

I. Overview of the Audit Sector

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A. CPAs

1. Introduction of the CPA system

A certified public accountant system was introduced in Japan in 1948. The Securities and Exchange Act was promulgated in 1947, requiring companies that issue or solicit investment in shares, corporate bonds or other securities to submit reports. The issuer of listed securities is required to obtain audit attestation from certified public accountants (CPAs) by the full overhaul of the 1948 Securities and Exchange Act (now the Financial Instruments and Exchange Act (FIEA)) as well as the promulgation/enforcement of the Certified Public Accountants Act (CPA Act).

Accordingly, the Certified Public Accountants Management Committee was established to conduct CPA examinations, etc. (becoming the CPA Examination and Investigation Board in 1952 after a transfer of jurisdiction, and expanded/restructured into the current Certified Public Accountants and Auditing Oversight Board in 2004). The Corporate Accounting Principles were released in 1949, and the Audit Standards in 1950.

The present CPA Act clearly sets out the mission and professional responsibilities of CPAs as given below. CPAs must always be self-aware of this mission and these professional responsibilities in performing their duties regardless of audit attestation services or non-audit services.

“The mission of certified public accountants, as professionals on auditing and accounting, shall be to ensure matters such as the fair business activities of companies, etc., and the protection of investors and creditors by ensuring the reliability of financial documents and any other information concerning finance from an independent standpoint, thereby contributing to the sound development of the national economy” (Article 1).

“A certified public accountant shall always maintain his/her dignity, endeavor to acquire knowledge and skills, and provide services with fairness and integrity from an independent standpoint” (Article 1-2).

2. CPAs

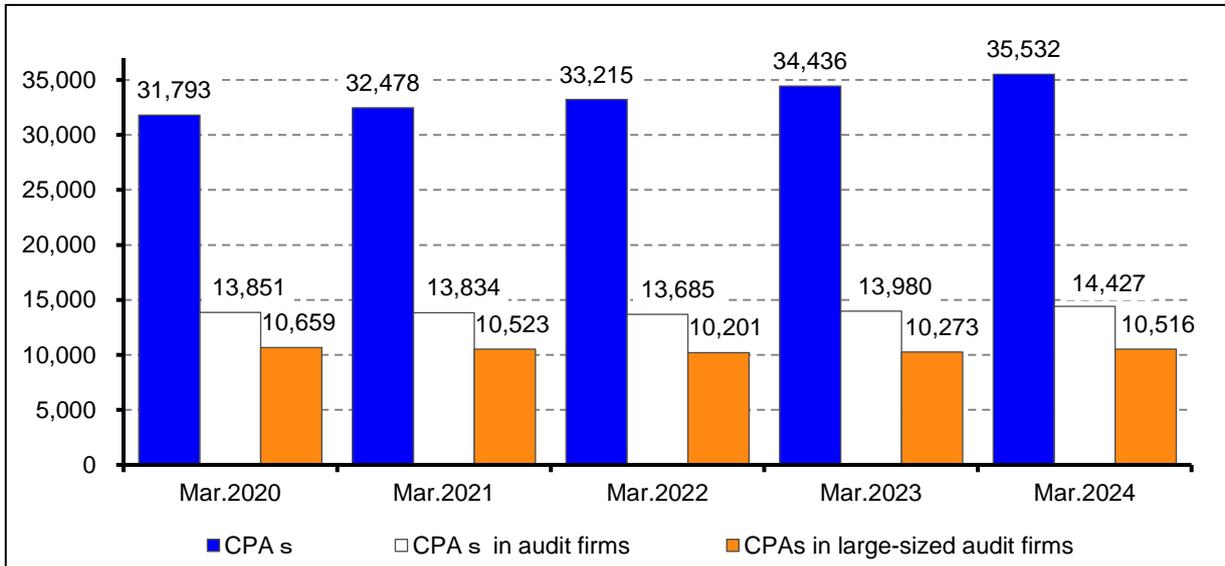
To become a certified public accountant, a person must pass the certified public accountant examination, satisfy certain requirements (business assistance, professional accountancy education program, etc.), and be registered on the roster maintained by the Japanese Institute of Certified Public Accountants (Articles 3, 17, and 18 of the CPA Act).

The number of registered CPAs has been gradually increasing over the past few years. However, but the number of CPAs working at audit firms has not increased as much as the number of registered CPAs. The ratio of the number of CPAs working at audit firms to the total number of registered CPAs has been declining year by year, and continued to decline from 43.6% at the end of March 2020 to 40.6% at the end of March 2024. Of the registered CPAs belonging to audit firms, around 70% at large-sized audit firms (Figure I-1-1).

CPAs must be members of the JICPA (Article 46-2 of the CPA Act) and must belong to a regional chapter, i.e., one of the JICPA branches established across Japan (16 regional chapters as of March

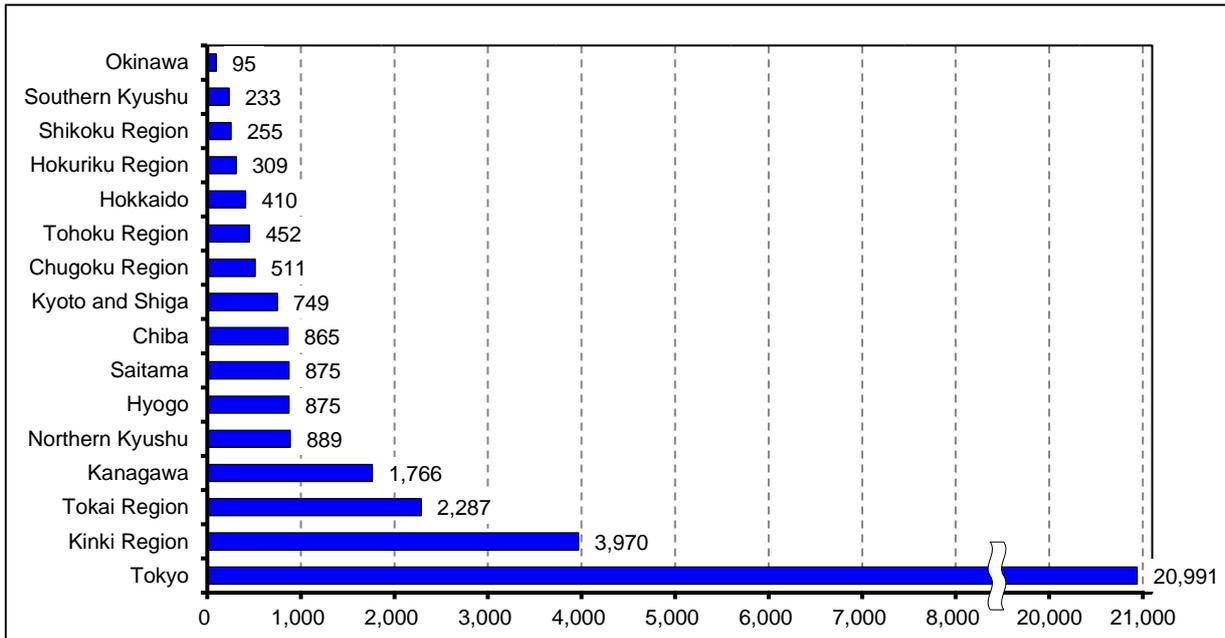
31, 2024). Around 70% of CPAs are based in the Tokyo metropolitan area (Tokyo, Kanagawa, Saitama, Chiba) (Figure I-1-2).

Figure I-1-1. Number of registered CPAs (unit: persons)



(Source) Prepared by the CPAAOB based on data from the JICPA

Figure I-1-2: Number of CPAs by regional chapter (March 31, 2024; unit: persons)



(Source) Prepared by the CPAAOB based on data (e.g. survey of numbers of members) from the JICPA

■ Initiatives to Improve the Attractiveness of Audit Services ■

The number of registered CPAs increased from 24,964 at the end of March 2013 to 34,436 at the end of March 2023 (37.9% increase). On the other hand, the number of personnel working at audit firms has not increased as much as the number of registered personnel, from 12,799 at the end of March 2013 to 13,980 at the end of March 2023 (9.2% increase). With the growing needs for audits in terms of both quality and quantity, there are concerns about a shortage of personnel in charge of audits. Improving the attractiveness of audit services and securing audit professionals are not issues unique to Japan and many countries are taking action. The International Federation of Accountants (IFAC) reported that more than 300,000 accountants in the United States, representing 17% of registered accountants, left their jobs between 2020 and 2022, and that the number of students applying to become an accountant has fallen by 2.6 million over the past decade.

As a background to this situation, IFAC states that the factors that caused personnel difficulties for small and medium-sized audit firms are now affecting the audit industry as a whole; specifically, (I) declining the number of applicants, (ii) increasing the opportunities for employment in other fields, and (iii) concerns about achieving work-life balance and flexible working styles. The Association of Chartered Certified Accountants in the United Kingdom (ACCA) has cited three reasons why young accountants do not want to audit services: (i) dissatisfaction with pay, (ii) lack of flexibility in working styles such as remote work, (iii) exhaustion from working long hours, and (iv) concern about being replaced by technology. In Japan as well, the increase in mechanical and monotonous work, long working hours, and inability to realize the results of one's own work are reported as reasons why accountants do not find audit attractive.

By classifying the above factors into (I) decline in motivation and incentive to engage in audit services or to belong to audit firms, (ii) increase in workload due to the refinement of audit standards and manuals, and (iii) increase in opportunities for employment in other fields, we would like to introduce the efforts of audit firms to increase the attractiveness of engaging in audit services and to secure personnel engaging audit services.

(I) Initiatives to address declining motivation and incentive to engage in audit services or to belong to audit firms

- Flexible timing of promotion, including earlier promotion for capable staff and promotions that take into account the preference for work-life balance;
- Career diversification (creating the promotion paths allow for the acquisition of expertise in addition to the promotion path from staff to partners);
- Providing work opportunities for non-audit work, such as tax and advisory services, as well as expanding opportunities for short-term secondments to external organizations and interdepartmental transfers;
- Enhancing communication within small groups and mentoring programs, as well as developing the sense of commitment by increasing opportunities for bottom-up proposals and awards, etc.

(II) Efforts to address workloads associated with the refinement of audit standards and manuals

- Creation of a function to centrally manage and equalize assignments handled by each partner/staff
- Greater flexibility in working locations and hours through remote work and flexible working hours
- Strengthening overtime management and restricting network access at night and on holidays
- Improving efficiency by introducing IT system and transferring operations to a service delivery center (an organization established to perform non-judgemental tasks such as sending and collecting balance confirmation letters)

In particular, large-sized audit firms are actively introducing IT system and transferring operations to service delivery centers, with the aim of reducing working hours and allowing audit staff to focus on tasks requiring high-level judgment.

(III) Initiatives to respond to the increase in employment opportunities in other fields

In recent years, the fields in which CPAs play an active role have expanded, and there are a growing number of careers in which CPAs can make a tangible contributions to organizations and society, such as accounting managers of business companies, CFOs of start-ups, consulting firms, and NPOs.

