

Self-regulation Report 2024

— Quality Control Review System —



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(*)JICPA's fiscal year begins on April 1 and runs until March 31 of the following year, therefore, the fiscal year beginning April 1, 2024 is shown as FY 2024 in the report.

I. Quality Control Review System

1. Overview of the Quality Control Review System

(1) Overview and Purpose of the Quality Control Review System

The Japanese Institute of Certified Public Accountants ("JICPA") has implemented the "Quality Control Review System" as part of its self-regulatory activities since FY1999 with an aim to maintain and enhance an appropriate quality level of audit and to maintain and ensure social trust in those services.

In accordance with Article 77 of the JICPA Constitution and the intent of Article 46-9-2 of the Certified Public Accountants Act ("CPA Act"), the Quality Control Committee established in JICPA conducts quality control reviews to assess^(*) the design and operation status of the audit system of quality management (hereinafter, simply referred to as "system of quality management."), including the risk assessment process (which refers to the setting of quality objectives for audits, identify and assess quality risks, and addressing quality risks) conducted by certified public accountants or audit firms (hereinafter, these are referred to as "audit firms."), notify them of the results, require to take appropriate corrective actions, and impose appropriate measures as necessary.

Quality control reviews are focused on instructing and supervising audit firms (including taking supervisory measures). They are not intended to expose or penalize audit firms or interfere with audit opinions issued by audit firms.

In addition, due to the amendment of the CPA Act in May 2022, JICPA has been operating the Registration System for Auditors that Engage in Audits of Listed Companies and Similar Companies since April 2023. In this system, JICPA confirms the eligibility of auditors that engage in audits of listed companies and similar companies through the Quality Control Review System.

(*) We review the status of the development and operation of systems of quality management, including risk assessment processes, so that quality control reviews that correspond to the introduction of a risk-based approach at audit firms will be conducted from the first quality control review covering the accounting period of audited companies that begins after July 1, 2023. For audit firms that apply the previous quality management standards, we continued to review the status of the design and operation of the systems of quality management as before.

(2) The Audit Firm's System of Quality Management

Audit firms must properly establish and operate a system of quality management with regard to the following matters:

- The audit firm, partners, and the entire professional staff belonging to the audit firm (hereinafter collectively referred to as "professional personnel") shall fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements, and conduct engagement in accordance with such standards and requirements.
- Engagement reports issued by the firm or engagement partners are appropriate in the circumstances.

A system of quality management operates in a continual and iterative manner and is responsive to changes in the nature and circumstances of the firm and its engagements. It also does not operate in a linear manner. A system of quality management addresses the following components:

