Material 1

Provisional translation

Ensuring confidence in audits/ Internal control and risk management

March 9, 2021
Japan Financial Services Agency

(1) General remarks

(1) Ensuring confidence in audits / Principles of the Corporate Governance Code concerning internal control - ①

- The Corporate Governance Code states that it is important for the board of listed companies to **establish appropriate internal control and risk management systems**, and establishes principles regarding confidence in audits, internal control and risk management in Section 4 (Responsibilities of the Board).

General Principle	Principle / Supplementary Principles
Section4: Responsibilities of the Board	4.3 Roles and Responsibilities of the Board (3)
	4.3.4 Perspectives when establishing internal control and risk management systems
	4.4 Roles and Responsibilities of *Kansayaku* and the *Kansayaku* Board
	4.4.1 Ensuring the Effectiveness of the the *Kansayaku* Board and Cooperation between *Kansayaku* and Outside Directors
	4.13 Information Gathering and Support Structure
	4.13.3 Ensuring coordination between the internal audit department, directors and *kansayaku*.

(Note) In addition to the above, supplementary principle 3.2.2 (iii) states that the Board of Directors and the Board of Corporate Auditors ensure adequate coordination between external auditors and each of the *kansayaku*, the internal audit department and outside directors.

(1) Ensuring confidence in audits / Principles of the Corporate Governance Code concerning internal control - ②

Corporate Governance Code (Excerpt)

【General Principle 4】
Given its fiduciary responsibility and accountability to shareholders, in order to promote sustainable corporate growth and the increase of corporate value over the mid-to long-term and enhance earnings power and capital efficiency, the board should appropriately fulfill its roles and responsibilities, including:

(1) Setting the broad direction of corporate strategy;
(2) Establishing an environment where appropriate risk-taking by the senior management is supported; and
(3) Carrying out effective oversight of directors and the management (including *shikkoyaku* and so-called *shikkoyakuin*) from an independent and objective standpoint.

Such roles and responsibilities should be equally and appropriately fulfilled regardless of the form of corporate organization - i.e., Company with *Kansayaku* Board (where a part of these roles and responsibilities are performed by *kansayaku* and the *kansayaku* board), Company with Three Committees (Nomination, Audit and Remuneration) or Company with Supervisory Committee.

【Principle 4.3 Roles and Responsibilities of the Board (3)】
The board should view the effective oversight of the management and directors from an independent and objective standpoint as a major aspect of its roles and responsibilities. It should appropriately evaluate company performance and reflect the evaluation in its assessment of the senior management. In addition, **the board** should engage in oversight activities in order to ensure timely and accurate information disclosure and **should establish appropriate internal control and risk management systems**.

【Principle 4.4 Roles and Responsibilities of *Kansayaku* and the *Kansayaku* Board】
Kansayaku and the *kansayaku* board should bear in mind their fiduciary responsibilities to shareholders and make decisions from an independent and objective standpoint when executing their roles and responsibilities including the audit of the performance of directors' duties, appointment and dismissal of external auditors and the determination of auditor remuneration. Although so called "defensive functions," such as business and accounting audits, are part of the roles and responsibilities expected of *kansayaku* and the *kansayaku* board, in order to fully perform their duties, it would not be appropriate for kansayaku and the kansayaku board to interpret the scope of their function too narrowly, and they should positively and proactively exercise their rights and express their views at board meetings and to the management.

【Principle 4.13 Information Gathering and Support Structure】
In order to fulfill their roles and responsibilities, directors and kansayaku should proactively collect information, and as necessary, request the company to provide them with additional information. Also, companies should establish a support structure for directors and *kansayaku*, including providing sufficient staff. The board and the *kansayaku* board should verify whether information requested by directors and *kansayaku* is provided smoothly.

The preamble to the draft of the Corporate Governance Code (Excerpt)

Companies in Japan may choose one of the following three forms of corporate organization: Company with *Kansayaku* Board, Company with Three Committees (Nomination, Audit and Remuneration), or Company with Supervisory Committee. **The Code does not express a view on any of these forms of company organization. It specifies fundamental principles for corporate governance that should be applicable to whichever form of organization a company may choose**.

Given that most Japanese companies are Companies with *Kansayaku* Board, a number of principles specified in the Code are drafted under the assumption that the form of Company with *Kansayaku* Board is chosen. **It is anticipated that companies that take a form other than Company with *Kansayaku* Board will apply these principles by making necessary adjustments in accordance with their form of company organization**.

(1) The overview of *Kansayaku* board, Supervisory committee, and Audit committee under the Companies Act