Under these circumstances, the message that "audit is a social infrastructure that ensures the fairness of capital markets," which has been a source of attraction for audit services, has become relatively less convincing, and audit firms have yet to find effective measures to address this situation. Furthermore, audit firms' compensation tends to be less favorable than that of business companies and consulting firms. It is not easy for audit firms to increase audit fees, which are the source of their salaries, and therefore they have not found effective measures to increase the economic attractiveness of audit services.

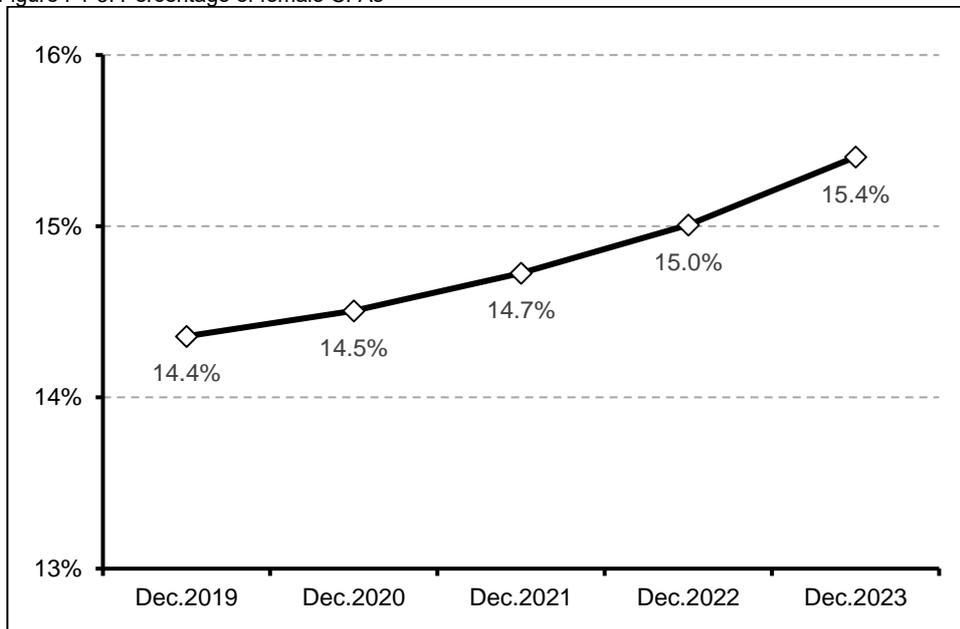
Some firms have attempted to promote the attractiveness of auditing by hiring people who want to take the CPA exam and giving them the opportunity to experience audit practice at an early stage. However, given that most CPA candidates find employment after passing the essay exam, these efforts remain on a small scale.

Some large-sized audit firms are planning to expand the scope of audit and assurance beyond financial information to include third-party evaluation of information security, AI assurance, and evaluation of governance effectiveness. Providing CPAs with a wide range of assurance opportunities that are not limited to the adequacy of financial statements may be a way to increase the attractiveness of the audit profession compared to other types of careers.

3. Percentage of Female CPAs

The percentage of women among the total number of registered CPAs is gradually increasing (Figure I-1-3), and at the end of 2023 the figure reached 15.4%, which is the same as the level for female tax accountants¹. On the other hand, it is still lower than the percentages of female attorneys and female CPAs in the UK².

Figure I-1-3: Percentage of female CPAs



(Source) Prepared by the CPAAOB based on data from the JICPA

¹ According to "2023 Survey on Women's Participation in Policy and Decision-making Processes" by the Cabinet Office's Gender Equality Bureau, the percentage of female tax accountants was 15.6% at the end of March, 2023, and the percentage of female attorneys was 19.9% at the end of September, 2023.

² The percentage of female CPAs in the U.K. is as follows:

UK: According to the Financial Reporting Council's "Key Facts and Trends in the Accountancy Profession 2023," there are several CPA institutes in the UK, and the average female membership for them is 38%.

■ Efforts to ensure empowerment of female CPAs ■

The Japanese Institute of Certified Public Accountants (JICPA) intends to increase the share of successful female examinees to 30% by 2030 and the share of female members and semi-members to 30% by 2048. And it is promoting arrangements to further empower female CPAs, such as the use of maiden names, support for employment and return to work, exemption or relief from continuing professional development (CPD) and membership fees during absence from work for childbirth, childrearing and other reasons. There are some large-sized audit firms that are setting KPIs such as the share of female executives, nurturing female executives and providing support for female CPAs at each life stage, holding training sessions and seminars to develop an organizational culture to accept diverse working styles, and offering support for creating networks.

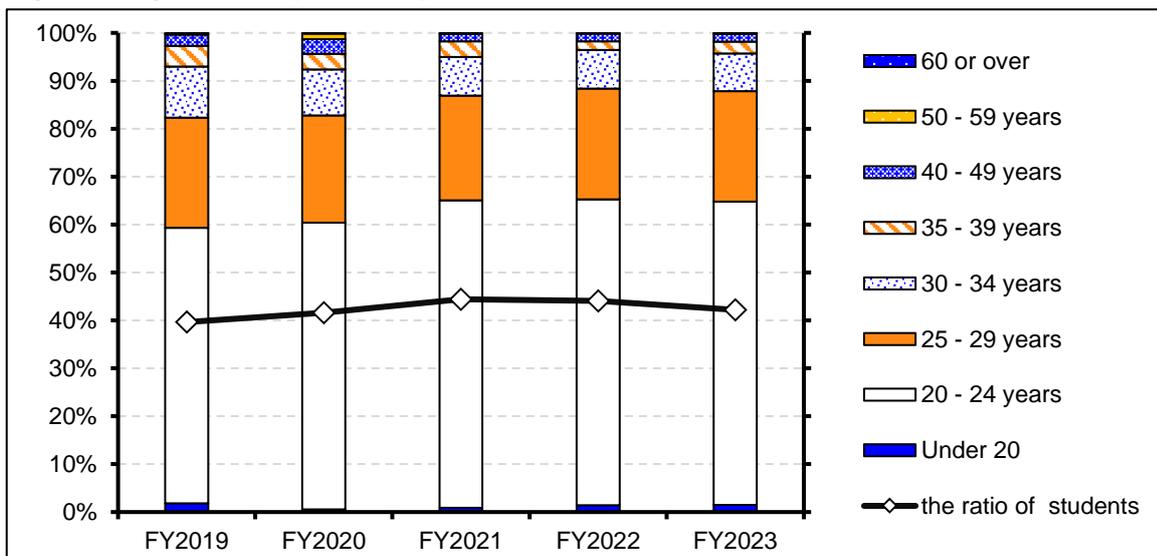
Furthermore, large-sized audit firms are working to promote DEI (Diversity, Equity & Inclusion) and are promoting initiatives that enable each staff member to maximize performance regardless of gender identity, sexual orientation, etc. The report on audit quality lists major initiatives such as the development of guidelines and norms, awareness-raising through group activities within the firm, and participation in external events.

To encourage more females to take the CPA examination, the CPAAOB disseminates female CPAs' messages about the attractiveness and worthiness of their work and career plans through lectures at high schools and universities and the pamphlet of the CPA examination. In 2023, 22.3% of all successful examinees were women. The ratio of successful female examinees was 6.37%, while 8.05% for male examinees. Although these ratios of successful female examinees decreased compared to the previous year, the number of successful female examinees increased. Females submitting applications for the examination and passing it has been showing an upward trend in recent years.

4. Age Structure of Persons who Passed the CPA exam

Breaking down the age structure of persons who passed the CPA examinations, we see that the largest age group is 20-24 years. People in this group accounted for 71.8% of those who passed it in 2023. As for occupation, the ratio of students (excluding persons enrolled in courses at vocational schools etc.) is the highest. Among them, the proportion enrolled in universities (including junior colleges) was 42.2% in the 2023 examinations (Figure I-1-4).

Figure I-1-4: Age structure of persons who passed the CPA exam



(Source) Prepared by the CPAAOB based on data from the CPAAOB survey of persons who passed the CPA exam

B. Audit Firms

Audit firms, i.e., CPA firms engaged in providing audit and attestation services, numbered 2,382 at the end of March 2023, but they vary by service and business format.

Audit and attestation services cover both statutory audits and non-statutory audits. Statutory audits are CPA audits required by the law. When CPA audits were first introduced, the only statutory audits were FIEA audits, but thereafter CPA audits under the Companies Act were introduced, and then educational corporation audits under the Act on Subsidies for Private Schools. There are now a multitude of statutory audits, including audits of labor unions, credit unions, credit associations, agricultural cooperatives, social welfare corporations and medical corporations, etc. Further explanation of audit and attestation services is provided on [C. Audited Companies, 1. Types of Audit and Attestation Services](#).

There are three types of entities providing audit and attestation services: audit firms, partnerships, and solo practitioners. Audit firms are established pursuant to the CPA Act for the purpose of organizationally performing audit and attestation services. When the audit firm system was forged in 1966, the tasks involved in audit and attestation services had increased in volume and complexity as corporations subsequently grew larger in scale and management became more multifaceted. Additionally, numerous incidents of fraudulent accounting were occurring at the time, bringing into question the raison d'être of CPAs. The system of audit firms was therefore introduced to improve audit quality for promoting the conduct of organizational audits.

The CPAAOB classifies audit firms by scale into large-sized audit firms, mid-tier audit firms, and small and medium-sized audit firms. The firms were classified as shown below based on their size and the audit services they provide (Figure I-2-1), and the CPAAOB mainly monitors those audit firms conducting FIEA audits of domestic listed companies (except for foreign companies, the same hereafter).

Figure I-2-1: Classifications of audit firms (as of March 31, 2023)

| Audit firm | Number of firms | Statutory audits | | | Non-statutory audits |
|------------------------------------|------------------------------------|----------------------|----------------------|-------|----------------------|
| | | FIEA audits (Note 4) | Companies Act audits | Other | |
| Large-sized audit firms | 4 | ○ | ○ | ○ | ○ |
| Mid-tier audit firms | 5 (Note 2) | ○ | ○ | ○ | ○ |
| Small and medium-sized audit firms | 2,373 | ○ (Note 5) | ○ | ○ | ○ |
| (Breakdown) | Small and medium-sized audit firms | (271) | | | |
| | Partnerships (Note 1) | (51) | | | |
| | Solo practitioners (Note 1) | (2,051) | | | |

(Note 1) The number of audit offices in fiscal 2022 (book closing date from April 1, 2022, till March 31, 2023) listed in copies of audit summaries or audit implementation reports submitted to the JIPCA.

(Note 2) As of December 1, 2023, PricewaterhouseCoopers Kyoto (PwC Kyoto), a mid-tier audit firm, merged with PricewaterhouseCoopers Arata LLC (PwC Arata), a large-sized audit firm. The above figures represent the number of audit firms before the merger.

(Note 3) The symbol "○" in the table above means that audits concerned can be conducted.

(Note 4) Registration as a registered auditor of listed companies etc. is required to audit listed companies. For information on the registration system for listed company auditors, see "[IV. Responses to Changes in the Global Environment Surrounding Audits, 1. Trends Surrounding Small and Medium-sized Audit Firms!](#)".

