

(Outline of inspection results)

There were deficiencies in the composition of engagement teams according to risk, which resulted from the following issues:

- Appropriate risk assessment suited to the actual situation of the audited company was not performed.
- An engagement partner was appointed with priority given to the audit division to which he / she belongs without giving sufficient consideration to the quality control capabilities of partners.
- The firm prioritized the acquisition of new audit engagements without giving sufficient consideration to factors such as the competence and experience of the professional staff and the competence of the audit firm as a whole in performing audit engagements.

(Expected response)

- Professional staff should be selected from among persons with expertise, practical experience, and capabilities commensurate with the audited company's business profile, scale, risks, etc. In order to ensure that these persons have sufficient time to perform audit engagements, audit firms should take measures such as monitoring workload, and strive to establish appropriate arrangements and procedures for performing audit engagements.

6. Audit Documentation

Preparation of Audit Documentation and Supervision / Review by Superiors

(Outline of inspection results)

There were many examples of deficiencies where a review by a superior failed to appropriately correct a deficient audit documentation. The causes of these deficiencies include the following:

- Excessive reliance on engagement partners conducting reviews;
- The engagement team did not sufficiently recognize the importance of the role of the audit documentation;
- Performing audit procedures is left to assistants to engagement partners.

(Expected response)

- Engagement partners should keep in mind that the review of audit documentation is an important opportunity for education and training to communicate to assistants to engagement partners the level of audit procedures to be performed for individual audit engagements as well as the ideal way to describe in the audit documentation the conclusions reached by the assistants to engagement partners and the basis for their judgments, etc. It is therefore important to sufficiently confirm whether the conclusions reached by the engagement team are supported by the audit evidence obtained, and provide guidance and supervision as necessary.

6. Audit Documentation

Final assembly of the audit file and control and retention of the audit documentation

(Outline of inspection results)

- In recent years, the number of cases where electronic audit documentation systems have been introduced has been increasing, but there are also cases where the creation date and review date included in electronic audit documentation are changed after the fact.
- Causes of the deficiencies included a lack of awareness of the importance of audit documentation and its management.

(Expected response)

- Set appropriate quality objectives for the preservation and maintenance of audit documentation, taking into account such factors as the safe custody, integrity, accessibility or recoverability of the underlying data, and controls over related technology;
- The final assembly of the audit file shall be completed within an appropriate period after the date of the auditor's report, and all possible measures shall be taken to prevent the loss of audit documentation and the leakage of confidential information.

7. Engagement Quality Control Review

(Outline of inspection results)

There were deficiencies in the qualifications of the EQC reviewers, as well as in the failure of the EQC reviewers to conduct objective reviews and detect significant deficiencies in audit procedures. The causes of these deficiencies include the following:

- A qualified EQC reviewer has not been appointed due to reasons such as restrictions on the personnel composition of the audit firm;
- The EQC reviewer does not spend enough time for the review;
- The audit firm did not recognize the need to establish an adequate EQCR environment.
- There was a lack of awareness of performing critical examination of the engagement team's views.

7. Engagement Quality Control Review

(Expected response)

- When reviewing the audit plan, the EQC reviewer needs to review, from an objective perspective, the risk assessment performed by the engagement team and the planned audit procedures to address the risk, in light of the business risks of the audited company.
- Engagement teams should not only discuss significant matters for forming an audit opinion with engagement partners, but also review audit documentation to determine whether the conclusions of the engagement team are supported by sufficient appropriate audit evidence.
- Audit firms are required to take actions to enhance and strengthen their EQC reviews, while reaffirming the importance of EQC reviews of audit engagements.

8. Monitoring the Firm's System of Quality Control Policies and Procedures

(Outline of inspection results)

The following deficiencies were identified:

- Persons in charge of implementation of daily monitoring and periodic inspection (including external persons in charge of implementation) performed these activities merely as a formality using checklists, etc., and the PICOQC did not give instructions to persons in charge of implementation before inspection or did not conduct monitoring after inspection.
- During periodic inspections, engagement partners only received explanations from the engagement team and did not review audit documentation.
- This was because the audit firm did not fully understand the importance of monitoring the quality control system and did not devote sufficient time or personnel to the inspection.