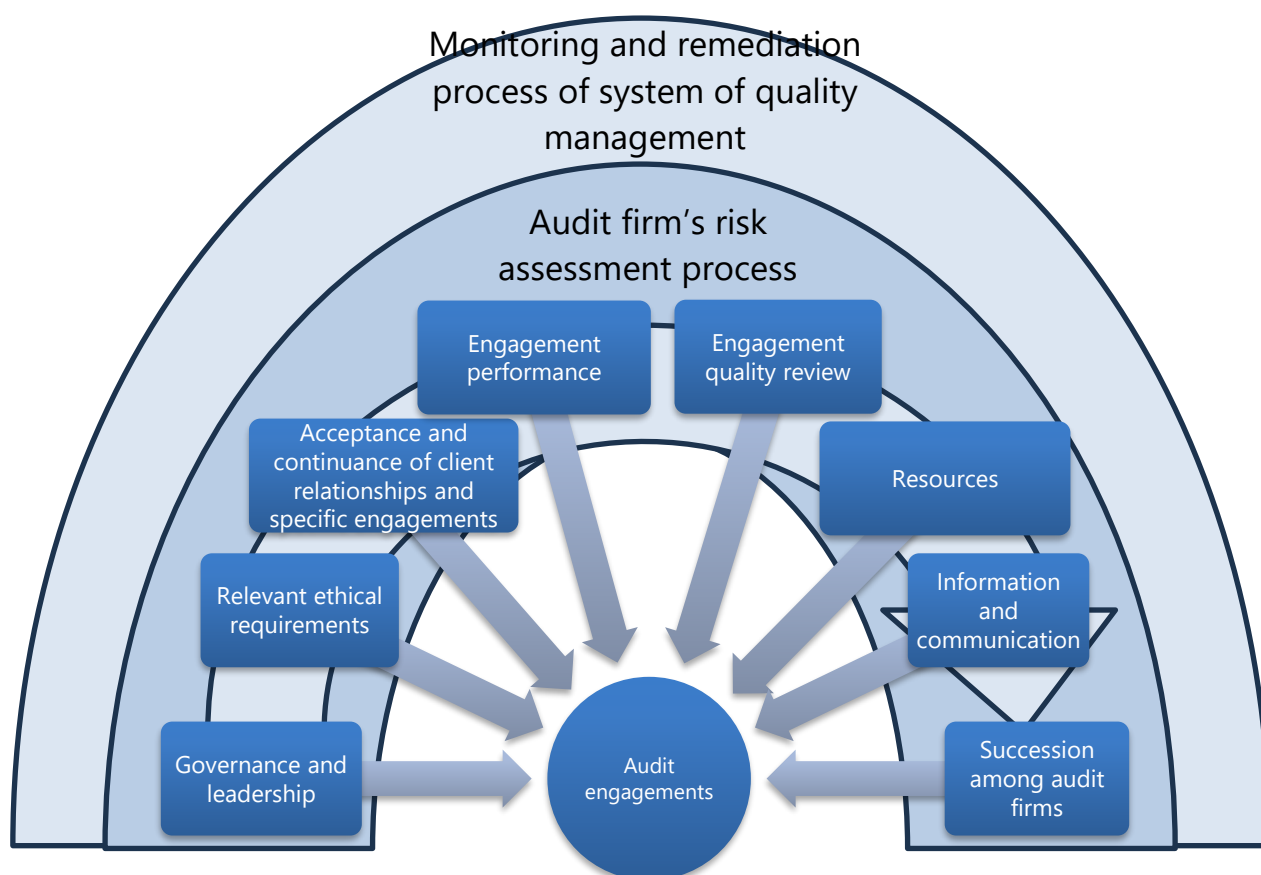
(Reference)

The International Federation of Accountants (IFAC) Board of Directors has established the "Statements of Membership Obligations" (hereinafter referred to as "SMO") 1-7, and member organizations are obligated to clearly state and implement actions to fulfill the requirements set out in the SMO. SMO1 "Quality Assurance" sets out requirements for member organizations regarding the quality assurance review system for firms that perform assurance work such as audits.

JICPA is a member of the International Federation of Accountants, and we conduct quality control reviews in compliance with SMO1 in Japan.

[Components of an audit firm's system of quality management]

"Quality Management Standards Report 1: Quality Management at Audit Firms" requires the firm to apply a risk-based approach in designing, implementing and operating the components of the system of quality management in an interconnected and coordinated manner such that the firm proactively manages the quality of engagements performed by the firm. .



| | |
|--|--|
| <p>Audit firm's risk assessment process (Process established by the audit firms as a part of the system of quality management)</p> | <p>It is a process that audit firms must follow when applying a risk-based approach to quality management. It consists of setting quality objectives, identifying and assessing quality risks, and developing and implementing responses to address the quality risks.</p> |
| <p>Governance and leadership (Fundamentals of the operation of the system of quality management)</p> | <p>It covers the audit firms' culture, the responsibilities of chief executives and others related to quality, the firm's organizational structure, assignment of roles and responsibilities, and resource planning and allocation.</p> |