(Note 5) For solo practitioners to provide audit and attestation services to listed companies, they are required by law and each exchange's securities listing regulations to provide them jointly with other CPAs, etc.

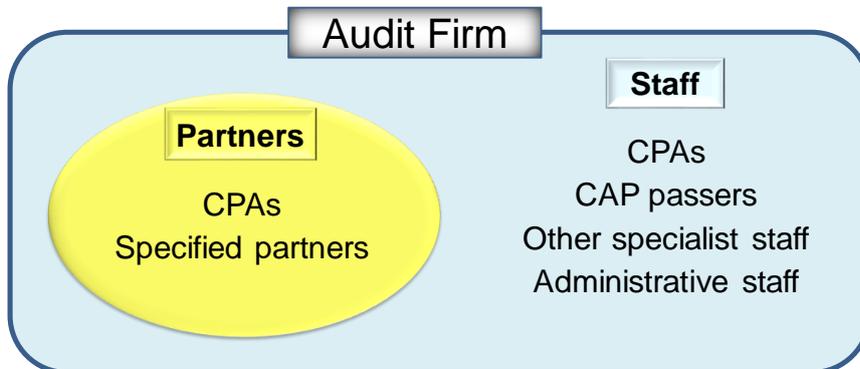
1. Organizational Structure of Audit Firms

Audit firms are established through investment by persons including five or more CPAs, and their defining characteristics are that the persons who invested (partners) are directly engaged in management and that they ensure organizational discipline via mutual monitoring. Some audit firms comprise only partners, but those of a certain scale ordinarily employ CPAs (CPAs who have not invested in order to become partners of the audit firm), CPA examination passers (persons who have passed the CPA exam but have not been registered as CPAs after undergoing practical training and providing assistance with audit work), and other experts as staff.

In the past, partners of audit firms were limited to CPAs, but in today's more sophisticated economy and society, partners are required to have a wide range of knowledge and experience including management, law, IT, pension mathematics to ensure appropriate operational management of the audit firm and to provide effective organizational audit services. Accordingly, as a result of legal revisions in 2007, a "specified partner system" allowed non-CPAs to be partners at an audit firm. However, CPAs must comprise at least 75% of the audit firm's partners if specified partners join the firm. In FY2023 large-sized audit firms had 145 specified partners among a total of 1,845 partners.

The personnel composition of an audit firm is outlined below (Figure I-2-2), and explained in more details in "[III. Operation of Audit Firms, A. Operations Management System, 3. Human Resources of Audit Firms](#)".

Figure I-2-2: Personnel composition at audit firms



(Source) Prepared by the CPAAOB with reference to page 55 of "New CPA/Audit firm Audit System - Ensuring Fair Financial/Capital Markets" (Dai-Ichi Hoki Co., Ltd., 2009), Yuichi Ikeda and Hidenori Mitsui, ed.

| | Large-sized audit firm | Mid-tier audit firm | Small and medium-sized audit firm |
|-----------------|-----------------------------------|------------------------------|-----------------------------------|
| Partners | Approx. 190 up to approx. 580 | Approx. 40 up to 90(Note2) | Up to approx. 40(Note3) |
| Full-time staff | Approx. 2,800 up to approx. 7,300 | Approx. 200 up to 900(Note2) | Up to approx. 100(Note3) |

(Note1) See "Figure III-1-3: Characteristics of each type of audit firm" (page 61) for Characteristics of organizational structure based on audit firm size.

(Note2) The number of partners and full-time staff is calculated based on the business report of PricewaterhouseCoopers Japan LLC³ (PwC Japan) before its establishment, and does not take into account the impact of the merger of PwC Aarata and PwC Kyoto.

(Note3) The fiscal years of small and medium-sized audit firms cover a wide range of months, and the figures for FY2023 have not yet been compiled. For this reason, small and medium-sized audit firms are included up to FY2022. Excluding an audit firm whose number of partners and full-time staff members is much higher than others.

³ Limited Liability Audit Corporations (LLC): An audit firm in which the individual partners assume unlimited joint and several liability only with respect to the audit attestation (specified attestation), in which the partners are involved as designated limited liability partners, and other operations are the responsibility of the partners to the extent of their capital contributions

In response to the increasing complexity and internationalization of corporate activities at domestic listed companies, especially major ones, audit firms grow bigger. The large-sized audit firms responsible for the majority of audits of major listed companies have workforces exceeding several thousand people; even mid-tier audit firms now have more than 200 people.

As audit firms grow in scale, they necessitate introducing job classification system defined by abilities, experience, etc. for effective management of organization. (Figure I-2-3). It is standard practice for personnel to move up the ranks from staff and senior staff to manager, senior manager and, if selected, to partner. In recent years, some large-sized audit firms hire a larger number of audit assistants (staff without qualifications relating to financial statement audits, such as a qualification of CPA) to reduce the workload of CPAs and enable them to concentrate on duties requiring professional judgment.

The expanding size of audit firms and the increasing complexity of their organizational administration has made the difficulty of ensuring audit quality even more apparent. In response to this situation, Principles for Effective Management of Audit Firms (the Audit Firm Governance Code) were formulated in March 2017, and are now being adopted, particularly by large-sized audit firms and mid-tier audit firms. As for the situation of amendments of Audit Firm Governance Code, refer to [III. Operation of Audit Firms A. Operations Management System 2. Efforts in Response to Audit Firm Governance Code](#).

Figure I-2-3: Professional hierarchy in a large-sized audit firm

| | Staff | Senior Staff | Manager | Senior Manager | Partner |
|------------------|---|--------------|---|----------------|--|
| Roles | Personnel who perform audit practice, under the guidance and supervision of superiors and seniors who may, depending on their experience, supervise engagement teams performing audits of SMEs (Small and Medium-sized Enterprises) | | Personnel who oversee audit teams | | Personnel who oversee all audit engagements and are involved in the management of the firm |
| Skills required | Specialist knowledge on audit practices, accounting and audits | | Management skills in staff mentoring and coordination with audited companies, as well as problem solving skills | | High level of skill as a audit supervisor |
| Primary training | Annual accounting audits training, Fraud prevention training, Global training, etc. | | | | |
| | Audit procedure training, etc. | | Management training, specialty-specific training, etc. | | |

(Note) For details, see "[III. Operation of Audit Firms A. Operations Management System, 4. Organizational Structure for Providing Audit Services](#)" and "[5. Organizational Structure for Supporting Audit Services](#)".

2. Development of Quality Control Structures and Responses by Audit Firms

To ensure audit quality, it is important that audit firms develop/administer appropriate quality control structures to serve as a foundation for having their partners perform audit services properly.

Furthermore, the "Standard on Quality Control for Audits" were formulated for audit and attestation services in 2005, but the services requiring development of quality control as part of firm's operation control structure are not limited to audit and attestation services but encompass all of audit firm's

operations. Consequently, audit firms need to comply with professional ethics in their services other than audit and attestation services as well.

In association with the "Quality Control Standards for Audits," the International Standard on Quality Management (ISQM) 1 (ISQM1: Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements), which is an international quality management standard, and other standards were newly established or revised. Accordingly, the Audit Standard Committee of the Business Accounting Council commenced deliberations in February 2021, and a written opinion on the revision of the Quality Control Standards for Audits was compiled at the general meeting of the Council in November 2021. The revised Quality Control Standards for Audits (hereinafter referred to as the "Revised Standards") require individual audit firms to introduce a quality control system based on a risk-based approach, under which they should

- a. set their own quality objectives,
- b. distinguish quality risks that hinder the achievement of such quality goals and assess them one by one,
- c. determine policies or procedures for dealing with those assessed quality risks and implement them, and
- d. make improvements based on the root cause analysis of defects, if any.

Additionally, the Revised Standards state that the quality control system should include the following as component elements:

- a. Process to assess risks of the audit firm;
- b. Governance and leadership;
- c. Professional ethics and independence;
- d. Conclusion and renewal of audit engagements;
- e. Implementation of services;
- f. Resources for operational management of the audit firm;
- g. Information and communication;
- h. Monitoring of the quality control system and improvement process; and
- i. Succession among audit firms.

Furthermore, the Revised Standards newly require the top officer in charge of an audit firm's quality control system to evaluate the system at least once a year by setting a base date and draw a conclusion as to whether the system provides reasonable assurance to the audit firm that the purpose thereof is surely achieved.

The Revised Standards are effective for audits of financial statements for a business year or an accounting period starting on or after July 1, 2023 (for audit firms other than large-sized audit firms under the Certified Public Accountants Act, for a business year or an accounting period starting on or after July 1, 2024).

According to interviews with large-sized audit firms, they are moving ahead of the ISQM1, which went

into effect in December 2022, in cooperation with the global networks. They are receiving risk assessment tools from the global networks and are adding evaluation items based on the Revised Standards' own requirements while taking into account the quality goals and quality risks set by global networks.

Regarding the operation of quality control systems, at many large-sized audit firms, the persons responsible for each division have process owners identify quality risks and policies and procedures for dealing with risks, and assess risks under the steering committee, which comprehensively manages responses to quality risks. Some firms have person in charge of monitoring compliance with the relevant standards from independent standpoint.

The number of quality goals, quality risks, and policies and procedures to address these risks varies from firm to firm ranging from 15 to 200 in quality goals, 117 to 271 in quality risks, and 352 to 1,236 in policies and procedures to address the risks.

The timelines for the evaluation of quality management systems also vary between firms, and the reporting time of evaluation results spread over the period from December 2023 to September 2024. Regarding the overall evaluation results, one firm reported that it gave an overall evaluation that included conformance to the standards, while the other firm gave an evaluation based on ISQM1. Both firms concluded that the quality control system provided reasonable assurance that the objectives of the system were being achieved.

According to reports collected during PY2019, mid-tier audit firms are taking action based on risk assessment tools provided by their global networks, and some mid-tier audit firms have been applying the revised standards since July 1, 2023. Regarding the risk assessment process, similar to large-sized audit firms, they are developing the quality goals, quality risks and the policies and procedures based on the items shown in the global network's tool as well as adding evaluation items based on the Revised Standards' own requirements.

In addition, as part of the efforts to penetrate and establish the quality management system in the workplace, meetings and training sessions such as partner meetings are held. Some firms have stated a quality control committee held once every three months, with at least one member from each regional office participating.

