IV. Responses to Changes in the Global Environment Surrounding Audits

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A. Trends Surrounding Small and Medium-Sized Audit Firms

1. Changes in the Environment Surrounding Audits by Small and Medium-Sized Audit Firms

In recent years, there has been a continuing trend of changing accounting auditors for audits of listed domestic companies from large-sized audit firms to mid-tier/small and medium-sized audit firms and the role of small and medium-sized audit firms as auditors of listed domestic companies is increasing. In addition, the Quality Control Standards for Audits were revised in November 2021 to require the introduction of a quality control system based on a risk approach in order to maintain and improve audit quality. In order to strengthen independence, the Code of Ethics were also revised in October 2022 (for specific details on the revision of the Code of Ethics, please refer to "B. Recent Trends with Auditing, 2. Revision of the Code of Ethics by JICPA").

In light of these changes in the audit environment, the revision of the CPA Act in May 2022 introduced a legal registration system for auditors of listed companies in place of the self-regulatory registration system for auditors of listed companies, which had been conducted by the JICPA. The registration of audit firms, etc. that conduct audits of listed companies had been conducted by the Quality Control Committee of the JICPA, which had been responsible for the review system. Since April 1, 2023, it has been conducted by the "Registration Review Committee for Auditors of Listed Companies", which was newly established within the JICPA. The Committee consists of seven members, three of whom are members of the JICPA and four of whom are non-members. This has added further transparency and objectivity to the screening of registrations and decisions on cancellation of registrations. The revised Ordinance for Enforcement of the CPA Act ("Ordinance for Enforcement") requires registered auditors of listed companies to establish a framework for information disclosure and business operations in accordance with the Audit Firm Governance Code amended in March 2023, to be applied from the beginning of the first accounting period of audited companies that starts on or after July 1, 2024 (July 1, 2023 for large-sized audit firms).

2. Response by the JICPA to Small and Medium-Sized Audit Firms

In response to 1. above, the JICPA is responding to changes in the environment surrounding audits of small and medium-sized audit firms from three perspectives: (i) confirmation of eligibility through quality control reviews following the introduction of the legal registration system for auditors of listed companies, (ii) enhancement of information disclosure by small and medium-sized audit firms, and (iii) support for strengthening the foundations of small and medium-sized audit firms.

a Confirmation of eligibility through quality control reviews in connection with the introduction of the legal registration system for auditors of listed companies, etc.

In accordance with the revision of the CPA Act, the JICPA is required to conduct quality control reviews to confirm whether the operational control systems of registered auditors are in compliance with laws and regulations, etc. for conducting audits of listed companies, etc. fairly and appropriately ("confirmation of eligibility"). In response, the JICPA published the Guideline for confirmation of eligibility of audit firms engaged in the audit of listed companies (“Guideline”). This Guideline provide viewpoints and standards for judging whether an entity who intends to be registered in the list of auditors of listed companies, etc. ("applicant for registration") or a registered listed company auditor has a sufficient system to fairly and appropriately perform audit and attestation services pertaining to financial documents of listed companies. At the same time, the purpose of the Guidelines is for audit firms conducting audits of listed companies to perform self-assessments to check for deficiencies in the items described in the Guidelines, and if any deficiencies are identified, to take voluntary improvement measures. In "4. How to Use the Guidelines at Audit Firms" of the Guidelines, the JICPA requires audit firms conducting audits of listed companies to perform self-assessments, stating that "An applicant for registration or a registered listed company auditor shall perform self-assessments to determine whether the conditions at the audit firm are not in the situation described in the Attachment, and if any deficiency is identified, shall immediately plan and implement voluntary improvement measures."

The JICPA not only requires applicants for registration to perform self-assessment, but also examines the assessment results and encourages them to improve the system to enable them to apply for registration through quality control reviews and other communication for items where the assessment results are not satisfactory.

b Enhancement of information disclosure by small and medium-sized audit firms

Under the Ordinance for Enforcement, registered listed company auditors are required to establish a system for : (I) appropriately evaluating the status of operations management system and publishing the results of the evaluation and the reasons for the evaluation, etc. (Article 93); (ii) publishing the status of business management, etc. (Article 95); and (iii) conducting business in accordance with the Audit Firm Governance Code and publishing the status of application of the Code (Article 96).

The publication under Article 93 of the Ordinance for Enforcement is made by making explanatory documents containing matters set forth in the Order of Enforcement available for public inspection. However, the publication under Article 95 and 96 of the Ordinance for Enforcement does not specifically designate the subject and media in which the information should be described. This is because it is not appropriate to require registered listed company auditors to disclose a uniform set of items, and they are expected to proactively determine the disclosure items they consider important and to carry out substantial information disclosure through originality and ingenuity.