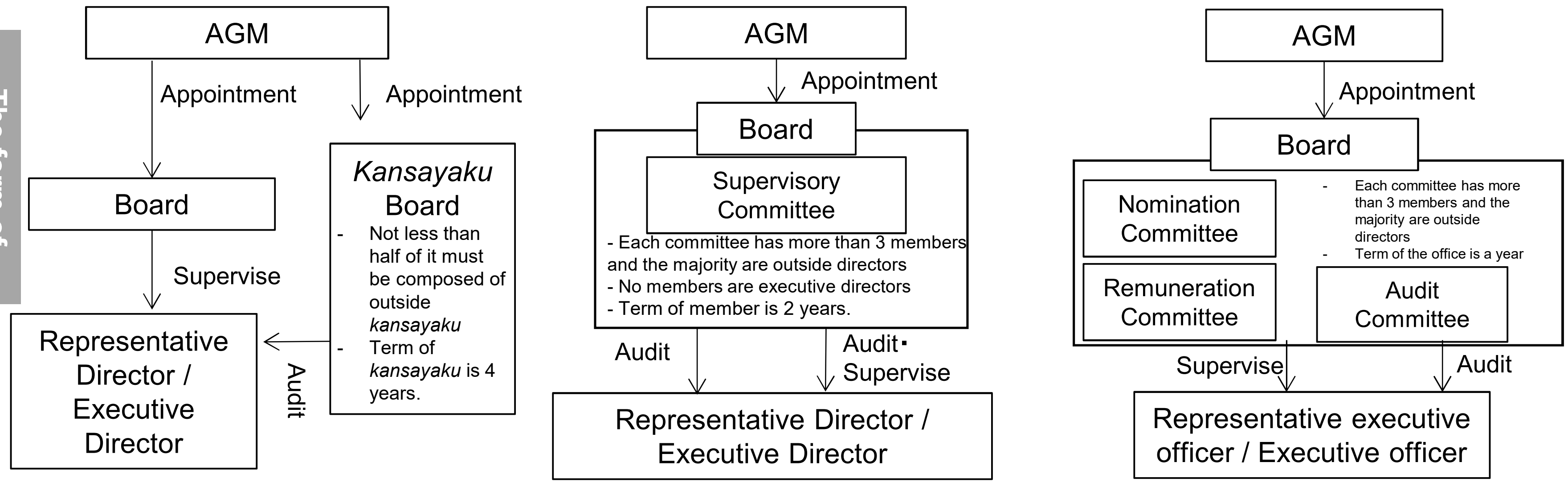
- In Japan, *Kansayaku* Board, Supervisory Committee, and Audit Committee are mainly assumed to be the entities that conduct audits under the Companies Act. The structure of these three and the methods of auditing are as follows.

	Kansayaku Board	Supervisory Committee	Audit Committee
Form of corporate organization	Company with *Kansayaku* Board	Company with Supervisory Committee	Company with Three Committees
Basic positions of members	*Kansayaku*	Directors	Directors
Structure	Three or more members Not less than half of it must be composed of outside *kansayaku*	More than 3 non-executive officers In addition, the majority of them are outside directors	More than 3 non-executive officers In addition, the majority of them are outside directors
Audit target	Execution of duties by directors (+ accounting advisors)	Execution of duties by directors (+ accounting advisors)	Execution of duties by executive officers and directors (+ accounting advisors)
Attribution of audit authority	*Kansayaku* (Solitary)	Supervisory Committee (Utilize internal control system)	Audit Committee (Utilize internal control system)
Authority regarding accounting auditor	Right to submit proposals for appointment, dismissal, and non-reappointment Right to consent to remuneration Right to dismiss Right to appoint a temporary accounting auditor Counterparties to the accounting auditor's reporting obligations	Right to submit proposals for appointment, dismissal, and non-reappointment Right to consent to remuneration Right to dismiss Right to appoint a temporary accounting auditor Counterparties to the accounting auditor's reporting obligations	Right to submit proposals for appointment, dismissal, and non-reappointment Right to consent to remuneration Right to dismiss Right to appoint a temporary accounting auditor Counterparties to the accounting auditor's reporting obligations
Authority regarding personnel and remuneration of directors (*)	–	Right to state opinions	–
Authority regarding personnel and remuneration of *kansayaku, etc.*	Right to consent to proposal on the election of *kansayaku* Right to demand submission of the election of *kansayaku* Right to an opinion about remuneration Remuneration is determined through discussion with the auditors (when there is no relevant provisions of articles of incorporation or resolution at a general shareholders meeting. etc.	Right to consent to proposal on the election of Supervisory Committee Member Right to demand submission of the election of Supervisory Committee Member Right to an opinion about remuneration Remuneration is determined through discussion with the Supervisory Committee Member (when there is no relevant provisions of articles of incorporation or resolution at a general shareholders meeting. etc.	–

(*) Directors who are not members of the supervisory committee.

(1) The overview of the form of corporate organization under the Companies Act

The form of corporate organization



Overview

Company with *Kansayaku* Board

- The board shall **supervise the execution of duties by the directors**. It must also **make its own decisions on the execution of important operations**.
- *Kansayaku* does not have the authority to exercise voting rights at meetings of the Board.
- It was introduced in the former Commercial Code of Japan, which was first enacted in Japan in 1890, referring to the legal systems of France, Germany, and other countries. Since the end of World War II, the auditor system has been revised and strengthened every time a scandal involving a major corporation became a problem.
- 1,447 companies in the First Section of the TSE (September 2020)

Company with Supervisory Committee

- The board can **delegate decisions on the execution of important business operations to representative/executive directors.** The Board is primarily responsible for supervisory functions.
- Supervisory Committee members shall have voting rights at meetings of the board as directors.
- A company with a supervisory committee was introduced by the Companies Act enacted in 2015 as an intermediate governance structure between a Company with *Kansayaku* board and a Company with Three Committee.
- 662 companies in the First Section of the TSE (September 2020)

Company with Three Committees

- The board **can delegate decisions on the execution of important business operations to the (representative) executive officers**. The Board is primarily responsible for supervisory functions.
- The Nomination and Remuneration Committee shall have the authority to make decisions regarding the appointment and remuneration of directors.
- It was introduced in 2003, referring to the governance structure of listed companies in Europe and the United States, where the primary function of the board of directors is to supervise management, rather than to make decisions on business execution.
- 63 companies in the First Section of the TSE(September 2020)

(Note) As a matter common to each form, *kansayaku* board, Supervisory Committee and Audit Committee have the authority to conduct accounting audits.