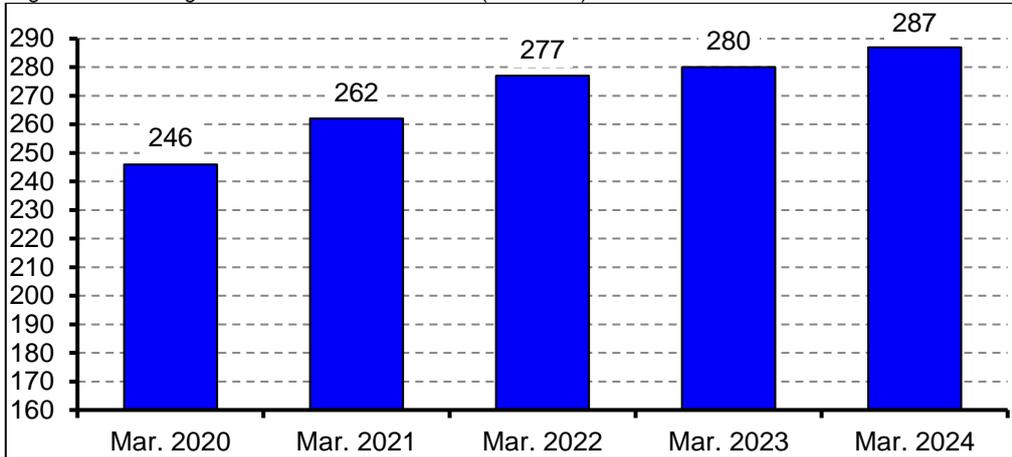
According to the collection of reports from 55 small and medium-sized audit firms in PY2023, approximately half of the firms (45%) are in the process of establishing frameworks and rules for the Revised Standards. On the other hand, the other half of the firms (55%) are only gathering information and have not yet started establishing specific frameworks⁴ (Data was aggregated for 53 audit firms out of 77 firms).

⁴ It should be noted that the answers of the collection of reports were as of June 30, 2023, which may be different from the current situation.

3. Number of Audit firms

The number of audit firms has been on an upward trend in recent years. As of March 31, 2024, there were 287 firms, and 5 firms disappeared as a result of dissolution or merger and 12 were established in the period April 2023-March 2024, ending up with a net increase by 7 firms (Figure I-2-4) year on year. See "[4. Mergers of Audit Firms](#)" for details on mergers from FY2019 onwards.

Figure I-2-4: Change in the number of audit firms (unit: firms)



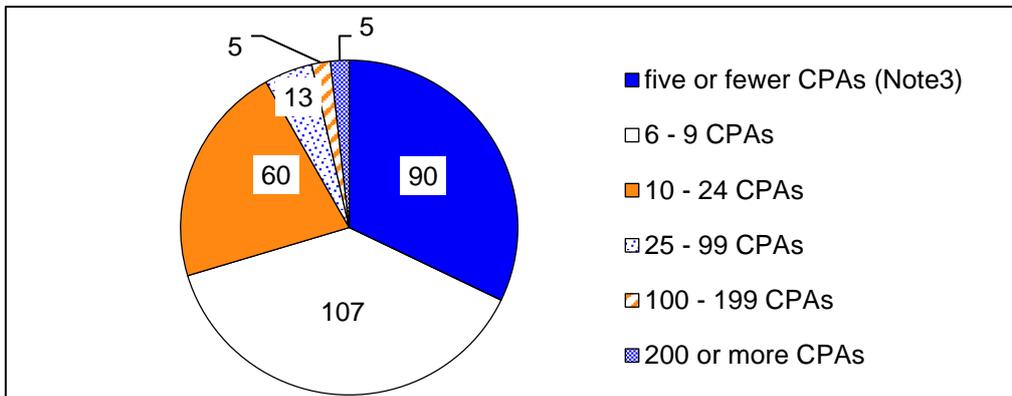
(Note1) The number of audit firms as of the end of March 2022 is adjusted based on the data obtained after publishing the previous Monitoring Report.

(Note2) The number of limited liability audit firms as of the end of March 2024 was 36.

(Source) Prepared by the CPAAOB based on data (e.g. survey of numbers of members) from the JICPA and reports of individual audit firms. The list of limited liability audit firms is published on the FSA website.

Classification by the number of full-time CPAs belonging to each audit firm reveals that firms with fewer than 25 CPAs make up over 90% of the total (Figure I-2-5).

Figure I-2-5: Number of audit firms by scale in terms of full-time CPAs (FY2021; unit: firms)



(Note 1) The number of full-time CPAs is the total of partners who are CPAs and full-time staff who are CPAs.

(Note 2) Data on 280 audit firms (excluding dissolved and disappearing firms during the period) was collected from operational reports submitted by these firms in FY2023

(Note 3) An audit firm where the number of partners who are CPAs drops to four or fewer should be dissolved, but six months is granted as suspended term as stipulated in the CPA Act.

(Note 4) The timing of the submission of the business reports of each audit firm differs depending on the financial year, and for the sake of compiling the data for this report, information for 2022 is used for small and medium-sized audit firms (the same applies to the subsequent figures).

4. Mergers of Audit Firms

There have been 9 mergers of audit firms since FY2019 (Figure I-2-6). The main reasons for the mergers were to reinforce management infrastructure and to expand business.

Figure I-2-6: Audit firms involved in mergers from FY2019 (March 31, 2024)

| FY | Surviving firm | Disappearing firm |
|------|---|--|
| 2018 | Grant Thornton Taiyo LLC | Yusei Audit & Co. |
| | Toho Audit Corporation | Aoyagi Accounting Office |
| 2019 | Sohken Audit Corporation (Sohken Nichiei Audit Corporation) | Nichiei Audit Corporation |
| 2020 | Ark LLC | Kinki Daiichi Audit Corporation |
| | Nishi-Nihon Audit Corporation (Kowa Audit Corporation) | Hibiya Audit Corporation |
| 2021 | Yasaka Kaikeisha Audit Corporation | Keihin Audit Corporation |
| 2022 | Kyoritsu Audit Corporation (Kyoritsu-Shinmei Audit Corporation) | Shinmei Audit Corporation |
| | Moore Shisei Audit Corporation (Moore Mirai Audit Corporation) | Kisaragi Audit Corporation |
| | SKIP Audit Corporation | Godai Audit Corporation |
| 2023 | Souken Nichiei Audit Corporation (Fujimi Audit Corporation) | Seinan Audit Corporation, Nagoya Audit Corporation |
| | PricewaterhouseCoopers Aarata LLC (PricewaterhouseCoopers Japan LLC) | PricewaterhouseCoopers Kyoto |

(Note) Names in parentheses show the name of the surviving firm as of March 31, 2024.
(Source) Prepared by the CPAAOB from materials made publicly available by audit firms

Reports collected from mid-tier audit firms (five firms at the time of collection of reports) in PY2023 showed that many of them considered mergers as an option for their future business strategies. As stated in Figure I-2-6, PwC Kyoto, mid-tier audit firm, merged with PwC Arata, large-sized audit firm, and changed the name to PwC Japan as of December 1, 2023.

The collection of reports from small and midsize audit firms (involving 53 firms) in the same program year found that roughly 51% of them were willing to consider mergers if they find a promising merger partner.

5. Financial Condition (Operating Revenue, Proportion of Audit and Attestation Services and Non-audit and Attestation Services)

Audit firms offer not only audit and attestation services but – non-audit services such as assurance services other than audit and attestation services and financial advisory services (support for initial public offerings, introduction of IFRS, organizational realignment and so forth). Operating revenues over the five years until FY2023 (FY2022 in the case of small and medium-sized audit firms) showed an uptrend all at large-sized, mid-tier and small and medium-sized audit firms.

Revenues from audit and attestation services roughly accounted for 70% of operating revenues at large-sized audit firms, while the ratio was about 95% and 90% respectively at mid-tier and small and medium-sized audit firms (Figure I-2-7). For audit firm groups' operating revenues, see "[III. Operation of Audit Firms, A. Operations Management System, 9. Domestic Audit Firm Groups](#)".

Characteristics of audit firms, classified by size, are as follows:

a. Large-sized audit firms

The ratio of audit service and attestation revenues, which has been around 75% for large-sized

audit firms as a whole. Seeing the ratio of each large-sized audit firm, the ratio has ranged between 60% and 85% at three of the four firms, but at the remaining firm it has hovered at around 50%.

Large-sized audit firms operate certain extent of non-audit services based on their organizational policy that performing non-audit services provides their personnel with opportunities to acquire a wide variety of business experiences to grow, a broad range of experiences and knowledge through non-audit services serves to enhance audit quality, and non-audit service is effective for attracting talent.

b. Mid-tier audit firms

Audit and attestation service revenues have been rising at all firms, and the ratio of them in operating revenues has mostly maintained a level over 90%.

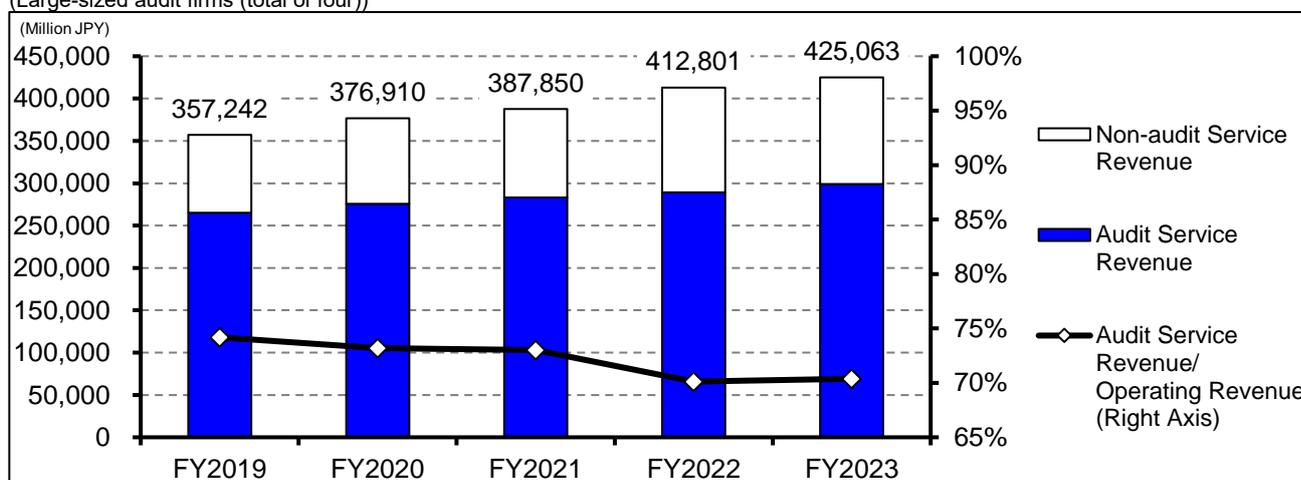
As mid-tier audit firms' business is centered on audit and attestation services, they provide non-audit services that are considered useful when conducted together with audit and attestation services or only within a limited range based on their individual circumstances, including available staff members.

c. Small and medium-sized audit firms

The ratio of audit and attestation service revenues has been around 90%.