As part of its self-regulation, the JICPA has been encouraging small and medium-sized audit firms to annually publish the "Annual Report on Audit Quality Management" ("annual report"), in accordance with Article 95 and Article 96 of the Ordinance of Enforcement. Also, the JICPA published "Guidance for the Preparation of Annual Reports on the Management of Audit Quality" in September 2023, and presented the concept of disclosure by small and medium-sized audit firms so that their information disclosure would be more substantial.

Small and medium-sized audit firms are required to prepare their first annual report for the first fiscal year ending on or after the first day of the first audited company's accounting period beginning on or after July 1, 2024, and to publish the report within six months of the first day of the first fiscal year ending on or after July 1, 2024. (For example, if an audit firm whose fiscal year ends in June and the first audited company whose accounting period begins on or after July 1, 2024 has a fiscal year that ends in March, the beginning of the audited company's accounting period is April 1, 2025, and the audit firm is required to report on the fiscal year ending June 30, 2025 and to publish its annual report by the end of December 2025. The audit firms are required to publish their annual reports by the end of December 2025 for the reporting period ending in June.)

c Support for strengthening the fundamentals of small and medium-sized audit firms

The JICPA accelerate efforts to strengthen the business foundation of small and medium-sized audit firms and improve audit quality through enhancement of information disclosure and various support measures. These efforts are led by the Small Medium Practices Policy Committee and the Small and Medium-Sized Audit Firms Liaison Council, and represented as follows.

- Publication of guidance for revised Quality Control Standards
  For QCSCS, Practical Guidance No.3 (Q&A on Quality Control and Engagement Quality Control Reviews for Audit Firms and Audit Engagements) and Practical Guidance No.4 (Tools for Quality Control at Audit Firms) were published.
- Training for Compliance with the revised Code of Ethics
- Opinion Exchange Meeting with Capital Market Participants
- Support for recruitment and training of small and medium-sized audit firms
- Maintenance of overseas office directory
- Interactive training for small and medium-sized audit firms
  In order to foster and support small and medium-sized audit firms and strengthen the individual consultation function, former reviewers of quality control reviews serve as lecturers, and opinions and information are exchanged and shared through Q&As and discussions with the participation of a small number of firms.
- Support for digitalization of small and medium-sized audit firms
  Identifying the state of IT infrastructure development and the use of IT-based audit methods at small and medium-sized audit firms. Providing support for the development of IT infrastructure, including cybersecurity measures, and the development of IT-based audit tools. Specific digitalization support measures include the establishment of a shared IT

infrastructure environment (support for the creation of a platform for use by small and medium-sized audit firms of an electronic audit documentation system) and hosting of IT communities (networking among IT personnel at small and medium-sized audit firms).

- Holding regular meetings to exchange opinions with small and medium-sized audit firms, etc.

3. Response by the CPAAOB

The revised Quality Control Standards, as "Points to Note Regarding Implementation of the Revised Quality Control Standards," state that it is particularly important for small and medium-sized audit firms to be provided with necessary support from a medium - to long-term perspective, and that the administrative authority should strive to ensure proactive quality control by audit firms through inspections by the CPAAOB, while supporting the efforts of the JICPA. The CPAAOB is making efforts to place greater emphasis on inspections to small and medium-sized audit firms based on the Basic Policy for Monitoring Audit Firms for the 7thTerm.

B. Recent Trends with Auditing

1. Trends in International Auditing Standards and Ethical Standards

The International Auditing and Assurance Standards Board (IAASB) and the International Ethics Standards Board for Accountants (IESBA), both established within the International Ethics and Auditing Federation (IFEA)[1], are engaged in the development of international auditing standards and ethics standards. Recent major revisions to the International Standards on Auditing (ISA) issued by the IAASB include the release of an Exposure Draft revising “Fraud” (ISA240) in February 2024. This Exposure Draft requires auditors to communicate with management and those with governance responsibilities regarding fraud, and to identify matters that they consider to be of particular importance in the audit of the current year’s financial statements as Key Audit Matters. Comments on this Exposure Draft are due by June 2024. The revision of "Going Concern" (ISA570), which sets a 12-month period for management’s assessment on going concern from the date of financial statement approval, is scheduled to be finalized in December 2024 after the public comment period ends in August 2023.

Recent developments in the IESBA Code of Ethics include the publication in January 2024 of Exposure Drafts of the "Proposed International Ethics Standards for Sustainability Assurance (Including international Independence Standards) (IESSA) and Other Revisions to the Code Relying to Sustainability Assurance and Reporting" and the "Using the Work of an External Expert".

The former sets out the revisions to establish a new part (Part 5) that regulates the independence and ethics of the practitioners, including those who are not professional accountants, who perform sustainability assurance engagements that meet certain criteria,. The latter provides guidelines for evaluating competence, capability, and objectivity when using a person with expertise other than that of a professional accountant or sustainability assurance practitioners. IESBA expects to finalize both drafts in December 2024.