8. Monitoring the Firm's System of Quality Control Policies and Procedures

(Expected response)

- Audit firms are required to establish and operate a system in which they can fully perform their primary function of monitoring the quality control system. Specifically, they are required to identify and understand problems related to the quality control system on their own and voluntarily take corrective measures.
- Even if a CPA outside the audit firm is appointed as the person in charge of conducting periodic inspections, it should be noted that, in the same way as when persons from within the audit firm are appointed, it is necessary to confirm whether the primary monitoring function is being fully exercised.
- It is necessary to establish a system of internal and external reporting, and to develop and operate a system in which complaints and doubts are identified in a timely manner and appropriate investigations are conducted as necessary.

9. Cooperation with Company Auditors

(Outline of inspection results)

The following deficiencies were identified:

- As a result of a lack of understanding of matters that should be communicated with company auditors, the content of communication was not comprehensive. Some audit firms received quality control review results notifications from the JICPA but did not communicate the results of the quality control reviews to company auditors.

9. Cooperation with Company Auditors

(Expected response)

- The importance of collaboration between accounting auditors and company auditors has recently been reemphasized in response to the occurrence of cases of fraudulent financial reporting by companies. The audit standards stipulate that "auditors must ensure appropriate collaboration, such as consulting with company auditors at each stage of the audit."
- Audit firms need to establish systems to support engagement teams so that engagement teams can appropriately engage in effective two way communication with company auditors, etc.
- It should also be noted that when an auditor discovers a violation of laws and regulations, etc., the auditor is obliged to notify company auditors, etc. of the details of the fact in accordance with Article 193, Paragraph 3 of the Financial Instruments and Exchange Act.

III. Individual Audit Engagements

Summary

Examples of deficiencies in individual audit engagements are identified when there are deficiencies in some way in the matters required under audit standards. They are identified from a wide range of areas, from audit planning to the formation of an audit opinion.

There are various causes of deficiencies, but the following causes are relatively common in recent inspections.

- Inadequate consideration of the appropriateness of procedures to respond to audit risks and the sufficiency and appropriateness of audit evidence
- Lack of professional skepticism as an auditor
- Lack of understanding of the level of procedures required by current auditing standards

Unless the assertions of the engagement team are objectively proven by the audit documentation, the engagement team should be treated in the same manner as if audit procedures had not been performed.

1. The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements

(Outline of inspection results)

The following deficiencies were identified:

- Whether unusual or unexpected relationships identified through audit procedures could indicate risks of material misstatement due to fraud (hereinafter referred to as "fraud risks") has not been sufficiently examined;
- Only the portion of revenue recognition that is considered to be particularly risky is identified as fraud risk, and other portions are deemed to be free from fraud risk without sufficient consideration.
- Fraud risks have been identified for revenue recognition items, but procedures for responding to risks have not been sufficient.
- Audit procedures for risks related to management override remain perfunctory.
- The engagement team identified significant or unusual transactions with related parties that were outside the normal course of business but were not carefully considered for potential fraud.

1. The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements

(Expected response)

- Professional skepticism needs to be maintained throughout the audit process and exercised when considering fraud risks.
- When developing the audit plan, obtain information to identify fraud risks, and through discussions within the engagement team, carefully examine whether such information indicates the existence of fraud risk factors.
- When identifying and assessing fraud risks relating to revenue recognition, the engagement team should not easily limit the areas where fraud risks are assumed to exist, but should fully consider where and how material misstatements due to fraud may occur in the financial statements, based on the engagement team's understanding of the audited company and its business processes.
- Audit evidence that is more relevant, reliable or voluminous than assertions that do not identify fraud risks must be obtained when performing fraud risk procedures.

2. Risk Assessment and Response to Assessed Risks

(Outline of inspection results)

The following deficiencies were identified:

- The engagement team did not assess the audited company's accounting policies.
- Internal controls for important business processes were not understood or assessed.
- The engagement team did not appropriately consider revising the audit plan in cases where the business environment or performance of the audited company deteriorated during the term.
- The engagement team did not examine the appropriateness of assessed risks and procedures to address those risks.
- Substantive procedures were not performed despite the risks of material misstatement having been identified;
- Information systems and general IT controls are not sufficiently understood.
- The appropriateness of the presentation and the notes to the financial statements was not sufficiently examined.