(1) Ensuring confidence in audits / Internal control disciplines in foreign codes

- Corporate Governance Codes of foreign countries have **separate chapters on ensuring confidence of audits, internal control and risk management**, or **include these matters in the chapter on the role of the board**.

Structure of codes in each country and location of disciplines related to ensuring confidence in audits, internal control, and risk management

(*) The blue chapter in each country's code sets out principles for ensuring confidence in audits and for internal control and risk management.

OECD	ICGN	U.K.	Germany	Singapore	Hong Kong	Japan
I. Ensuring the basis for an effective corporate governance framework II. The rights and equitable treatment of shareholders and key ownership functions III. Institutional investors, stock markets, and other intermediaries IV. The role of stakeholders in corporate governance V. Disclosure and transparency **VI. The responsibilities of the board**	Principle 1: Board role and responsibilities Principle 2: Leadership and independence Principle 3: Composition and appointment Principle 4: Corporate culture Principle 5: Risk oversight Principle 6: Remuneration **Principle 7: Reporting and audit** Principle 8: Shareholder rights (*)The revised draft under the consultation establishes Principle 8 "Internal and external audit" and moves the guidelines for audits.	Chapter 1: Board Leadership and Company Purpose Chapter 2: Division of Responsibilities Chapter 3: Composition, Succession and Evaluation **Chapter 4: Audit, Risk and Internal Control** Chapter 5. Remuneration	**A. Management and supervision** B. Appointments to the Management Board C. Composition of Supervisory Board **D. Supervisory Board procedures** E. Conflicts of interest F. Transparency and external reporting G. Remuneration of the Management Board and the Supervisory Board	1 Board Matters 2 Remuneration Matters **3 Accountability and audit** 4 Shareholder rights and engagement 5 Managing stakeholder relationships	A. Directors B. Remuneration of Directors and Senior Management and Board Evaluation **C. Accountability and Audit** D. Delegation by the Board E. Communication with Shareholders F. Company Secretary	Section 1: Securing the Rights and Equal Treatment of Shareholders Section 2: Appropriate Cooperation with Stakeholders Other Than Shareholders Section 3: Ensuring Appropriate Information Disclosure and Transparency **Section 4: Responsibilities of the Board** Section 5: Dialogue with Shareholders

(2) Coordination between *kansayaku* audits, etc. and the internal audit department

(2) Remarks on coordination between *kansayaku* audits and the internal audit department

- In the Follow-up Council's opinion statement No.4 published in April 2019, it was stated that "defensive governance" is indispensable to realizing the sustainable growth of companies and their mid- to long-term increases in corporate value, and that **efforts toward confidence in audits** to ensure their effectiveness are issues for future consideration.
- In the public consultation on the Stewardship Code, which was revised in March 2020, it was suggested that **institutional investors should cover the status of the development and utilization of internal audit department**. Based on this, the "Second Revision of the Stewardship Code" identified this as an issue that should be further examined, taking into account the actual situation.

Opinion statement No. 4 in the Follow-up Council (Excerpt)

1. Ensuring Confidence in Audits

"Defensive governance" is indispensable to realizing the sustainable growth of companies and their mid- to long-term increases in corporate value. **Ensuring confidence in audits through "triple auditing" (internal audits, *kansayaku* audits, etc. and external auditor-led audits) is an extremely important prerequisite to this defensive governance**.

It has been pointed out that the internal audit department is under the control and supervision of the CEO in most companies, and that the oversight function of this department has not been fully performed in cases where senior management has been involved in dishonest practices.

It is important to promote the establishment of processes where the internal audit department reports to organizations which are independent from management, such as the Board of Directors, Audit Committees, the *kansayaku* Board, etc., so that internal audit works effectively and with independence.

Starting with this internal audit issue, the Council will review measures **for ensuring confidence in audits in order to secure effective corporate governance**, while taking into account companies' specific institutional structures and characteristics.

The second revision of the stewardship code (Excerpt)

3. The following issues were also raised in the Public Consultation. It is expected that relevant authorities, including the Financial Services Agency and the Follow-up Council, have further discussions about them.

・**As internal audits are an essential function for ensuring effective corporate governance, institutional investors should cover the status of the development and utilization of the internal audit division when monitoring the governance of investee companies.**

(2) Efforts for Cooperation between *kansayaku* audits, etc. and Internal audit department (Example)

- The Japan Audit & Supervisory Board Members Association (JASBA) conducted a survey **on how *kansayaku* audits, etc. and internal audits are coordinated**. The following are the responses from the companies to the survey regarding **reporting from internal audit departments to *kansayaku*, etc..**

(*)The term “*kansayaku*, etc." refers collectively to *Kansayaku*, Audit Committee Members, and Supervisory Committee Members (the same in this secretariat material).

Specific efforts for reporting audit results from the internal audit department to *kansayaku, etc..*

Company with *Kansayaku* board

- **Each audit is reported to the *kansayaku, etc.*** in the form of an audit report, and special matters are reported at the information exchange meeting held once every three months.
- Individual audit reports are **reported at the end of the audit at a meeting with the full-time *kansayaku, etc.***.
- **Reports are made to *kansayaku*, etc. at monthly meetings**, and **when necessary, the head of the internal audit department makes direct reports**. **At the quarterly meetings with independent directors and *kansayaku* - the head of the Internal Audit Division also attends and reports**. The accounting auditor is also present at two of these meetings to share information. The information is also reported to the Board.