2. Revision of the Code of Ethics by JICPA

Referring to revisions made to the IESBA Code of Ethics, the JICPA amended its Code of Ethics in July 2022. Major additions and modifications to individual rules include matters related to compensation and non-assurance activities.

Regarding compensation, audit firms are required to disclose information related to audit fees (audit fees and non-audit fees) when the client of an audit engagement is a business entity with a high degree of social impact ("PIE"). Also, as a safeguard for cases where the firm's fee dependence on PIEs exceeds or is likely to exceed 15% for two consecutive years, pre-audit opinion review is now required, and disclosure of fee dependency becomes mandatory. In addition, in cases where the firm's fee dependence on PIEs continues to exceed or is likely to exceed 15% for five consecutive years, the firm is required to resign after the fifth annual opinion.

For non-assurance engagements, if the client of the audit engagement is a PIE, the audit firm or

[1] An organization created to replace the International Federation of Accountants (IFAC) and bring under its umbrella the IAASB and IESBA, in the interest that standard-setters should be independent of professional accountants

network firm must not provide non-assurance engagements that could be subject to self-review as a disincentive.

The Cabinet Office Ordinance on Audit Certification of Financial Statements, etc. ("Audit Certification Ordinance") was also revised to require audit firms to add matters concerning the fees that CPAs or audit firms (including those who belong to the same network as these firms) receive from audited companies (including consolidated subsidiaries and non-consolidated subsidiaries) as descriptions in audit reports.

3. Other Trends in Financial Reporting Systems

a　Abolition of quarterly disclosure system

The quarterly reporting system was legislated in June 2006. However, in recent years, economic and social conditions have changed significantly, and the demand for reviewing framework of company’s information disclosure is observed. Under these circumstances, the importance of non-financial information related to medium- to long-term corporate value has increased in corporate disclosure. On the other hand, it is pointed out that there are overlaps between quarterly reports based on the FIEA (Quarterly Securities Report) and those based on exchange rules (Quarterly Earnings Report (Tanshin)), and such reports should be reviewed from the viewpoint of cost reduction and efficiency. In light of this, on November 20, 2023, the "Act for Partial Amendment of the Financial Instruments and Exchange Act, etc." was enacted to abolish the quarterly report system and uniformly require companies submitting securities reports to submit semiannual reports.

In November 2023, based on the council of experts, the Tokyo Stock Exchange (TSE) formulated the “Practical Policy Concerning the Revision of the Quarterly Disclosure System” and revised the Securities Listing Regulations in March 2024, making reviews of the first and third quarters by an auditor mandatory only in the following cases.

1) A listed company receives a result other than an unqualified opinion in an audit report of their latest Annual Securities Report, Semiannual Securities Report or Quarterly Earnings Report (only if a review has been conducted)
2) A listed company receives a result other than an unqualified opinion in an Internal Control Audit Report of the latest Annual Securities Report
3) A listed company has significant deficiencies in internal controls that should be disclosed in their latest Internal Control Report
4) A listed company does not submit the latest Annual Securities Report or Semiannual Securities Report by the initial deadline
5) The Semiannual Securities Report for the current term is amended and a review report is attached to the amended financial statements

* 1) and 3) are also applicable to cases where the most recent Annual Securities Report, Semiannual Securities Report, Quarterly Earnings Report (only in receiving a review) or

Internal Control Report is amended, and the amendment report meets the conditions.

** Except where it is clear that the reliability of financial statements is not in question regarding 4) and 5).

In addition, the Business Accounting Council has released "Written Opinion of the proposals to revise the quarterly review standards to the interim review standards". This revision changes the name of the quarterly review standards to the interim review standards, as it is common to all interim reviews conducted by auditors who audit annual financial statements, including reviews on quarterly earnings reports (kessan tanshin), in addition to reviews on interim financial statements under the revised FIEA. And it also introduces a form of conclusion regarding compliance in addition to the form of conclusion regarding fair disclosure stipulated in the current quarterly review standards.
The differences between the conclusion regarding fair disclosure and the conclusion regarding compliance are described in the Secretariat's materials of the Corporate Accounting Committee of the Business Accounting Council at its 55th meeting held on December 14, 2023.
Both the "Conclusion regarding fair disclosure" and the "Conclusion regarding compliance" require an assessment of whether the accounting policies used by management are in accordance with accounting principles generally accepted in Japan and applied on a consistent basis, whether the choice and application of policies fairly reflects the reality of accounting events and transactions, and whether the interim financial statements are in accordance with accounting principles.
In addition, "conclusions regarding fair disclosure" involves an assessment from a step away point of view whether the financial statements as a whole are appropriately presented for the users of interim financial statements to understand the financial position and results of operations.