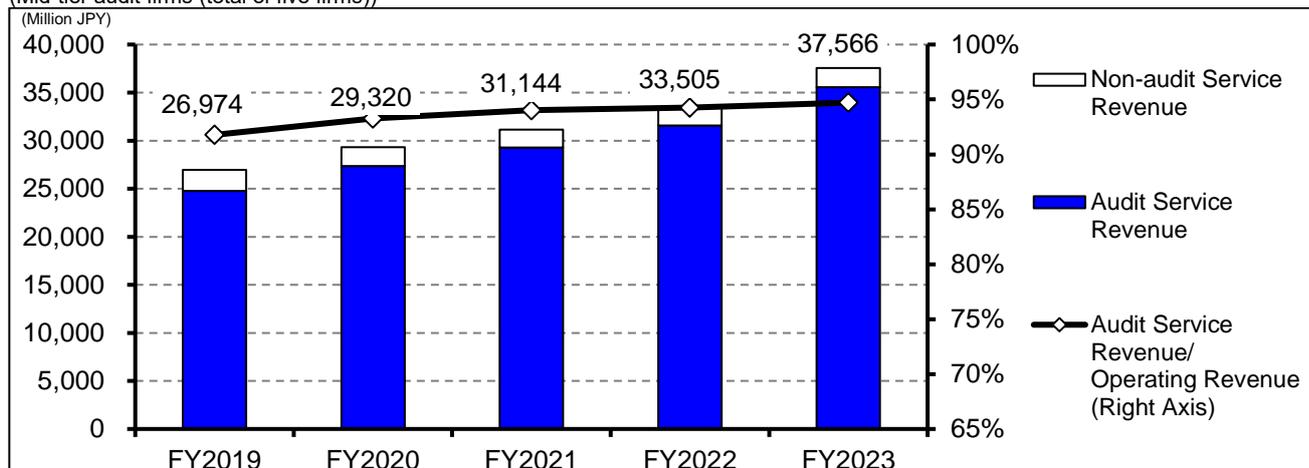
The operating revenues of small and medium-sized audit firms are moderate on the whole, but some of the largest firms in this category are expanding their business through newly concluding audit engagements with companies for which mainly large-sized audit firms had cancelled audit engagements. In particular, since 2021, the number of companies audited has increased by around 100 per year due to changes in auditors, resulting in a significant increase in revenue from audit and attestation services. For changes in accounting auditors, see "[III. Operation of Audit Firms, E. Acceptance of New Audit Engagements and Changes of Accounting Auditors](#)".

Figure I-2-7: Operating revenues, breakdowns of operating revenues, and proportions of audit and attestation service revenues to total operating revenues
(Large-sized audit firms (total of four))



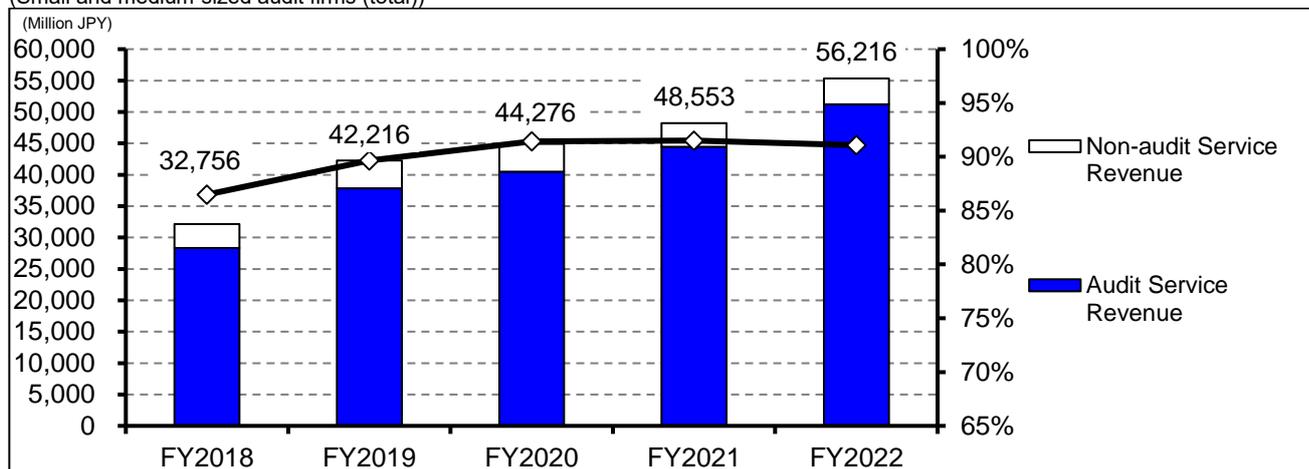
(Note) The business report, including those for FY2023, is prepared for the financial year before the establishment of PwC Japan and does not take into account the effects of the merger of PwC Arata and PwC Kyoto.

(Mid-tier audit firms (total of five firms))



(Note) The business report, including those for FY2023, is prepared for the financial year before the establishment of PwC Japan and does not take into account the effects of the merger of PwC Arata and PwC Kyoto

(Small and medium-sized audit firms (total))



(Note 1) As fiscal year-end varies widely among small and medium-size audit firms, their results in FY2023 have yet to be tallied. This report therefore covers their results through FY2022 (from April 2022 through March 2023). The number of small and medium-sized audit firms differs each fiscal year. For FY2022, the results of 270 firms were tallied.

(Note 2) Audit and attestation service revenues greatly increased as a whole because of a steep rise at a firm.

(Source) Prepared by the CPAAOB based on operational reports submitted by audit firms.

C. Audited Companies

1. Types of Audit and Attestation Services

As previously noted in “[B. Audit Firms](#)”, audit and attestation services include statutory audits, which are based on such laws as the FIEA, the Companies Act, the Act on Subsidies for Private Schools, and the Labor Union Act and non-statutory audits whose objectives and content are decided by the parties involved. The types of audit and attestation services provided by audit firms are shown below (Figure I-3-1).

Figure I-3-1: Types of audit and attestation services by audit firm

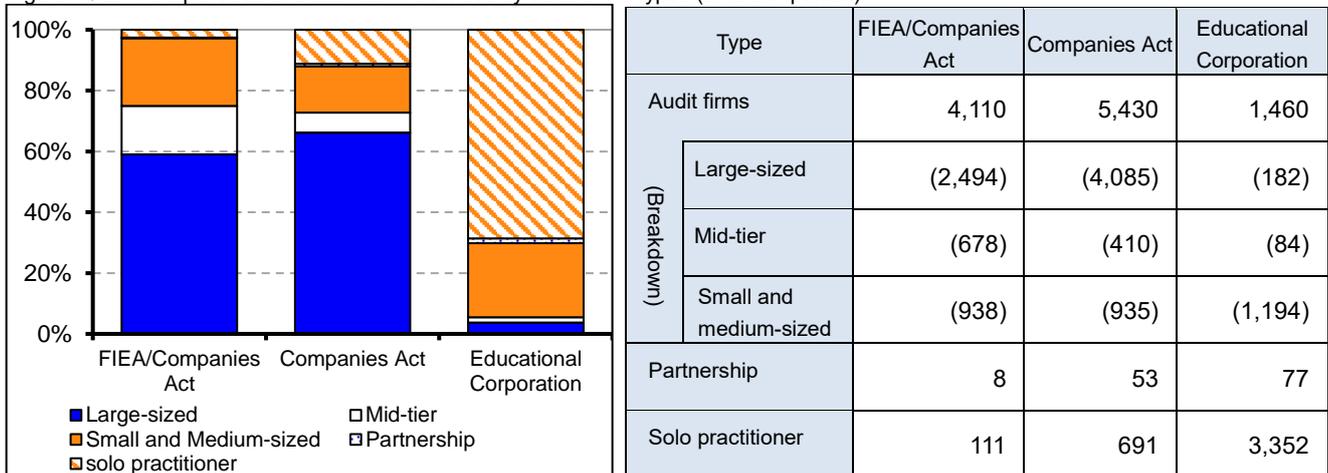
| Type | Statutory audits | | | | | | Non-statutory audits | Total |
|---------------------|----------------------|------|---------------|--------------------------------------|-----------------|-------|----------------------|--------|
| | FIEA / Companies Act | FIEA | Companies Act | Act on Subsidies for Private Schools | Labor Union Act | Other | | |
| Number of companies | 4,094 | 308 | 5,465 | 1,535 | 436 | 4,270 | 5,579 | 21,687 |
| Percentage | 18.9 | 1.4 | 25.2 | 7.1 | 2.0 | 19.7 | 25.7 | 100.0 |

(Note 1) The number of audited companies has been aggregated from operational reports submitted by audit firms in FY2022

(Note 2) “FIEA/Companies Act” denotes operations where audit and attestation under both the FIEA and Companies Act are required, while “FIEA” and “Companies Act” denote operations where audit and attestation under the respective act only is required.

Audit firms, partnerships and solo practitioners are the entities that provide audit and attestation services. Looking at the entities providing audit and attestation services, about 60~70% of FIEA/Companies Act audits and Companies Act audits are conducted by large-sized audit firms, while about 70% of educational corporation audits are conducted by solo practitioners (Figure I-3-2).

Figure I-3-2: Principal audit and attestation services by audit firms' types (unit: companies)



(Note 1) Data was aggregated from audits conducted from the term ended April 2022 to the term ended March 2023. The figures do not match with the figures in Figure I-3-1 because the collection period is different.

(Note 2) The figures in the column “FIEA/Companies Act” include services requiring audit and attestation only under the FIEA, in addition to services requiring audit and attestation under the FIEA and the Companies Act.

(Source) Prepared by the CPAAOB based on data from the JICPA

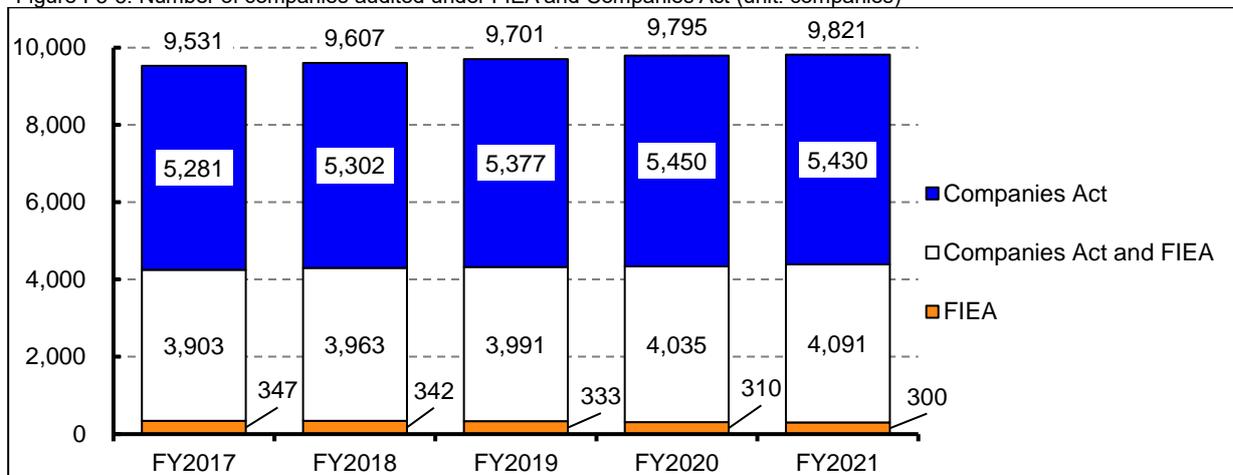
2. FIEA and Companies Act Audits

The results of analysis of audited companies etc. and listed companies that are subject to statutory audits under the FIEA and the Companies Act are as follows:

- a. Number of companies audited under the FIEA and the Companies Act and share by scale of audit firm