Company with Three Committees

- The results of individual audits are **reported by the head of the internal audit department to the Audit Committee** (in principle, every quarter), and the head of the internal audit department receives specific instructions in response to requests for investigation as necessary. A summary of the audit results for a certain period is **reported by the head of the internal audit department to the Audit Committee and the Board** (in principle, every quarter).

Company with Supervisory Committee

- The results of individual audits are **reported in writing to the Supervisory Committee each time**. The summary of audit results for a certain period is reported monthly **at a meeting with full-time Supervisory Committee members**, and reported quarterly at Supervisory Committee meetings.
- The Regulations of the Supervisory Committee stipulate that **the Supervisory Committee members may request reports from the internal audit department** on the results of individual audits as necessary.

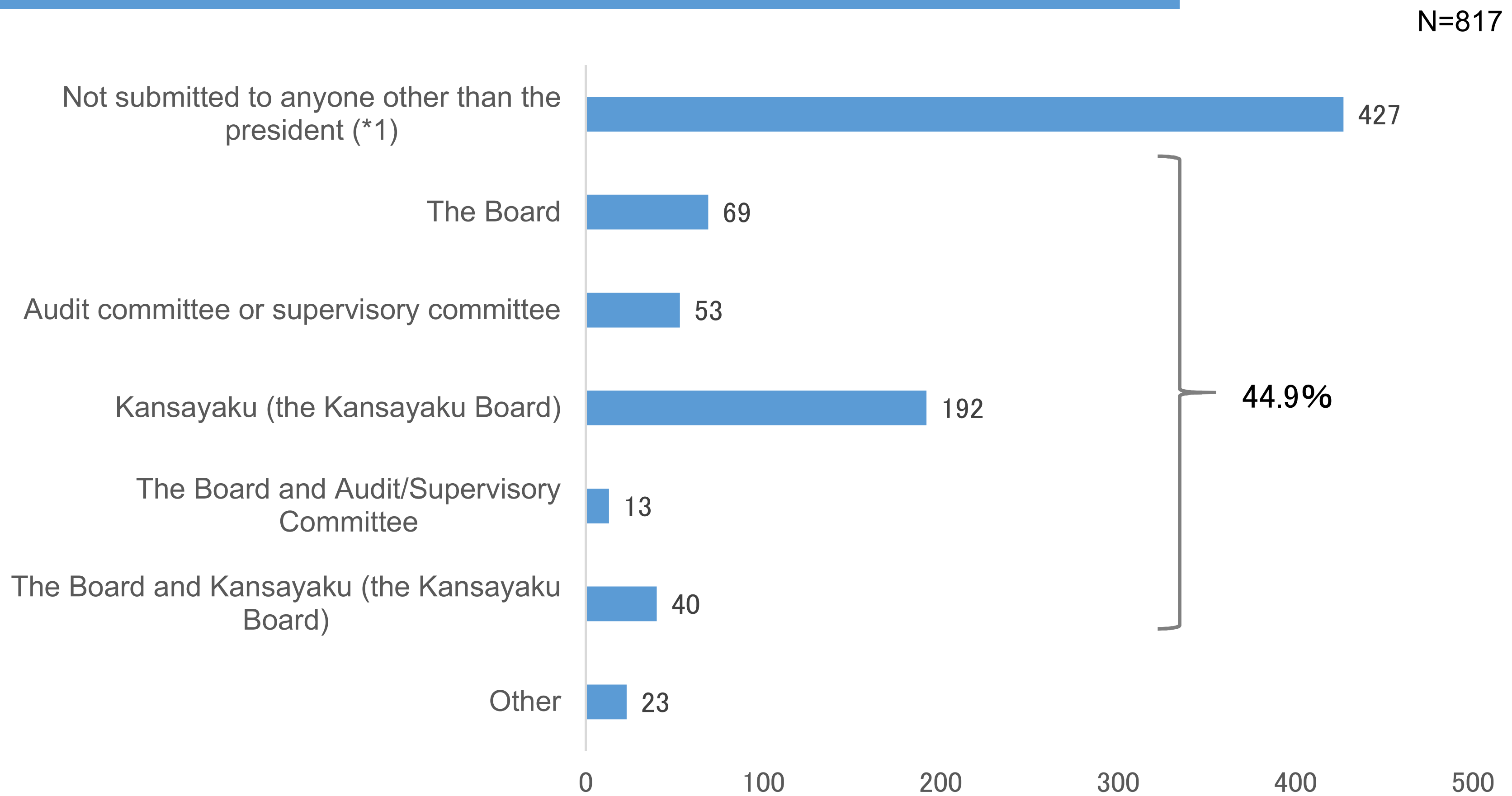
(Note) The JASBA selected two to four companies for each form of corporate organization and conducted a survey based on information about coordination between *kansayaku, etc..* and the internal audit department disclosed in the annual securities reports as of June 2019.

Source: Prepared by JFSA from the JASBA, ”Follow-up Survey on Coordination between *kansayaku*, etc.. and internal audit department” (December 16, 2020)

(2) A system in which the internal audit department reports directly to the Board, Audit committee, and the *Kansayaku* board, etc..