JICPA has published the following practical guidelines for the review of interim financial statements and related matters that require understanding.

- Interim Review Standards Statement No. 1, "Review of Interim Financial Statements Conducted by an Independent Auditor": an amendment to the existing Quarterly Review Standards Report No. 1, "Quarterly Review", responding to the reviews of interim financial statements under the FIEA.
- Interim Review Standards Statement No. 2, "Review of Interim Financial Statements Conducted by the Independent Auditor", responding to interim reviews other than interim reviews under the FIEA conducted by annual auditors.
- Revision of the Practical Guidelines for Assurance Engagements 2400, "Review of Financial Statements": responding to interim reviews other than FIEA reviews conducted by auditors other than annual auditors.
- Interim Review Standards Statement No. 2 - Practical Guidance No. 1 "Q & A Regarding

Interim reviews of Quarterly Financial Statements, etc. Prescribed by the Securities Listing Regulations of the Tokyo Stock Exchange (Practical Guidance)"

Major audit firms noted that when they do not conduct voluntary reviews, they will perform procedures as part of their annual audits, but in doing so, they will be careful not to mislead the audited company into believing that they are providing any assurance on the quarterly financial statements. CPAAOB will review the implementation status of voluntary reviews, etc., and the practical impact and issues related to the impact of the abolition of the quarterly report system on audit work, including audit firms other than major audit firms.

b Internal Control Reporting System

There have been some cases in which material deficiencies that should be disclosed outside the scope of management's assessment of internal controls have become clear, and in which sufficient reasons were not disclosed when the evaluation of the effectiveness of internal controls was corrected. There are concerns about the effectiveness of the internal control reporting system, such as whether management has not appropriately considered the importance of the impact on the reliability of financial reporting when examining the scope of evaluation of internal controls.

Against this background, the Business Accounting Council published "Revision of Standards and Practice Standards for Management Assessment and Audit concerning Internal Control Over Financial Reporting (Council Opinion)" in April 2023.

As for the main points of revision, for example, regarding the evaluation and reporting of internal controls over financial reporting, the revised Standard indicates that the following indicators should not be automatically applied when management determines the scope of assessment of internal controls: "approximately 2/3 of sales, etc." and "three accounts of sales, accounts receivable, and inventories," which are exemplified; it is appropriate to describe in the internal control report the reasons for judgment regarding the scope of assessment of internal controls by management; and regarding the audit of internal controls over financial reporting, the revised Standard indicates that it is important to utilize audit evidence obtained in the process of auditing financial statements and to have appropriate discussions with management in order to conduct an effective internal control audit.

In light of the above revisions, the "Cabinet Office Ordinance Partially Amending the Cabinet Office Ordinance on the System for Ensuring the Appropriateness of Documents on Financial Calculation and Other Information" was published in June 2023. The ordinance adds new matters to be included in the internal control report, etc. In July 2023, the JICPA amended Internal Control over Financial Reporting Auditing Standards Statement No. 1 “Auditing of Internal Controls over Financial Reporting.”

The following issues were raised during deliberations by the Internal Control Standard Committee and will be addressed as medium to long-term issues.

- The treatment of non-financial information such as sustainability in the internal control reporting system should be considered based on domestic and overseas discussions.
- Whether or not to adopt direct reporting should be discussed in light of the nature of internal control audits.
- With regard to enhancing the disclosure of the internal control audit report, whether or not to adopt, for example, "Key Audit Matters" related to internal controls should be considered in light of progress in disclosure in the internal control report.
- The audit of the corrected internal control report is currently not required. However, the way how the auditor is involved should be considered.
- Administrative monetary penalty and penal provisions should be reviewed in order to clarify the responsibility of management and to deal with management override of internal controls.
- Alignment between the FIEA and the Companies act, such as stipulating obligations to build internal control in Companies Act, is necessary. In the future, stipulations regarding internal control of the Companies Act and the FIEA should be integrated so that comprehensive judgments can be made covering the four objectives of internal controls.
- In the written confirmation by the company representative concerning the appropriateness of the content of the securities report, it may be appropriate to consider enhancing the content of statements related to internal controls.
- If the FIEA aims to promote extraordinary disclosure instead of periodic disclosure, we should be conscious of internal control even for extraordinary reports.

C. Trends in Sustainability Disclosure and Assurance

1. Trends in Sustainability Disclosure

a Expansion of non-financial information disclosure

In recent years, emphasis has been placed on sustainability in corporate management and investors' investment decisions, and non-financial information related to medium - to long-term corporate value has become increasingly important. Non-financial information is expected to contribute not only to corporate management and investment decisions, but also to direct capital toward companies that are actively engaged in addressing social issues related to climate, nature, human rights and the exclusion of marginalized groups, thus embedding such efforts in society in terms of the financial system. On January 31, 2023, the FSA announced revisions to the Cabinet Office Ordinance on Disclosure of Corporate Affairs, etc., which result in the following new disclosures and enhanced disclosures regarding corporate information prior to the "Status of Accounting" in securities reports and registration statements for the fiscal years ending on or after March 31, 2023.