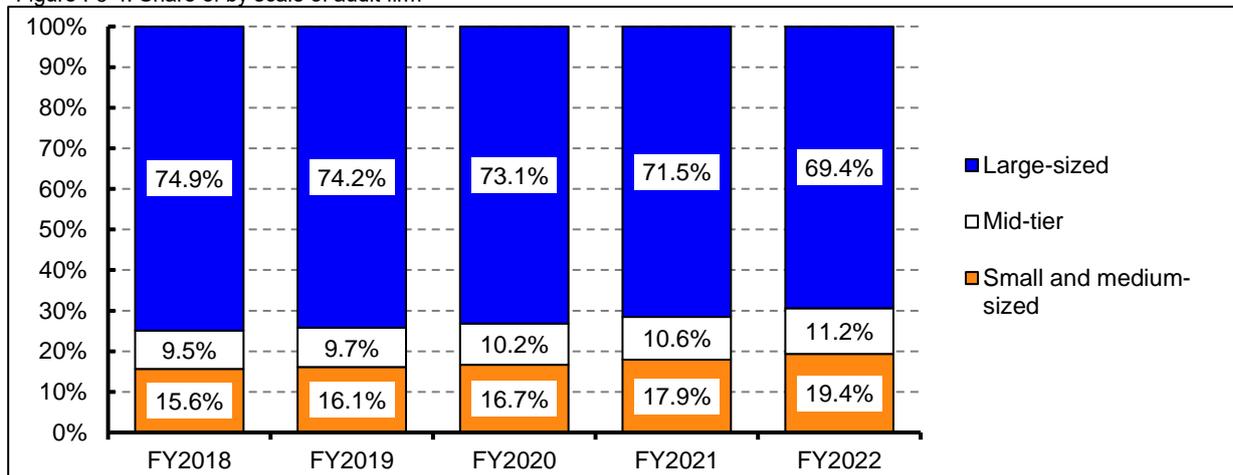
There has been no significant change in the number of companies audited under the FIEA or the Companies Act (Figure I-3-3). With regard to share by scale of audit firm, large-sized audit firms' share has been going down, mid-tier and small and medium-sized audit firms' share have been going up annually (Figure I-3-4).

Figure I-3-3: Number of companies audited under FIEA and Companies Act (unit: companies)



(Note) The number of audited companies is compiled based on operational reports submitted by audit firms.

Figure I-3-4: Share of by scale of audit firm



(Note) The number of audited companies is compiled based on operational reports submitted by audit firms.

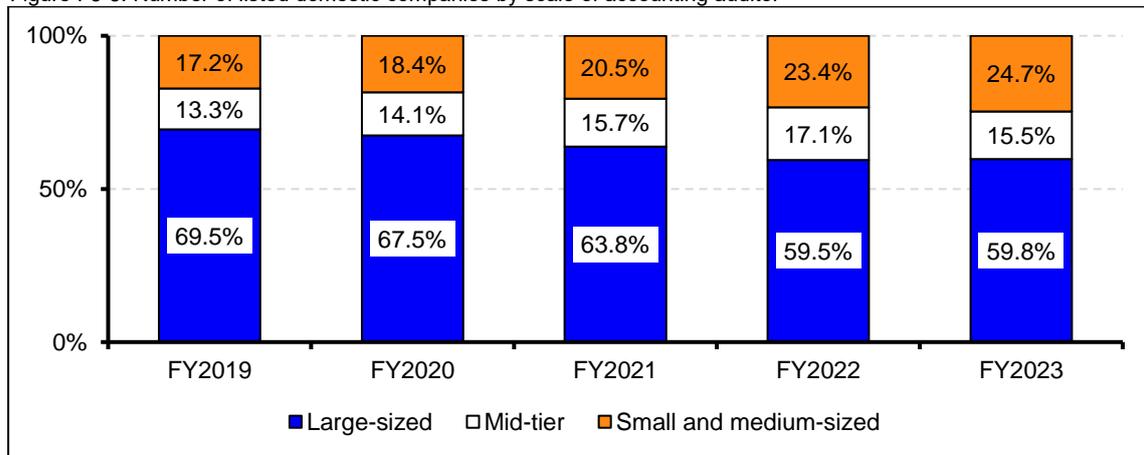
- b. Share of listed domestic companies by scale of audit firms

Audits at about 60% of listed domestic companies are conducted by large-sized audit firms, but in terms of market capitalization, large-sized audit firms have about 90% share and this trend has been persisting for many years. This is because listed domestic companies with large market capitalizations conduct operations on a large scale, and their operations are complex as

well as international by nature. As a result, their audits require a large number of audit personnel and various specialist capabilities, which likely makes it difficult for firms other than large-sized audit firms to handle their audits (Figures I-3-5 and I-3-6).

At the end of FY2023, there were 3,930 domestic listed companies, and 2,349 were audited by large-sized audit firms, 610 were audited by mid-tier audit firms, and 971 were audited by small and medium-sized audit firms. Meanwhile, the market capitalization of domestic listed companies was 750,156.9 billion yen, of which large-sized audit firms handled 704,046.5 billion yen, mid-tier audit firms handled 19,873.3 billion yen, and small and medium-sized audit firms handled 26,236.7 billion yen.

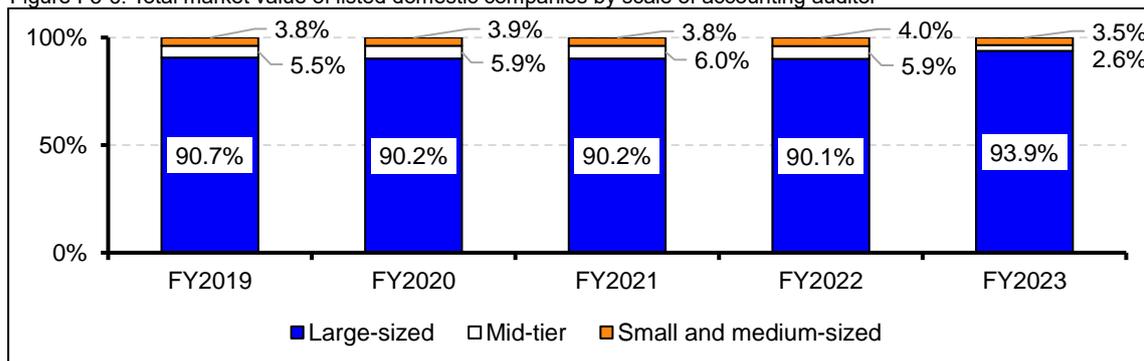
Figure I-3-5: Number of listed domestic companies by scale of accounting auditor



(Note) The number of listed domestic companies audited by mid-tier audit firms up to FY2022 is the total of five audit firms: Gyosei & Co., BDO Sanyu & Co., Grant Thornton Taiyo LLC, Crowe Toyo & Co, and PwC Kyoto. The number of listed domestic companies audited by mid-tier audit firms in FY2023 is the total of four audit corporations: Gyosei & Co., BDO Sanyu & Co., Grant Thornton Taiyo LLC, and Crowe Toyo & Co., due to the merger of PwC Arata and PwC Kyoto in December 2023.

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

Figure I-3-6: Total market value of listed domestic companies by scale of accounting auditor



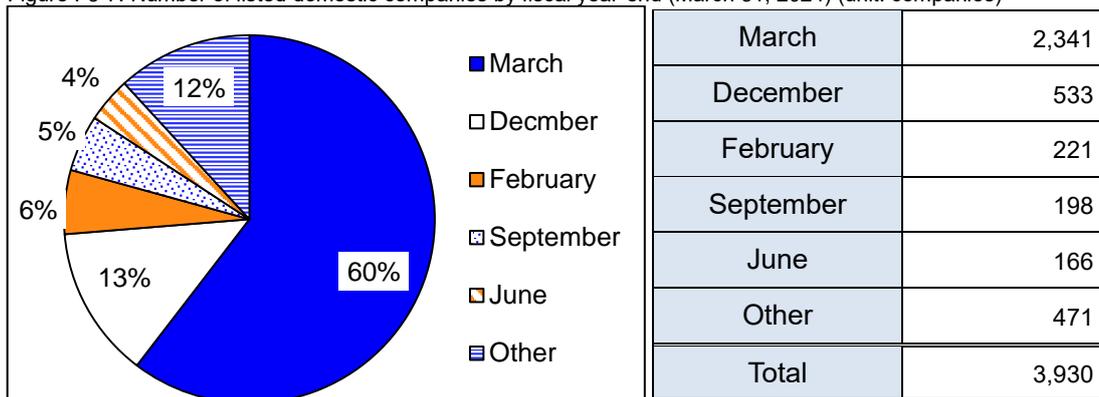
(Note) The ratio of mid-tier audit firms up to FY2022 is the total of five audit firms: Gyosei & Co., BDO Sanyu & Co., Grant Thornton Taiyo LLC, Crowe Toyo & Co, and PwC Kyoto. The ratio of mid-tier audit firms in FY2023 is the total of four audit corporations: Gyosei & Co., BDO Sanyu & Co., Grant Thornton Taiyo LLC, and Crowe Toyo & Co., due to the merger of PwC Arata and PwC Kyoto in December 2023.

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

c. Number of listed domestic companies and total market value by fiscal year-end

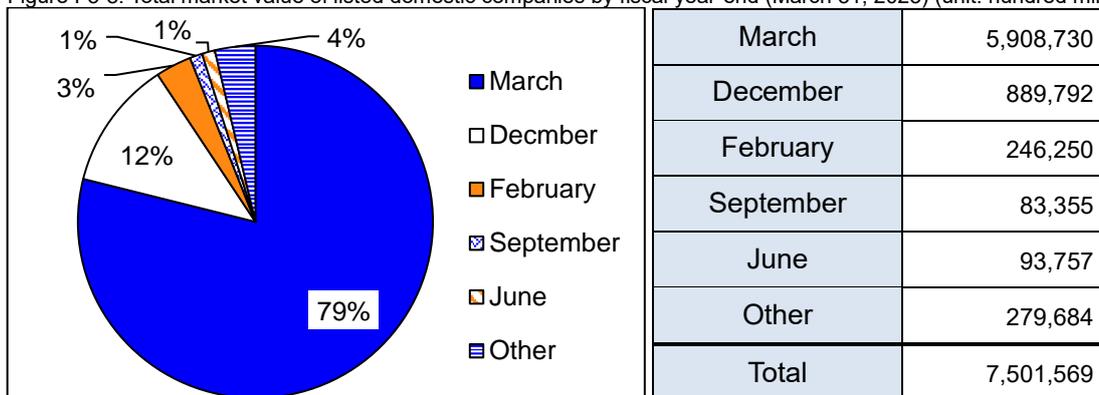
60% of listed domestic companies close their books at the end of March, and that they account for 79% of the total market capitalization. This fact explains why audit operations are heavily concentrated in specific periods (Figures I-3-7 and I-3-8).