| | |
|---|--|
| Relevant ethical requirements(Specific items that are the basis for the engagement performance) | It covers quality objectives and specific measures related to professional ethics to be observed by audit firms and their professional personnel. |
| Acceptance and continuance of client relationships and specific engagements (Specific items that are the basis for the engagement performance) | It covers quality objectives and specific responses related to the audit firm's judgement about whether to accept or continue contracts. |
| Engagement performance (Specific items that are the basis for the engagement performance) | It covers direction and supervision and review of engagement documentation, exerting professional judgment and skepticism, consultation on difficult or contentious matters, as well as quality objectives and specific responses to support the implementation of high-quality audits, including differences of opinion. |
| Resources (enables operation of other components) | It covers the appropriately obtaining, developing, using, maintaining, allocating and assigning of human, technological and intellectual resources and service providers that enable the operation of the system of quality management and quality objectives. |
| Information and communication (enables operation of other components) | It covers obtaining, generating or using information regarding the system of quality management, and quality objectives and specific responses regarding communicating information within the audit firms and to external parties on a timely basis. |
| Monitoring and remediation process of system of quality management (A process established by the audit firms as a part of its system of quality management) | <ul style="list-style-type: none"> • The process that provides the firm with reliable and timely information about the design and operation of the system of quality management • The process that addresses taking appropriate actions to respond to deficiencies in order to remedy deficiencies on a timely basis |
| Succession among audit firms (Specific items that are the basis for the engagement performance) | It addresses quality objectives regarding the communication of significant audit matters to successor audit firms and inquiries about significant audit matters to predecessor audit firms. |
| Engagement quality review (Specific items that are the basis for the engagement performance) | It addresses specific measures related to ensuring the competence and independence and objectivity of reviewers in relation to the audit engagement, including sufficient review time, and conducting and documenting timely and in-depth reviews. |

(*) Prepared by JICPA based on "Quality Management Standards Report 1: Quality Management at Audit Firms" and "Quality Management Standards Report 2: Engagement Quality Reviews."

In the quality control review, we confirm whether the audit firms appropriately develop and operate a system of quality management based on the quality control review standards and procedures based on the JICPA's Constitution.

In addition, in response to the revised Quality Management Standards, etc., the following handling has been added to the review procedures from June 2023.

- In order to evaluate the status of the audit firms' risk assessment process in the quality control review, we have added items related to the risk assessment process for the requirements and factors that cause a result with significant deficiencies and for the requirements that cause a result with extremely significant deficiencies.
- Examples of factors that constitute significant deficiencies (i) stipulated as special provisions for auditors that engage in audits of listed companies and similar companies have been added in line with the components of the revised Quality Management Standards Report 1.
- Added the statement that the items to be considered in understanding and evaluating the status of maintenance will be reviewed, and that information on the risk assessment process, monitoring and remediation process, and evaluation will be obtained.
- Added review procedures for monitoring activities by audit firms
- Added that the timing of the review work will be determined in consideration of the monitoring and remediation process by the audit firms and the timing of the evaluation.
- Confirm the conclusions of the evaluation of the system of quality management conducted by the audit firms at the time of formulating the review plan.
- Examine whether the results of the review deviate from the conclusions of the evaluation conducted by the audit firms.
- Added procedures for cases when the audit firms conclude other than "providing reasonable assurance that the objectives of the system of quality management are being achieved" after an on-site review.

(3) Types of Quality Control Reviews

Quality control reviews consist of "regular review", "special review" and "review for the examination of registration".

[Type of quality control reviews]

| | Regular review ^(*) | Special review | Review for the examination of registration |
|-------------------------------|--|--|---|
| Purpose | To assess the design and operation status of an audit firm's system of quality management | To assess the design and operation status of an audit firm's system of quality management <u>in certain audit areas or certain audit engagements</u> | <ul style="list-style-type: none"> To assess the design status of an audit firm's system of quality management To assess the operational system established by an audit firm for auditing the financial statements of listed companies and similar companies fairly and appropriately |
| Frequency | In principle, the review is conducted every three years. Based on the judgment of the Quality Control Committee, the frequency may be increased or decreased (however, the review is conducted at least once every five years) | When the Quality Control Committee deems it necessary, the review is conducted in a timely manner in order to mainly assess the following matters: <ul style="list-style-type: none"> - system of quality management of an audit firm - Implementation status of audit - Specific matters | If any of the following cases apply, the review is conducted based on a request from the Review Board for Registration on Auditors that Engage in Audits of Listed Companies and Similar Companies to the Quality Control Committee. <ul style="list-style-type: none"> • When applying for registration • When deemed necessary for the Confirmation of Eligibility of Auditors that Engage in Audits of Listed Companies and Similar Companies • Other necessary cases |
| Audit firms subject to review | Audit firms subject to regular review | All audit firms that provide audit engagements | (i) Audit firms which have applied for registration on the official roster of auditors that engage in audits of listed companies and similar companies (ii) Registered auditors that engage in audits of listed companies and similar companies which have not engaged in audits subject to regular review |
| Procedures | Site visit | Site visit, inquiry or in writing | Site visit |

(*) JICPA confirms the eligibility of registered auditors that engage in audits of listed companies and similar companies, which are subject to regular review, by assessing whether they comply with the matters stipulated

by laws and regulations as personnel systems and other operational control systems sufficient to fairly and accurately carry out an audit the financial documents of listed companies and similar companies.