- A new section titled "Views and Initiatives on Sustainability" has been added to the "Description of Businesses" section. Companies should describe their operations in accordance with four components consistent with international frameworks: "Governance," "Risk Management," "Strategy," and "Indicators and Targets."

- As human capital disclosure, the company shall describe the policy on human resource development including ensuring diversity of human resources, the policy on the internal environment, and the details of indicators related to such policy in "Strategy" and "Indicators and Targets" in the "Description Column" of Sustainability Information. These descriptions are required regardless of their materiality.
- In the "Status of Corporate Governance, etc." section, companies are required to describe the activities of the Board of Directors, the Nomination Committee, the Compensation Committee, etc. (frequency of meetings, specific matters to be discussed, attendance), the effectiveness of internal audits (dual reporting: a system whereby the Internal Audit Department reports directly to the Board of Directors and the Audit and Supervisory Board Members, as well as to the CEO), and an outline of business alliances with companies issuing cross-shareholdings.

Non-financial disclosures are being established and expanded in other countries as well. For example, in the United States, on March 6, 2024, the U.S. Securities and Exchange Commission (SEC) issued the final rule requiring climate-related disclosures for all domestic and foreign SEC-registered companies.[2] SEC-registered companies shall disclose the following in their annual reports and registration statements.

[Other than financial statements]
In line with concepts similar to the four components of the TCFD (Task Force on Climate-related Financial Disclosures) recommendations (“Governance”, “Risk Management”, “Strategy”, and “Indicators and Targets”), disclose the followings:

- Any oversight by the board of directors of climate-related risks and any role by management in assessing and managing the material climate-related risks,
- The actual and potential material impacts of any identified climate-related risks on the strategy, business model, and outlook,
- Disclosures regarding activities to mitigate or adapt to a material climate-related risk including the use of transition plans, scenario analysis, or internal carbon prices,
- If greenhouse gas (GHG) emissions are material, information about Scope 1[3] emissions and/or Scope 2 emissions (Scope 3 is not required), etc.

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- The capitalized costs, expenditures expensed, and losses incurred etc., as a result of severe weather events and other natural conditions, disclosed in a note.

[2] Since the publication of the rule, several U.S. energy companies and business associations have filed lawsuits, and on April 4, the SEC decided to suspend enforcement of the rule.
[3] Scope 1 refers to direct emissions by the business itself; Scope 2 refers to indirect emissions from the use of electricity, heat and steam supplied by other companies; and Scope 3 refers to indirect emissions other than Scope 1 and Scope 2 (emissions by other companies related to the business' activities).

With respect to the above information, large accelerated filers (companies that meet the requirements for market capitalization of $700 million or more, etc.) will be phased in beginning in 2025, accelerated filers (companies that meet the requirements for market capitalization of $75 million to $700 million, etc.) will be phased in beginning in 2026, smaller reporting companies (companies that meet the requirements for market capitalization of less than $250 million, etc.) will be phased in beginning in 2027, and emerging growth companies (companies that meet the requirements for market capitalization of less than $1,235 million, etc.) and non-accelerated filers (companies that do not meet the requirements for large accelerated filers or accelerated filers) will be phased in beginning in 2027.

In the EU, the CSRD (Corporate Sustainability Reporting Directive) requires the preparation and disclosure of sustainability reports not only for large companies and listed small and medium-sized companies, but also for subsidiaries of non-EU companies located in the EU and foreign parent companies of subsidiaries and branches located in the EU (subject to size criteria). The contents of the sustainability report are as follows.

i. General Information
- Governance, strategy and business model, value chain, and stakeholder engagement
- Due diligence process, description of sustainability-related management and internal control systems, etc.

ii. Environmental information
- Climate change
- Pollution, etc.

iii. Social information
- Own employees
- Employees in the value chain, etc.

(iv) Governance information
- Business Activities

Double materiality[4] is required in the sustainability reports.
As in the US, the start date for preparation and disclosure is set after 2024 in a phased manner depending on whether the company is listed or unlisted and on the size of the company.

b Consideration of sustainability disclosure standards

The mainstream of sustainability disclosure has been conducted voluntarily such as integrated reports; however, disclosure standards that stipulate specific disclosure content has been discussed in Japan and other countries.
Internationally, the International Sustainability Standards Board (ISSB) finalized Standard S1 (IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information)

[4] Examining material issues not only from the impact of the environment and society on the company, but also from the impact of the company's activities on the environment and society. Considering material issues solely from the impact of the environment and society on the company is called single materiality.

and Standard S2 (IFRS S2 Climate-related Disclosures) in June 2023. These standards are to be applied from financial years beginning on or after January 2024. Each country is developing its own standards that are comparable to the standards published by the ISSB.
In April 2024, the ISSB also tentatively agreed to initiate a new research and standard-setting work on a research project on disclosure of risks and opportunities related to “biodiversity, ecosystems and ecosystem services” and “human capital,” based on the results of a public consultation on future priorities. The ISSB will develop a two-year work plan, starting in 2024, that includes work on the above two topics.