Figure I-3-7: Number of listed domestic companies by fiscal year-end (March 31, 2024) (unit: companies)



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

Figure I-3-8: Total market value of listed domestic companies by fiscal year-end (March 31, 2023) (unit: hundred million JPY)



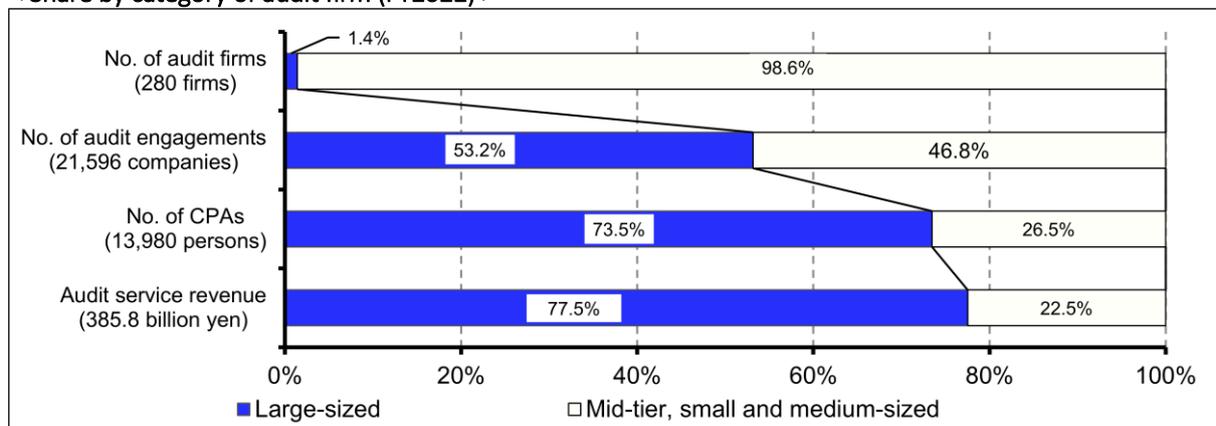
(Source) Prepared by the CPAAOB based on data from QUICK and exchanges

■ Share of Large-sized Audit Firms ■

Among the 281 audit firms as of the end of FY2022, large-sized audit firms accounted for a large portion of the number of audit and attestation engagements, the number of CPAs and audit and attestation service revenues.

The share of large-sized audit firms in the number of audit and attestation engagements, audit service revenues and other categories has been on the decline in recent years as a result of operations management related to the continuation of their audit service contracts. See [“III. Operation of Audit Firms, E. Acceptance of New Audit Engagements and Changes of Accounting Auditors”](#).

< Share by category of audit firm (FY2022) >



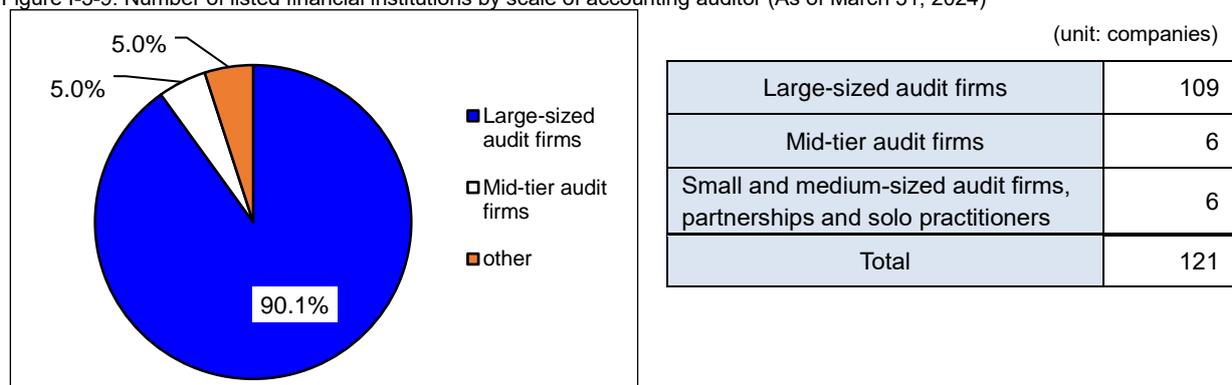
(Note) Compiled based on FY2022 JICPA member data and operational reports submitted by audit firms

3. Audits of Financial Institutions

90% of listed financial institutions (121 companies) were audited by large-sized audit firms, and in terms of market capitalization, large-sized audit firms handled 99%. So compared with all domestic listed companies, large-sized audit firms' share presented a further increase (Figures I-3-9 and I-3-10). For information about domestic listed firms as a whole, see “[2. FIEA and Companies Act Audits](#)”.

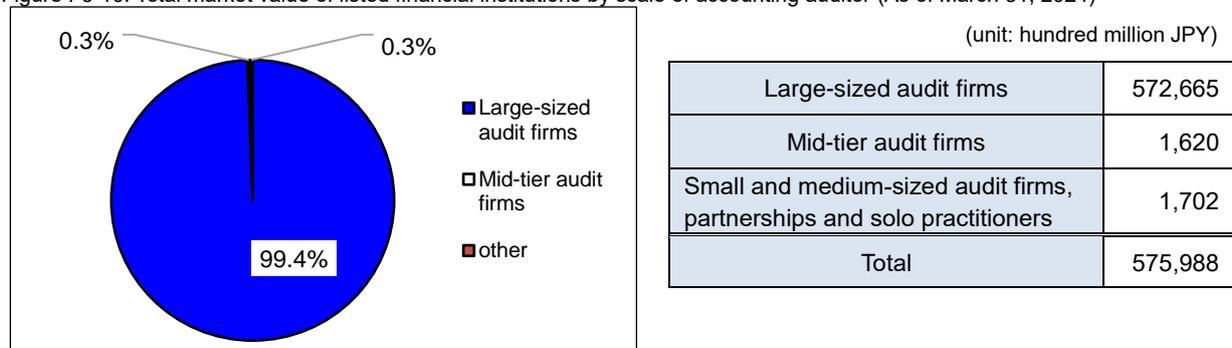
To cope with accounting and audit practices that are designed to the listed financial institutions, large-sized audit firms are establishing departments specializing in financial services in their audit operations divisions, and some mid-tier audit firms have established support systems that specialize in handling inquiries about the accounting procedures of financial institutions.

Figure I-3-9: Number of listed financial institutions by scale of accounting auditor (As of March 31, 2024)



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

Figure I-3-10: Total market value of listed financial institutions by scale of accounting auditor (As of March 31, 2024)



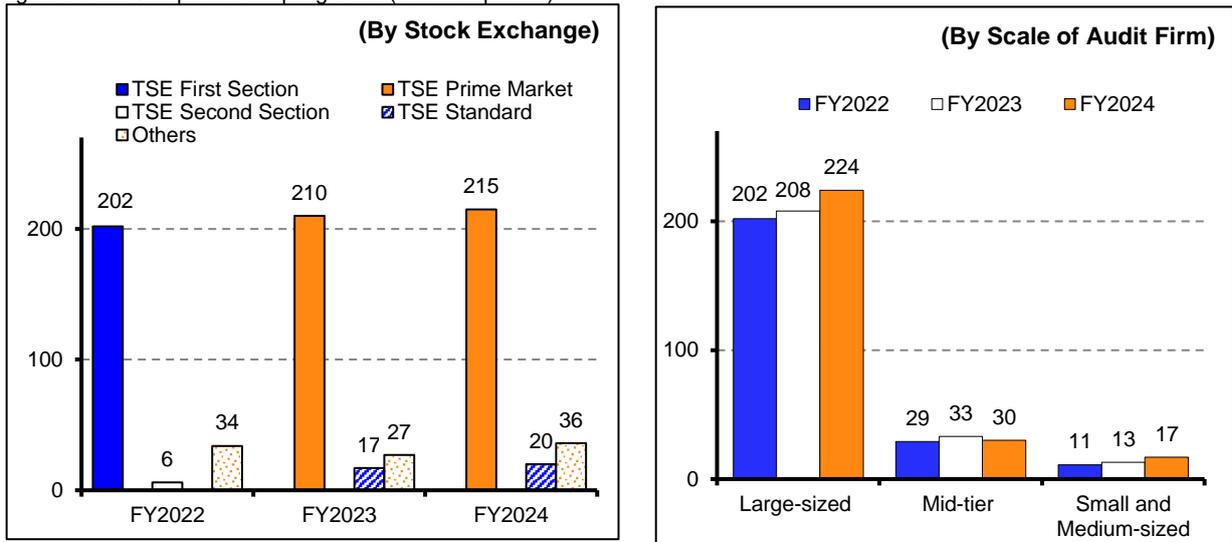
(Source) Prepared by the CPAAOB based on data from QUICK and exchanges

4. Companies Adopting IFRS

The following figures show the listing markets for companies that have adopted IFRS and the scale of the accounting auditors for these companies as of the end of March 2024 (Figures I-3-11).

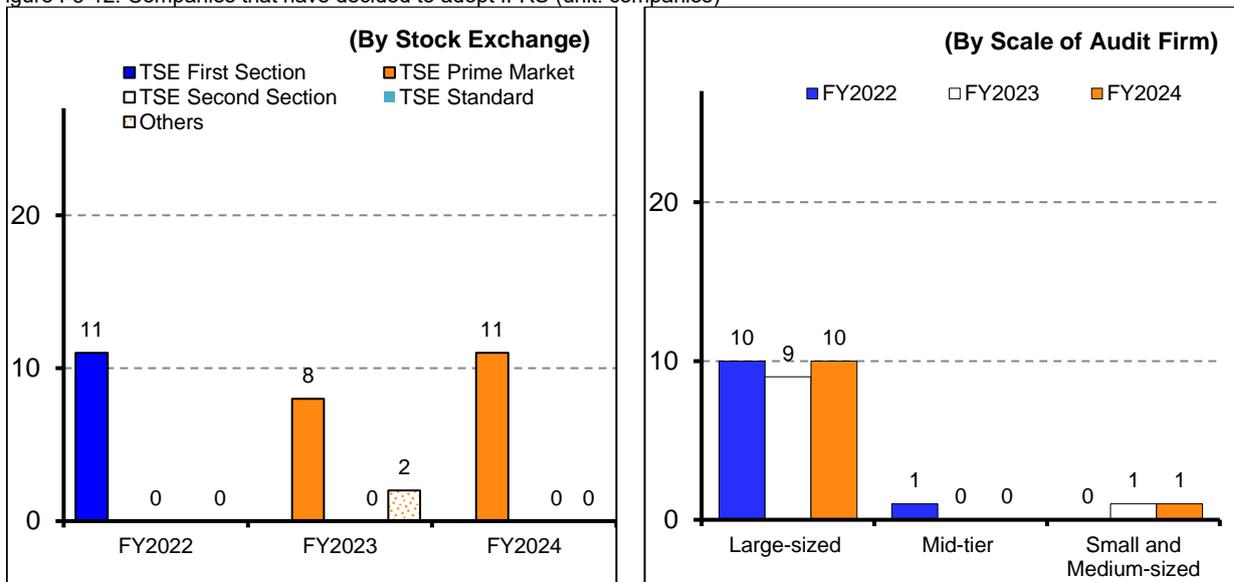
The majority of companies that have adopted IFRS are listed on the Prime Section of the Tokyo Stock Exchange, and many of them operate internationally. Audit contracts are concentrated in large-sized audit firms which collaborate with large global networks. A similar situation is seen with companies that have decided to adopt IFRS (companies in which the business execution body has decided to adopt IFRS and has disclosed this decision to the public) (Figure I-3-12).

