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In Japan, where the population is aging and shrinking, there are strong expectations that financial institutions will contribute to economic growth by enhancing their customers' corporate value and competitiveness through high-quality financial intermediation and high-quality financial services. To fulfill these expectations sustainably, Japanese financial institutions must maintain their financial soundness and business appropriateness.

In Japan, financial institutions seem to have comparatively developed a culture of "not taking excessive risks" due to differences in compensation structures compared to the United States and Europe and the experience of the "Heisei Financial Crisis" in Japan. However, in Japan as well, the business of financial institutions is becoming increasingly group-oriented and globalized, and the risks they face are becoming more diverse and complex. At the same time, human resources are becoming more fluid, and business experience and areas of expertise are becoming more diverse.

As a result, we cannot deny the possibility that the risk culture, internal controls, and risk management systems of Japanese financial institutions will change significantly in the future. Even under such circumstances, the role of internal auditing is extremely important in enabling Japan's financial institutions to continue to ensure their financial soundness and appropriate business operations, as the new "Global Internal Auditing Standards ™" state that a better functioning of internal auditing enhances an organization's ability to create, protect, and sustain value.

For the JFSA, with far fewer staff members than U.S. and European supervisory authorities, the internal audit departments of financial institutions are key partners in identifying and preventing the materialization of risks and vulnerabilities.

In fact, the JFSA determines the scope and depth of monitoring, including inspections, based on the reliability of internal audits of financial institutions, in order to improve the efficiency of supervision and reduce the burden on financial institutions. In this regard, the JFSA hopes that the internal audit departments will become more trustworthy.

As part of this effort, the JFSA published "Current Situation and Issues for Improving Internal Audit of Financial Institutions" in June 2019. Based on the results of subsequent monitoring, the JFSA published "Progress Report for "Improving Internal Audits of Financial Institutions" (Interim Report)" in October 2023 and "Monitoring Report for Improving Internal Audits of Financial Institutions (2024)" in September 2024.

"Current Situation and Issues for Improving Internal Audit of Financial Institutions" shows that the levels of internal audits can be evaluated between Stage 1 and Stage 4.

However, the evaluation still needs to be organized, as it discusses not only the mission and role of internal auditing at each stage, but also the methods of internal auditing.

If I exclude the methods of internal audits from the evaluation, I may define the stages as follows:

(a) In Stages 1 and 2, the audit process to detect administrative deficiencies and vulnerabilities is advanced through enhanced risk assessment so that the audit can contribute to ensuring the financial soundness and appropriateness of business operations.

(b) In Stage 3, audit results and recommendations are more involved in management, with maturing root-cause analysis and risk identification, and using off-site monitoring and thematic audits flexibly and effectively.

(c) In Stage 4, the knowledge of the internal audit department is broadly utilized in management, even from formulating management strategies. Trust between the internal audit department and audited departments matures as the understanding of internal audits spreads throughout the organization. In addition, audit methods are further enhanced, including the use of AI technology.

In the working group, we respectfully request that participants discuss a broad range of matters, including the level of internal auditing required for each sector and size of company, not only the evaluation of each Stage.

The results of discussion in the working group are planned to be compiled and published around June so that they can serve as guidelines not only for Japanese financial institutions but also for Japanese non-financial institutions and overseas financial supervisors.