In Japan, on March 29, 2024, the Sustainability Standards Board of Japan (SSBJ) issued the Universal Sustainability Disclosure Standard Exposure Draft “Application of the Sustainability Disclosure Standards”, the Theme-based Sustainability Disclosure Standard Exposure Draft No. 1 ”General Disclosures”, and the Theme-based Sustainability Disclosure Standard Exposure Draft No. 2 “Climate-related Disclosures.” The “Application of the Sustainability Disclosure Standards” describes the part of ISSB's S1 standard that defines fundamental matters such as the reporting period and timing of reporting. The “General Disclosures” and “Climate-related Disclosures” describe the matters to be disclosed regarding sustainability-related risks and opportunities (core contents) in ISSB Standards S1 and S2, respectively. The “Climate-related Disclosures” covers the disclosure of climate-related risks and opportunities, and the “General Disclosures” covers the disclosure of risks and opportunities for sustainability-related topics in general. The SSBJ has set July 31, 2024 as the deadline for comments on the three exposure drafts, with the goal of releasing finalized standards by March 31, 2025 at the latest.
These standards are intended to start with those companies focused on constructive dialogue with global investors (companies listed on the Prime Market or part thereof), as indicated at the 52nd General Meeting of the FSA Financial System Council held in February 19, 2024. In response to the Minister of State for Financial Services' consultation on February 19, 2024 ("Consideration on Sustainability Information Disclosure and Assurance"), the Working Group on Disclosure and Assurance of Sustainability-related Financial Information of the Financial System Council was established and held its first meeting on March 26, 2024.

2. Trends in Assurance on Sustainability Disclosures

It is also useful for investors and other stakeholders to set standards for the disclosure of sustainability information so that disclosure of each company has a certain degree of consistency, and increase the reliability of information through assurance by a third party. In recent years, with the background of increasing interest in a sustainable society, financing that proclaims sustainability, such as ESG investment, has increased, while society is paying attention to information dissemination that may cause mislead among stakeholders, such as greenwashing.
Regarding third party assurance on sustainability information, the US SEC has published a draft regulation mandating climate-related disclosures, under which limited guarantees on GHG emissions

for Scope1 and Scope2 are required from fiscal year 2029 for large accelerated filers and from fiscal year 2031 for accelerated filers, and shift to reasonable assurance after two years for large accelerated filers is planned.

In Europe, listed companies subject to Non-Financial Reporting Directive (NFRD) are scheduled to introduce a limited assurance in fiscal year 2024, other large companies in fiscal year 2025, and listed small and medium-sized companies (excluding micro-companies) in fiscal year 2026, along with reporting based on the CSRD, and to shift to reasonable assurance in the future. Non-EU companies, such as foreign parent companies of subsidiaries and branches located in the EU, are also scheduled to introduce limited assurance from fiscal year 2028 and shift to reasonable assurance in the future.

Standards for assurance are also being developed to ensure the quality of assurance. In August 2023, IAASB issued the Exposure Draft of International Sustainability Assurance Standard 5000 (ISSA5000), General Requirements for Sustainability Assurance Engagements. While this Exposure Draft is intended for all assurance providers, including non-professional accountants, it assumes that members of the engagement team and EQC reviewers will apply IESBA standards or at least equivalent or higher requirements for assurance engagements, and that the professional staff will be members of the audit firm applying ISQM1 or at least equivalent or higher requirements. The Exposure Draft also sets out requirements and application guidance for each component of the process, from the acceptance and continuance of service contracts to the preparation of assurance reports. IAASB stated that it would finalize ISSA 5000 in September 2024. Also, in January 2024, IESBA published the public comment for the Exposure Drafts “Proposed International Ethics Standards for Sustainability Assurance (Including International Independence Standards) and Other Revisions to the Code Relating to Sustainability Assurance and Reporting” and “Using the Work of an External Expert” which are scheduled for finalizing in December 2024. For more information, see "B. Recent Trends with Auditing, 1. Trends in International Auditing Standards and Ethical Standards".

In Japan, the Working Group on Sustainability Information Disclosure and Assurance, which was established under the Financial System Council, held its first meeting on March 26, 2024, and started discussions.