Figure I-3-11: Companies adopting IFRS (unit: companies)



(Note1) As the TSE changed the market segmentation in April 2022, the former segmentation data are included in the chart.
 (Note2) PwC Arata and PwC Kyoto merged on December 1, 2023 to form PwC Japan, and the former PwC Kyoto is classified as a large-sized audit firm for the fiscal year ended March 31, 2006 in the status of Scale of Audit Firm.
 (Source) Prepared by the CPAAOB based on data from exchanges

Figure I-3-12: Companies that have decided to adopt IFRS (unit: companies)



(Note1) As the TSE changed the market segmentation in April 2022, the former segmentation data are included in the chart.
 (Note2) PwC Arata and PwC Kyoto merged on December 1, 2023 to form PwC Japan, and the former PwC Kyoto is classified as a large-sized audit firm for the fiscal year ended March 31, 2006 in the status of Scale of Audit Firm.
 (Source) Prepared by the CPAAOB based on data from exchanges

5. Audits of Initial Public Offerings

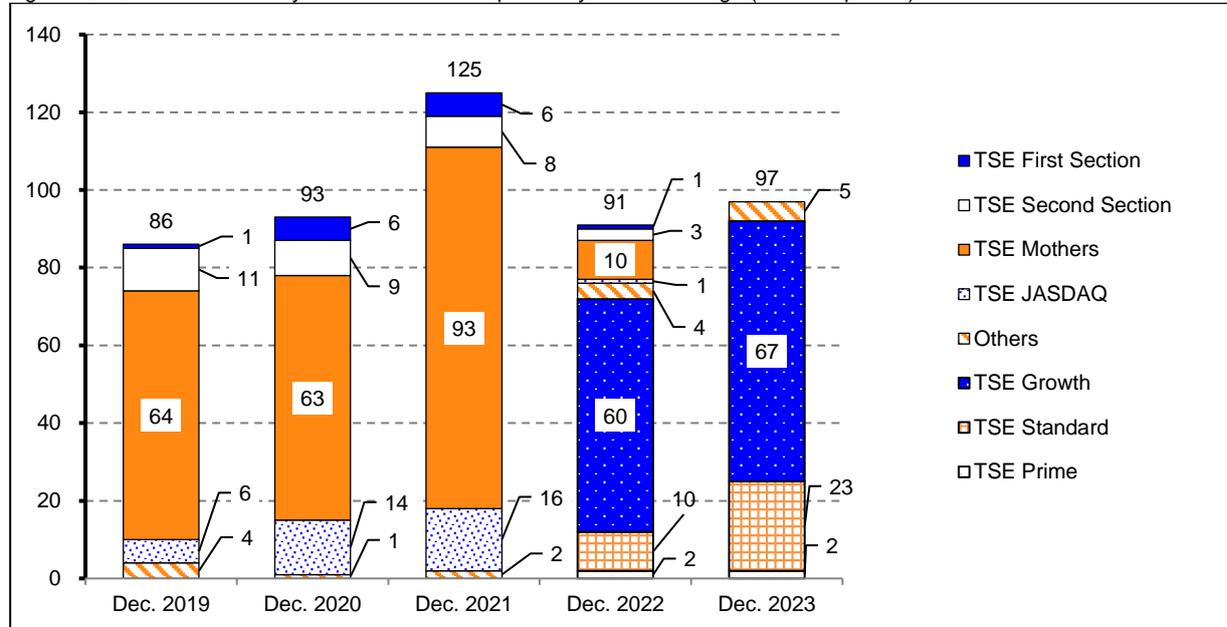
The number of IPOs (excluding listings on the Tokyo Pro Market) for the period from January 2023 to December 2023 (hereinafter referred to as the "year through December 2023") came to 97, which has increased from the previous year. Listings on the Tokyo Stock Exchange's Mothers and Growth market were particularly large in number (Figure I-3-13).

Seeing shares by size of audit firms, large-sized audit firms maintain a large share (Figure I-3-14). However, the shares held by each of the large-sized audit firms have changed, which likely reflects changes in the business operation policies and IPO operations embedded in each firm. For information

about the organizational structures, etc. of audit firms regarding the acceptance of IPO audit engagements, see “[III. Operation of Audit Firms, A. Operations Management System, 4. Organizational Structure for Providing Audit Services](#)”.

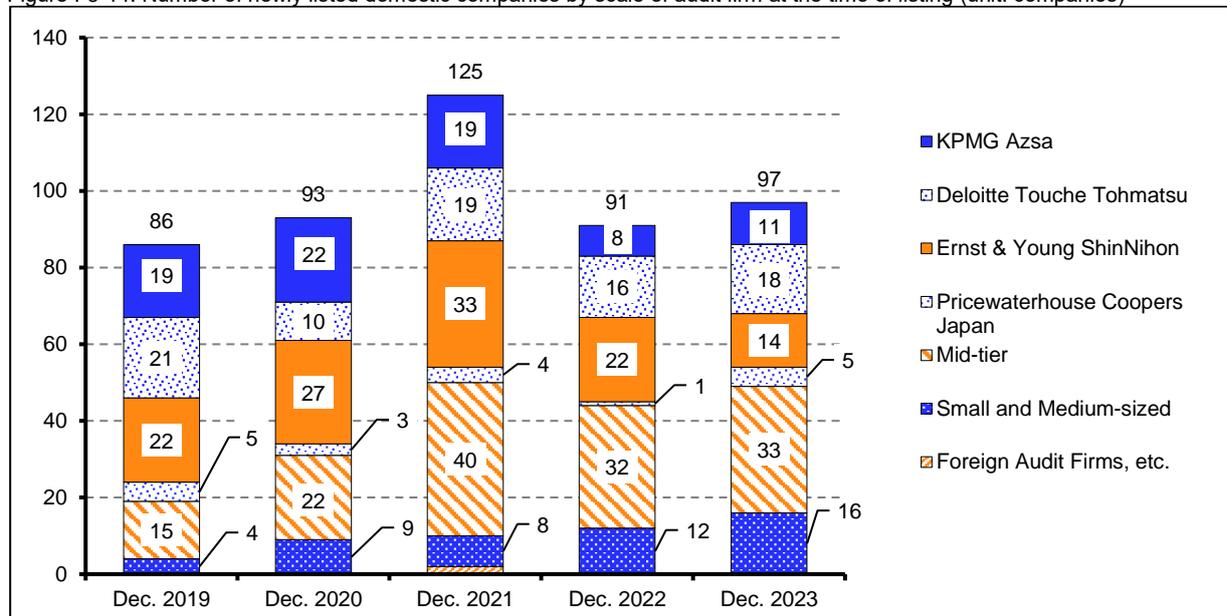
The share of large-sized audit firms was 49% in the year through December 2023. While the share of mid-tier and small and medium-sized audit firms showed an uptrend.

Figure I-3-13: Number of newly listed domestic companies by stock exchange (unit: companies)



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

Figure I-3-14: Number of newly listed domestic companies by scale of audit firm at the time of listing (unit: companies)



(Note) PwC Arata and PwC Kyoto merged on December 1, 2023 to form PwC Japan. Companies those newly listed from the former PwC Kyoto before the merger are classified as mid-sized audit firms.

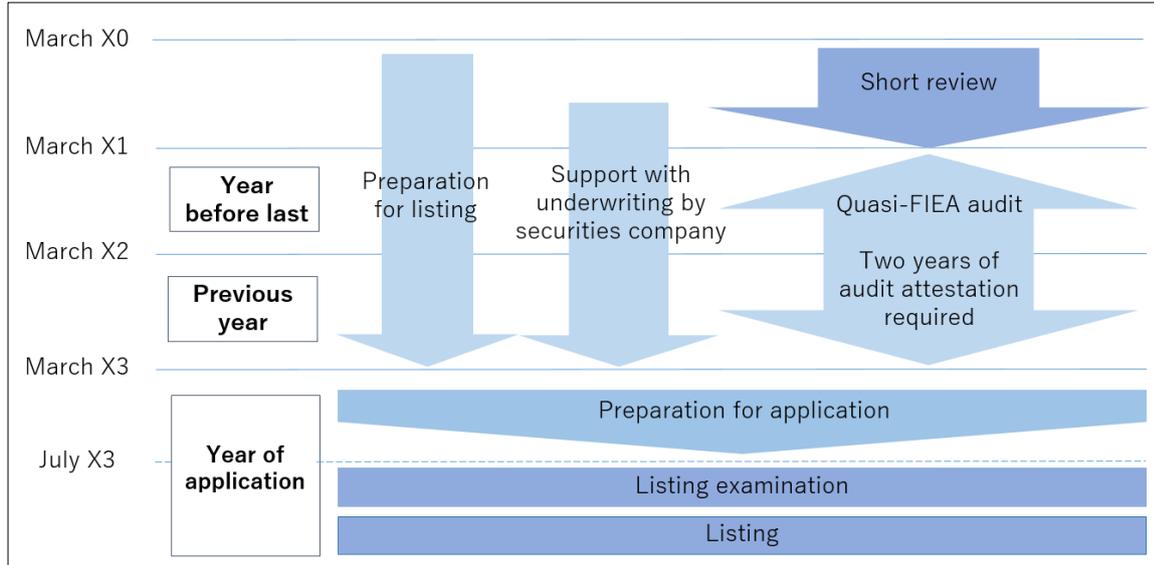
(Source) Prepared by the CPAAOB based on data from exchanges

Most audit firms regard the acceptance of IPO audit engagements as a part of their mission of audit firms since assisting with IPOs contributes not only to companies' growth but also to socioeconomic

development.

However, IPO audits often entail a relatively high audit risk, such as vulnerable internal control structure of the audited company, and there are cases where improper accounting had already been practiced by the time of IPO. Accordingly, before accepting IPO audit engagements, many audit firms follow their policies requiring more rigorous risk assessments than normal audit engagements.

Figure I-3-15: Example of schedule leading up to IPO (Fiscal year ending in March)



(Source) Prepared by the CPAAOB

■ IPO support services ■

Article 192-2, paragraph of the FIEA stipulate that for listing, a company needs to have its financial statements audited for the two years prior to the year in which it will be listed (application year). (This type of audit is described as “quasi-FIEA audit”). Furthermore, before concluding a quasi-FIEA audit contract, a short review is conducted so as to identify and resolve issues ahead of listing. This is the typical workflow when preparing for listing. Companies often ask CPAs and audit firms for support with conducting the short review and resolving issues, and CPAs and audit firms accept these engagements as non-audit work. The IPO-related support services that CPAs and audit firms provide as non-audit work include the following:

- Short reviews
- Support with establishing management structures
- Support with establishing internal control structures
- Support with speeding up bookclosing procedures
- Support with preparing listing application documentation