2. Risk Assessment and Response to Assessed Risks

(Expected response)

- Professional staff shall exercise due care and professional skepticism as professional experts, fully understand the audited company and its environment, and assess risks based on such understanding, and shall carefully identify and assess risks by referring to this Case Report and the Audit Recommendations issued by the JICPA.
- When designing procedures to respond to audit risks, examine not only the types of procedures but also the timing and scope of procedures to determine whether sufficient time is allowed to obtain sufficient appropriate audit evidence in response to the assessed risks.
- Respond to revisions in Auditing Standards Report 315 and assess inherent risk taking appropriate account of inherent risk factors (such as complexity, subjectivity, change and uncertainty).

3. Audit Evidence

(Outline of inspection results)

As in previous years, a number of deficiencies have been identified, including the following:

- The engagement team identified significant risks but did not perform substantive procedures to address those risks individually.
- The engagement team identified inconsistencies and irregularities with other audit evidence, but did not consider the need for additional audit procedures;
- In substantive analytical procedures, the reliability of data used and the accuracy of estimates were not examined.
- The engagement team did not consider whether a sufficient number of samples had been selected for audit sampling.
- In testing specific items, the engagement team did not consider the necessity of substantive procedures for the remainder of the population.
- The reliability of information prepared by the audited company was not assessed.

3. Audit Evidence

(Expected response)

- Most of the examples of identified deficiencies related to audit evidence were caused by a failure to appropriately perform risk assessment and design procedures to respond to audit risks as a precondition for audit evidence, as well as a lack of in-depth understanding of the audited company's business.
- There were also many cases where the audit procedures planned in the audit plan diverged from the actual audit procedures.
- The engagement team needs to obtain sufficient appropriate audit evidence to address the identified risks. In particular, the engagement team shall bear in mind that it must perform substantive procedures to address significant risks on a case-by-case basis.
- Engagement teams are required to sufficiently discuss risk assessment and audit procedures to be performed throughout the audit period, and to confirm the sufficiency and appropriateness of the obtained audit evidence through reviews.

4. Auditing Accounting Estimates

(Outline of inspection results)

A number of deficiencies were identified in a wide range of auditing accounting estimates, including:

- Due to a lack of understanding of the requirements under Auditing Standards Report No. 540, the engagement team did not appropriately perform risk assessment procedures, such as examining the finalized amounts of accounting estimates for past fiscal years and understanding management's estimation methods.
- The engagement team did not sufficiently understand the requirements of Auditing Standards Report 540 and did not sufficiently exercise professional skepticism. As a result, the engagement team only made qualitative assessments by asking management questions about the business environment. The engagement team also did not sufficiently perform procedures to examine the appropriateness of the estimation methods, significant assumptions and data used by management in making accounting estimates, such as the feasibility of the business plan used in making accounting estimates.

4. Auditing Accounting Estimates

(Expected response)

- It should be noted that these have been significantly enhanced following the revision of Auditing Standards Report 540.
- An engagement team needs to assess inherent risk factors (such as the uncertainty, complexity and subjectivity of estimates and other inherent risk factors) after sufficiently understanding the audited company and its environment, the applicable financial reporting framework and the audited company's internal control system, and after examining the amounts of finalized accounting estimates for the past fiscal years.
- Auditors should also note that in performing audit procedures for accounting estimates, auditors may examine how management made accounting estimates. Auditors should exercise professional skepticism and perform a critical review, considering all relevant audit evidence obtained, noting any indication of management bias against each of the estimation methods and significant assumptions and data used by management.
- It is necessary to fully examine the footnotes to the accounting estimates.