□ **44.9% of companies have a system in which the internal audit department reports directly to the Board, Audit Committee, the *Kansayaku* board, etc., in addition to the president.**

To whom internal audit reports are submitted (in addition to the president)



(*1) When addressed to the President and not to anyone other than the Board of Directors, Audit Committee, Supervisory Committee, or *Kansayaku*
(*2) The population is the number of companies that responded that their internal audit department reports directly to the president, excluding the 8 companies that did not respond.
Source: Prepared by JFSA from the Institute of Internal Auditors-Japan, “The 19th Comprehensive Audit Survey (2017 Audit White Paper)”

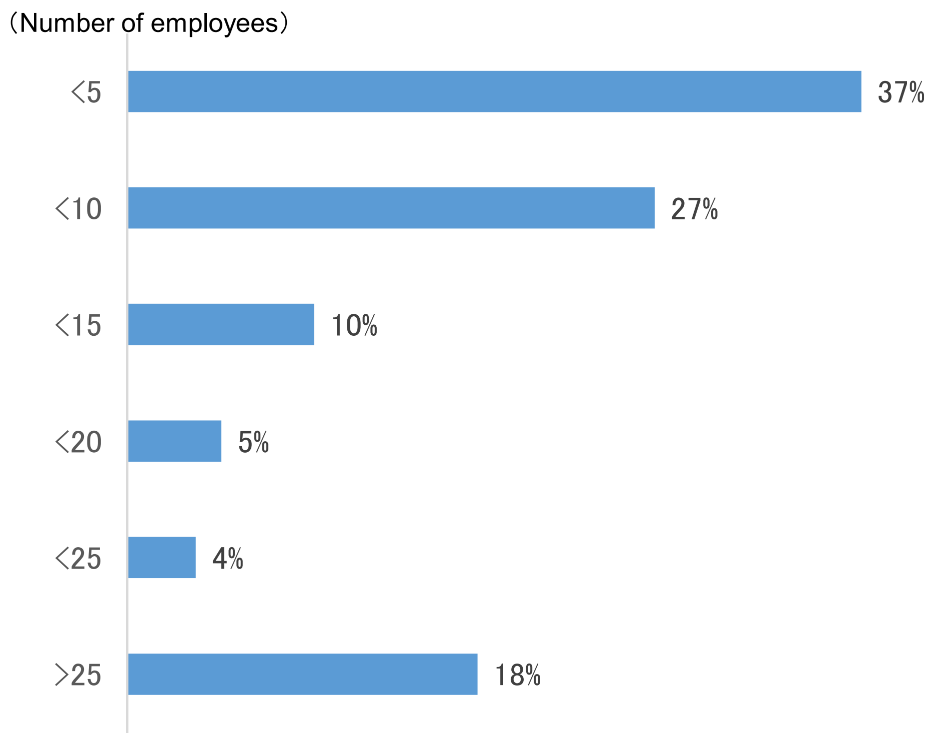
(2) The structure of internal audit departments

- Regarding the number of employees in the internal audit department, there is data that the number of employees is less than 5 in both group and non-consolidated.

The number of employees in the internal audit department

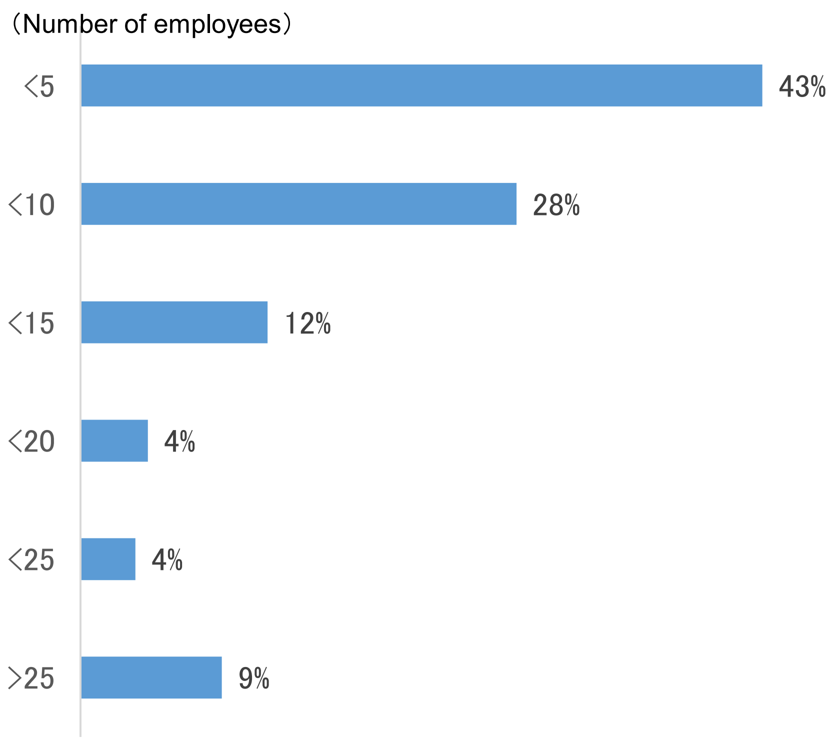
<Group>

N=678



<Non-consolidated>

N=754



Source: Prepared by JFSA from the Ministry of Economy, Trade and Industry “Research on Corporate Governance in Group Management”(March 2019)

(2) Internal audit department disciplines including reporting line of internal audit in the foreign codes

- In some cases, the Corporate Governance Code of other countries requires **an explanation of how the effectiveness of the internal control system is ensured when the internal audit function is not established**, and requires **the reporting line of the internal audit department to be the board or the audit committee**.