With regard to assurance of sustainability information, investors have expressed their desire to ensure the reliability of sustainability information. Audit firms with experience in assurance in accounting audits have responded as follows.

At large-sized audit firms, the audit firm itself or a group company of the audit firm provides advisory services related to sustainability information. In addition, the audit firm provides assurance engagement on sustainability information as an accredited assurance body of the Japanese Association of Assurance Organizations for Sustainability Information.[5] In addition, a department has been established to promote the sustainability information assurance engagements, which promotes

[5] The Japanese Association of Assurance Organizations for Sustainability Information is a general incorporated association. Its predecessor was the Japan Environmental Information Review Association, which was established in 2005 for the purpose of ensuring the reliability of reviews of environmental reports, etc. and contributing to the improvement of reliability of environmental reports, etc. by realizing efficient and effective reviews. The association has six accredited review organizations.

collaboration between audit-related departments and non-financial information specialists, and also allows audit staff to accumulate practical experience by engaging in the assurance of sustainability information.

Furthermore, those firms have developed a system of assurance procedures in collaboration with global network, formulated rules for quality control, and put in place quality control systems including EQC reviews. Human resources development for sustainability assurance engagements at large-sized audit firms is also relatively well developed in Japan, with systematic mandatory training programs through learning and practical work. Some firms established a sustainability disclosure assurance certification system.

Mid-tier audit firms recognize that assurance of sustainability information is a role that they should fulfill and it is a growth opportunity, so they have set up project teams to gather information and provide training within the firm. This includes gathering information on overseas trends in collaboration with global network. Some mid-tier audit firms have started gathering information through practical operations by having an advisory firm within the group start a service to support disclosure of sustainability information, etc. On the other hand, mid-tier audit firms indicate that they plan to improve quality control systems such as EQC reviews going forward.

No small and medium-sized audit firms have been observed to have started developing quality control systems or human resource capacity for sustainability information assurance. Of the 53 small and medium-sized audit firms that collected reports in the current year, all of the firms that responded that they were "interested in assurance engagements related to non-financial information, and are making specific consideration within the firm such as gathering information," stated that they are gathering information through training courses organized by the JICPA and global network.

In addition, around 80% of firms responded that they were "interested in assurance engagements on non-financial information but did not consider it specifically," or "not interested in assurance engagements on non-financial information, or do not intend to respond (even if consulted)." Of these, around 30% noted a lack of management resources. Since the reasons for responses are optional, it is possible that more audit firms are actually unable to engage in sustainability assurance engagements due to constraints on management resources.

■ Reasonable and limited assurance engagements for sustainability information ■

Third party assurance of sustainability information, which is introduced in the United States and Europe, starts with limited assurance and then shifts to reasonable assurance after several years. The Exposure Draft of ISSA5000 (General Requirements for Sustainability Assurance Engagements) ("Exposure Draft") defines reasonable assurance and limited assurance as follows:

Reasonable assurance engagement – An assurance engagement in which the practitioner reduces engagement risk to an acceptably low level in the circumstances of the engagement as the basis for the practitioner's conclusion (omitting the rest).

Limited assurance engagement – An assurance engagement in which the practitioner reduces engagement risk to a level that is acceptable in the circumstances of the engagement but where that risk is greater than for a reasonable assurance engagement as the basis for expressing a conclusion. (ellipsis) The nature, timing and extent of procedures performed in a limited assurance engagement is limited compared with that necessary in a reasonable assurance engagement but is planned to obtain a level of assurance that is, in the practitioner's professional judgment, meaningful. To be meaningful, the level of assurance obtained by the practitioner is likely to enhance the intended users' confidence about the sustainability information to a degree that is clearly more than inconsequential.

As described above, the level of assurance provided through reasonable assurance engagements is higher than that provided through limited assurance engagements. A report published by the International Organization of Securities Commissions (IOSCO) in March 2023 reported that investors expect reasonable assurance engagements in the long term, although limited assurance engagements may be a realistic goal in the short term. On the other hand, in Japan, there are challenges for both information providers and assurance providers in the transition to reasonable assurance engagements.

Reasonable assurance engagements are based on the premise that processes for gathering information to be assured and internal controls are appropriately established and operated. ISSA5000 requires that a practitioner of reasonable assurance understands components of the internal control system, including information system and communication as well as control activities. The "Report on the Effective Collection and Strategic Use of Sustainability-related Data ("Interim Report")" published by the Ministry of Economy, Trade and Industry in July 2023 lists various issues regarding the development and operation of internal controls of information preparers, including the difficulty of collecting data from consolidated subsidiaries (including overseas bases) and their value chain, inadequate business processes, and lack of human resources. The Interim Report also points out that while there are multiple media for disclosing sustainability information and multiple divisions in charge within the company, the coordination between the divisions in charge should be strengthened.