5. Group Audit

(Outline of inspection results)

The following deficiencies were identified:

- Uses the results of component auditors' audits with too much confidence and without adequate assessment;
- The group engagement team did not perform sufficient risk assessment, such as not considering the possibility that significant risks might be included in component financial statements.
- Inadequate communication with component auditors, such as failure to communicate clearly the audit procedures that component auditors should perform;
- Does not review the consolidation process or consolidated journal entries;

5. Group Audit

(Outline of inspection results)

The following deficiencies were identified:

- The group engagement team used the results of component auditors' audits with too much reliance and without adequate assessment.
- The group engagement team did not perform sufficient risk assessment, such as not considering the possibility that significant risks might exist in component financial statements.
- Inadequate communication with component auditors, such as failure to communicate clearly the audit procedures that component auditors should perform.
- The group engagement team did not review the consolidation process or consolidated journal entries.

5. Group Audit

(Expected response)

- Evaluate the work of component auditors, always bearing in mind that the responsibility for issuing an appropriate auditor's report lies with the group engagement team; and
- Communicate sufficiently with the component auditor regarding the nature, timing and extent of audit procedures performed on the component's financial information and any findings to obtain sufficient appropriate audit evidence regarding the component's financial information and the consolidation process;
- In order to appropriately conduct group audits, audit firms are required to satisfy ancillary abilities, etc. that vary depending on the situation, such as language skills and knowledge of accounting systems relating to specific countries. Audit firms need to pay attention to the assignment of the group engagement team members and develop a system to support engagement teams.
- Respond to the Auditing Standards Statement 600(Revised)

6. Using the work of Auditor's expert

(Expected response)

- Engagement teams are required to assess the work of experts they use, always bearing in mind that they are solely responsible for the audit opinion expressed, and that their responsibility is not lessened by the use of the work of experts.
- Auditors are required to determine the need for the use of experts, to evaluate their competence, competence and objectivity, and to evaluate whether their work is appropriate for the audit objectives.
- The engagement team needs to obtain sufficient appropriate audit evidence suited to the audit objectives by sufficiently discussing with the experts the purpose and scope of the services to be used, instead of leaving everything to the experts.

7. Audit of Internal Control over Financial Reporting

(Outline of inspection results)

The following deficiencies were identified:

- The engagement team used the results of the assessment of internal controls of the audited company without examining the appropriateness of the scope of the assessment of internal controls, the competence and independence of the internal auditors, etc., the appropriateness of samples, the appropriateness of assessment methods, etc.
- Amid changes in the environment at an audited company, such as the commencement of new business, responses in the audit of internal controls remained perfunctory.
- When using the work of internal auditors, the engagement team did not consider the need to expand the scope of work performed by the auditor itself despite the fact that the process was related to significant risks.
- The engagement team did not consider whether deficiencies identified in the course of the financial statement audit constituted material deficiencies that should be disclosed.
- Audit evidence specifically indicating the status of remediation of deficiencies was not obtained.

7. Audit of Internal Control over Financial Reporting

(Expected response)

- From the perspective of effective and efficient auditing, auditors are required to conduct financial statement audits and internal control audits in an integrated manner.
- On the other hand, it should also be kept in mind that auditors are required to perform a leadership function in constructing internal controls that take into account the characteristics of audited companies, such as their size and organizational structure.
- Audit procedures should not be performed uniformly or merely as a formality, but the timing, scope, and appropriateness of audit procedures should be reconsidered.
- In particular, the engagement team should carefully evaluate whether sufficient appropriate audit evidence has been obtained for high-risk areas, such as processes newly included in the assessment or processes related to significant risks.
- Respond to the revision of Auditing Standards Report No. 1 for Internal Control over Financial Reporting.

8. Key Audit Matters (KAM)

(Outline of inspection results)

The following deficiencies were identified:

- Incorrect reference to the notes in the financial statements included in KAM.
- Some of the audit responses described in KAM were not performed.

8. Key Audit Matters (KAM)

(Expected response)

- It is required that the auditor fully understand the purpose of KAM and take appropriate actions to prevent KAM from becoming boilerplate or a dead letter.
- Active communication with the management and company auditors of the audited company is required when determining KAM.
- It should be noted that the "Description of and reason for determination of KAM" included in the audit report should be directly linked to the specific circumstances of the company by identifying the areas and amounts subject to KAM.
- The "audit response" included in the audit report is required to describe the procedures, etc. that conform to the factors described in the reason for determination of KAM, as specifically as possible.