	Overview
OECD	• The Board should demonstrate a leadership role to ensure that an effective means of risk oversight is in place. (omitted) The board will also need to ensure that there is appropriate oversight by senior management. **Normally**, this includes **the establishment of an internal audit system directly reporting to the board**. It is considered good practice for the internal auditors to report to an independent audit committee of the board or an equivalent body which is also responsible for managing the relationship with the external auditor, thereby allowing a co-ordinated response by the board. (omitted)
ICGN	• (omitted) **Where an internal audit function has not been established, full reasons for this should be disclosed** in the annual report, as well as **an explanation of how adequate assurance of the effectiveness of the system of internal controls has been obtained**. (*)The revised draft under the consultation establishes new Principle "Internal and external audit" and adds new rules, “The board should ensure that the quality of internal and external reporting is supported by a rigorous and independent audit process, relating both to financial and non-financial information.”, etc..
U.K.	• The main roles and responsibilities of the audit committee should include: (omitted) - **monitoring and reviewing the effectiveness of the company’s internal audit function or**, **where there is not one**, **considering annually whether there is a need for one** and making a recommendation to the board; (omitted) • The annual report should describe the work of the audit committee, including: (omitted) - **where there is no internal audit function, an explanation for the absence, how internal assurance is achieved, and how this affects the work of external audit**; (omitted) 【Guidance on Audit Committees】 • The audit committee should approve the appointment or termination of appointment of the head of internal audit. **Internal audit should have access to the audit committee and board chairman where necessary** and the audit committee should ensure internal audit has a reporting line which enables it to be independent of the executive and so able to exercise independent judgement.
Netherlands	• **The duty of the internal audit function is to assess the design and the operation of the internal risk management and control systems**. The management board is responsible for the internal audit function. The supervisory board oversees the internal audit function and maintains regular contact with the person fulfilling this function. (*)In addition, the appointment and dismissal of internal auditors, evaluation of the internal audit function, the internal audit plan, etc.. are mentioned in detail.
Singapore	• **The primary reporting line of the internal audit function** is to **the AC (Audit Committee)**, which also decides on the appointment, termination and remuneration of the head of the internal audit function. (omitted)

Source: Prepared by FSA from the Corporate Governance Codes of each institution and country

(3) Internal control / Risk management

(3) Previous opinions on internal control and risk management

- ☐ The Corporate Governance Code requires the board to **establish appropriate internal control and risk management systems**.
- ☐ Companies and experts have pointed out that the following points should be kept in mind when developing these systems.
  - **The importance of understanding risks not only from a negative perspective, such as avoiding losses, but also from an appropriate perspective to enhance corporate value**
  - **The importance of discussing internal control and risk management in relation to governance issues**

Identifying risks

- We tend to have a negative impression when hearing the word "risk," but **striking a balance between risk and return is a basic premise of management**, and **both the supervisory and executive sides need to understand its importance**. (Expert)
- **The concept of risk approach is very important for enterprise internal control**. However, if the management does not have a concrete understanding of the risks identified by the risk approach, it is not connected to specific applications such as appropriate resource allocation. (Expert)
- In the past, the focus was on downside risks, but recently **it has been necessary to address upside risks (e.g., loss of growth opportunities), and the scope of risk management is expanding**. (Expert)

Internal control and risk management initiatives

- Even small-scale bases can become a major risk if a problem becomes apparent. For this reason, **we are preparing and evaluating risk assurance maps that take into account the composition of some overseas subsidiaries and the peculiarities of their business forms**. (Practitioner)
- After the Covid-19 pandemic, **corporate awareness of risk management has undoubtedly improved**, **and some companies have set up risk management committees to examine the issue separately from an offensive and defensive perspective**. (Expert)
- In light of the Covid disaster, **stronger corporate governance and risk management must be considered** for listed companies to lead the transformation toward a post-Covid economic and social structure in a drastically changing environment. (Expert)
- Company-wide risk management and risk appetite frameworks are not fully functional, and risk assessment is weak. In this sense, I think corporate governance reform still has a long way to go. (Expert)
- There is a need for **flexible allocation of resources, risk assessment, and flexible and repeated review of internal audit plans**, with full consideration of the impact of corporate changes resulting from the experience of crises. (Expert)
- **We have started to rebuild internal controls on a group basis**. The first step **is to visualize the situation within the group**. (Practitioner)

Source: Prepared by JFSA from the results of interview conducted from June to August 2020

(3) Previous discussions on internal control and risk management

	～1990's	1990's～2010	2010～
	Classic risk management	Contemporary risk management	

Trends in risk management discussions

Classic risk management (～1990's)

Focus only on the negative aspects of each risk and how to avoid or control the danger or loss.

Contemporary risk management (1990's～2010, 2010～)

Focus on how to manage risks by taking a comprehensive view of possible risks, **both positive and negative**, in conducting business.

Changes in Financial Institutions

1998
The Basel Committee, "Framework for Internal Control Systems in Banking Organisations."

1999 (*) revised in 2006
The Basel Committee, "Enhancing Corporate Governance for Banking Organisations."

Financial Crisis

2010 (*) revised in 2015 based on the thematic review below.
The Basel Committee, "Principles for Enhancing Corporate Governance."