Among the challenges for assurance providers, the Interim Report points to the need to expand human resources, including highly specialized experts in individual topics such as climate change and biodiversity, as well as experts in assurance services in general. It also states that it is important for assurance providers to fully understand the IT systems, internal controls, and governance used in the process of generating sustainability-related information.

The Interim Report notes that sustainability-related information includes different types of information and that the level of assurance demanded by information users varies depending on the type of information. In addition, due to the large amount of forward-looking and qualitative information contained in sustainability information, its materiality needs to be fully discussed. Moreover, the nature of such information may make it difficult to obtain objective evidence. The Interim Report also states that the level of assurance and the timing of the introduction of limited assurance and reasonable assurance should be discussed carefully in light of these characteristics.

■ Knowledge required for sustainability information assurance ■

The "JICPA Syllabus for Sustainability Capacity Building" ("syllabus"), published by JICPA in April 2024, lists the following knowledge and competencies required for all CPAs.

- Gain a comprehensive understanding of sustainability issues and their impact on society and economy
- Understand the basic framework of the relationship between sustainability and corporate management/corporate value
- Have the capacity to engage in high-level, constructive dialogue with senior management and others on key sustainability trends and their impact on the industry and the company.
- Possess the necessary knowledge of sustainability-related disclosure requirements (systems and standards)
- Understand the significance and the framework of assurance engagement

The syllabus also describes the following roles and competences required of core sustainability assurance professionals (CPAs who play a central role in performing assurance engagements)

Role	Competences
• Performing risk assessment of assurance engagements for sustainability information • Developing the plan (schedule, procedures) for implementation of assurance engagements • Communicating with Board of Directors and Audit and Supervisory Board • Communicating with the engagement team • Evaluating the results of the implementation • Forming assurance opinion (conclusions)	• Comprehensive knowledge on sustainability • An understanding of corporate management and corporate governance • An understanding of the material sustainability-related risks and opportunities associated with the assured company • An understanding of disclosure system and preparation standards • An understanding of disclosure processes and internal controls • An understanding of the interrelationships with financial reporting and financial statement audits • Advanced and expert knowledge and experience in the assurance engagements • An understanding of the professional ethics and independence required of persons engaged in assurance engagements

The syllabus is intended to serve as a compass for CPAs to gain an overall picture of the topics to be studied in acquiring such knowledge, skills, and expertise, and as a guide for training providers in planning and delivering training programs. The syllabus is divided into basic/common and advanced sections. The basic/common section is intended for all CPAs, while the advanced section is intended primarily for core personnel in assurance engagements.

	Basic/Common Section	Advanced Section
1. Overview of sustainability	Ba1: Sustainability in general and the expected role of CPA	
2. Sustainability and corporate management/governance	Ba2: Reflecting sustainability in governance, strategy, and risk management	Ad2: Sustainable finance
3. Information Disclosure	Ba3-1: Sustainability disclosure and integrated reporting (Overview) Ba3-2: Climate change (Overview) Ba3-3: Human capital and human rights (Overview)	Ad3-1: Sustainability disclosure and integrated reporting (Details) Ad3-2: Climate change (Details) Ad3-3: Biodiversity, ecosystems, and ecosystem services (Details) Ad3-4: Human capital (Details) Ad3-5: Human rights (Detail) Ad3-6: Other sustainability topics (Details)
	Se3: Key Topics by industry	
4. Assurance	Ba4: Ensuring reliability of sustainability information	Ad4-1-1: Professional ethics and independence Ad4-1-2: Quality control and related systems

	and assurance (Overview)	Ad4-2-1: Sustainability assurance practice standards and practical issues- (1) Basic framework and sustainability assurance standards for assurance engagements Ad4-2-2: Sustainability assurance practice standards and practical issues- (2) Acceptance of assurance engagement and planning Ad4-2-3: Sustainability assurance engagement standards and practical issues- (3) Risk procedures/responding to the risk of material misstatement Ad4-2-4: Sustainability assurance standards and practical issues- (4) Opinion and assurance reporting Ad4-2-5: Sustainability assurance engagement standards and practical issues- (5) Coordination of financial statement audits and assurance engagements on sustainability information Ad4-3: Further point of issue in sustainability assurance engagements Ad4-4-1: Practical topics by theme- Assurance of GHG information Ad4-4-2: Practical topics by theme- Assurance on human capital and human rights information

In Japan, there is currently no requirement to pass an examination in order to engage in sustainability assurance. However, there is a movement overseas, such as the EU CSRD, to require companies to pass an exam to be recognized as having sustainability expertise. In the United States, the Fundamentals of Sustainability Accounting (FSA) Credential, administered by the Sustainability Accounting Standards Board (SASB), is an example of a sustainability-related exam. This is open to non-US citizens and is administered in two levels: Level 1 (basic) and Level 2 (advanced).