2013
FSB, "Thematic Review on Risk Governance."

In addition, FSB published " Principles for an Effective Risk Appetite Framework" in 2013

- **The rise of modern risk management thinking**
- **Emphasis on risk management tied to business strategy in governance**
- **Growing importance of risk management in the wake of the Enron scandal in 2001**

USA (COSO)

1992
COSO "Internal Control - Integrated Framework"

<Purpose of internal control>
- Effectiveness and efficiency of operations
- Reliability of financial reporting
- Compliance with relevant laws and regulations

(*) The concept of risk management based on corporate strategy is not explicitly stated.

2004
COSO, "**Enterprise Risk Management - Integrated Framework**."

<Purpose of ERM>
- **Strategy** (high-level goals linked to and support the entity's mission)
- Operations (effective and efficient use of the entity's resources)
- Reporting (reliability of reporting)
- Compliance (adherence to applicable laws and regulations)

2013
COSO, "Internal Control – Integrated Framework" was revised.

2017
COSO, "Enterprise Risk Management: Integrating with Strategy and Performance" was revised.

Trends in the governance debate in the UK

1992
The Cadbury Committee Report

1998
The Hampel Committee Report

Clearly state that the importance of corporate governance is not only accountability but also contributing to corporate prosperity

1999
ICAEW "The Turnbull Guidance"

Assume that the board adopts a risk-based approach.
(Note) Formulated based on the Combined Code, which is a compilation of the above reports, etc..

2010 (*) Most recently updated on 2018
FRC, "Corporate Governance Code"

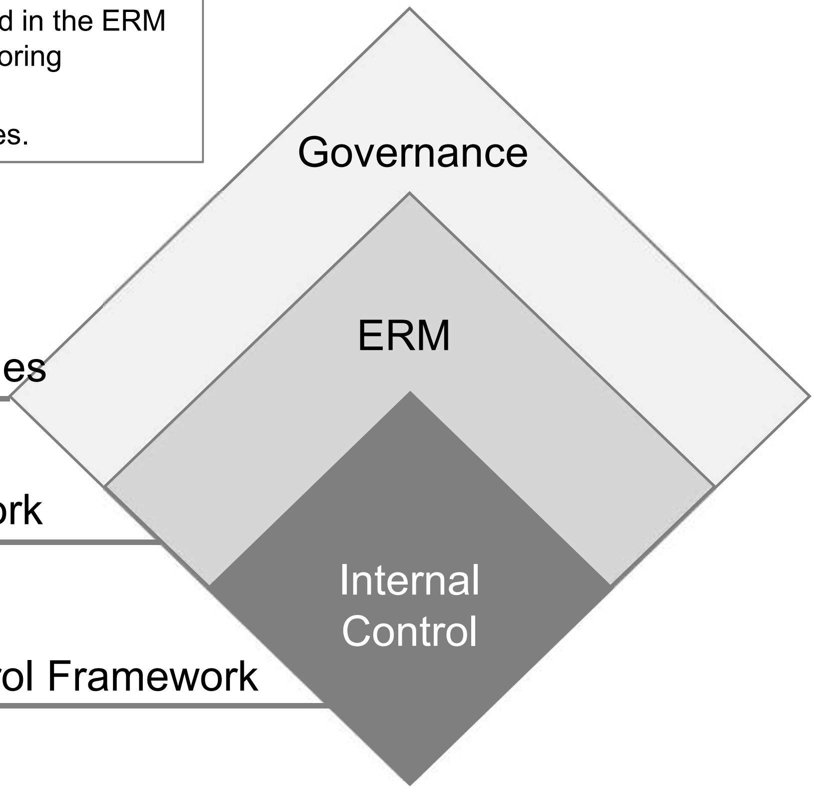
Source: Prepared by JFSA with reference to "Internal Control Integrated Framework" (1996), translated by TOBA Yoshihide Toba et al.; "Corporate Governance in the UK" (2000), translated by HATTA Shinji et al.; NOMURA Akiko, "From Internal Control to Business Risk Management" (2003); NITTA Keisuke, "New Trends in Risk Management" (2004); "Enterprise Risk Management" (2006), translated by HATTA Shinji; SUGINO Fumitoshi, "A Study on the Historical Development of Corporate Risk Management" (2009); "COSO Integrated Framework for Internal Control: Framework Edition" (2014), translated by HATTA Shinji et al.; "COSO Enterprise Risk Management" (2018), translated by HATTA Shinji, et al.

(3) Clarification of the relationship between internal control, risk management and governance

- The U.S. COSO (the Committee of Sponsoring Organizations of Treadway Commission), which formulates international frameworks for internal control, summarizes the relationship between internal control, risk management and governance as follows.
- **Internal control is an integral part of enterprise risk management**, and **enterprise risk management is positioned as a part of the overall governance process**.

Relationship between 3 lines

- Internal control is positioned within the ERM Framework as the foundation for enterprise risk management, while the ERM Framework focuses on areas beyond internal control.
- The Internal Control Framework and the ERM Framework complement each other, and descriptions of internal control common to both frameworks are not repeated in the ERM Framework, but instead refer to the Internal Control Framework (e.g., monitoring (supervisory) activities).
- Governance is positioned as a top-level concept that includes these activities.



(*) “ERM” refers to Enterprise Risk Management.

Source: Prepared by JFSA from material prepared by the Japan Internal Control Research Association, based on figures from "COSO Integrated Framework for Internal Control: Framework Edition" (2014), translated by HATTA Shinji et al. and "COSO Enterprise Risk Management" (2018), translated by HATTA Shinji, et al.

(3) Risk management initiatives at internal control departments in global companies

- Internal audit departments of global companies have the following characteristics: (x) **top management recognizes the importance of internal audit and encourages it within the company**; (y) **all risks related to the entire business are covered by internal audit**; and (z) **the internal audit department has a reporting line to the audit committee to ensure independence from the executive side**.

Risk management in global companies

	Current situation and issues in Japan	Characteristics of global companies
Role of internal audit department	• Companies tend to lack a high level of understanding of the importance of internal audits, and their positioning within the company is low. • Internal audits are seen as mere compliance measures, and are not strategically used as a mechanism to support mid-to long-term corporate value enhancement (only formal measures are taken such as confirming compliance) • Due to the budget constraints of the internal audit department, efforts to improve audit accuracy and efficiency through the use of digital technology are limited. • Emphasis is placed on the "autonomy" of the acquired company, and monitoring through internal audit is left to the acquired company.	• Top management recognizes the importance of internal audits and encourages them to be conducted internally. • Targeting all risks related to the entire business, not just legal compliance. • Strengthening its role as an advisor to business units and contributing to the improvement of corporate activities. • Developing audit plans based on risk assessment. • Proactive use of digital technology to improve audit accuracy and efficiency. • Thoroughly visualizing the actual status of acquired companies through internal audits.
Human resource development in internal audit department	• Personnel are assigned mainly based on personnel rotation, which results in the lack of specialized skills necessary for internal auditors.	• Utilizing the internal audit department as a leadership development hub. • Staffing with a balanced skill mix of internal audit expertise and understanding of the business.
Organizational structure of the internal audit department	• They are under the direction of the president and other executives and do not play an independent monitoring role. • In some cases, administrative departments of overseas subsidiaries are responsible for the internal audit of the subsidiary, and their independence from the local management is not ensured.	• Three-line defense is thoroughly enforced. • Internal audit departments have a reporting line to the audit committee to ensure independence from the executive side. • The internal audit department is vertically integrated within the group, ensuring independence from the organization. • Internal audits are carried out centrally by the corporate.
Crisis management	• Due to a lack of a global whistleblowing system, especially for overseas offices, information is retained locally.	• Whistleblowing systems are in place throughout the Group. • A detailed contingency action plan is in place.

Source: Prepared by JFSA from the Ministry of Economy, Trade and Industry “Research on Corporate Governance in Group Management”(March 2019)

(3) Internal control and risk management disciplines in the foreign codes

- Some Corporate Governance Codes in other countries state that with regard to internal control and risk management, the board shall **determine the nature and scope of risks to be undertaken as a company from the perspective of increasing corporate value**.

	Overview
OECD	The board should fulfil certain key functions, including: 1. Reviewing and guiding (omitted) risk management policies and procedures : (omitted) Such risk management oversight will involve oversight of the accountabilities and responsibilities for managing risks, specifying the types and degree of risk that a company is willing to accept in pursuit of its goals, and how it will manage the risks it creates through its operations and relationships.
ICGN	Strategy and risk are inseparable and should permeate all board discussions and, as such, the board should consider a range of plausible outcomes that could result from its decision-making and actions needed to manage those outcomes. The board should adopt a comprehensive approach to the oversight of risk(omitted). Fundamental to this is the board's agreement on its risk appetite, and the board should seek to publicly communicate this in basic terms.
U.K.	The board should establish procedures to manage risk, oversee the internal control framework, and determine the nature and extent of the principal risks the company is willing to take in order to achieve its long-term strategic objectives.
Netherlands	The management board should **identify and analyze the risks associated with the strategy and activities of the company and its affiliated enterprise**. It is **responsible for establishing the risk appetite**, and also **the measures that are put in place in order to counter the risks being taken**.
Singapore	The Board **determines the nature and extent of the significant risks which the company is willing to take in achieving its strategic objectives and value creation**. The Board sets up a Board Risk Committee to specifically address this, if appropriate.
Hong Kong	The board **is responsible for evaluating and determining the nature and extent of the risks it is willing to take in achieving the issuer's strategic objectives**, and ensuring that the issuer establishes and maintains appropriate and effective risk management and internal control systems.
Australia	The board or a committee of the board should: (a) **review the entity's risk management framework** at least annually to satisfy itself that it continues to be sound and that **the entity is operating with due regard to the risk appetite set by the board**; (omitted)

Source: Prepared by JFSA from the Corporate Governance Codes of each institution and country

Subjects to be discussed at the 25th Council

- It is pointed out that ensuring confidence in audits is important as a basis for increasing mid- to long-term corporate value.
- The Corporate Governance Code requires the board to establish appropriate internal control and risk management systems. The following points should be kept in mind when developing these system.
    - Importance of understanding risk not only from a negative perspective, such as avoiding losses, but also from an appropriate perspective to improve corporate value.
    - Importance of discussing internal control and risk management in connection with governance.
- Based on the above trends, how should be the following issues considered?
    - What do you think about the coordination between *kansayaku* audits,etc. and internal audits?
    - What do you think about the state of internal control and risk management in light of corporate strategy, etc..?
- Are there any other issues related to ensuring confidence in audits/internal control and risk management that should be considered?