(4) Audit Firms Subject to Quality Control Review

The Quality Control Committee collects information on the recent status of audit firms mainly through off-site monitoring, and based on this information, selects audit firms subject to regular and special reviews, and develops an annual quality control review plan. This annual review plan is revised from time to time through ongoing information gathering.

The number of audit firms subject to regular review as of March 31, 2025, is as follows:

[Number of audit firms subject to regular review as of March 31, 2025]

| | Audit Firms | CPA Offices ^(*1) | Total |
|---|-------------|-----------------------------|-------|
| Audit firms subject to regular reviews | 157 | 66 | 223 |
| Of the above, registered auditors that engage in audits of listed companies and similar companies ^(*2) | 130 | 2 | 132 |

(*1) For CPA joint offices (the "Joint Offices") in which multiple CPAs jointly conduct audits and other services, quality control reviews are conducted on a joint office basis. The number of Joint Offices is included in the number of CPA Offices.

(*2) "Audit firms for which the examination of eligibility for registration to be conducted" or "among audit firms whose registration has been refused, those that are conducting an audit of listed companies" by the Review Board for Registration on Auditors that Engage in Audits of Listed Companies and Similar Companies are included in the registered auditors that engage in audits of listed companies and similar companies.

(5) Process of Quality Control Reviews

In accordance with quality control review standards and procedures based on the JICPA Constitution, JICPA effectively and efficiently conducts quality control reviews, establishing formats for them.

(i) Regular review

In order to assess the status of audit quality managements on a firm-wide basis, regular reviews are conducted mainly through the following procedures.

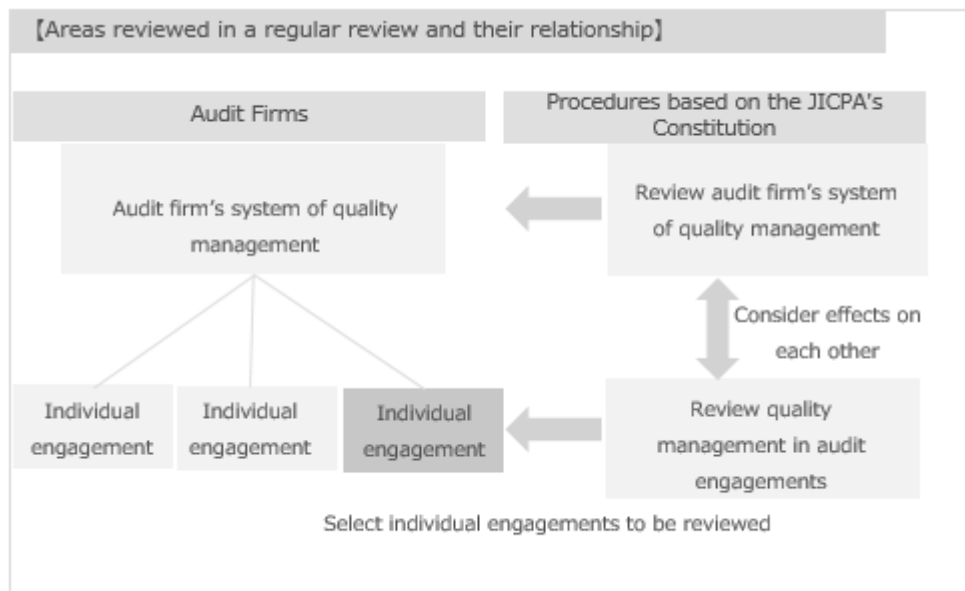
As illustrated below, "audit firm's system of quality management" and "quality management for audit engagement" are interrelated.

(a) Review audit firm's system of quality management

Review whether an audit firm designs the system of audit quality management appropriately and operates it effectively.

(b) Review quality management for audit engagements

Review whether the audit firm's system of quality management is appropriately applied to individual engagements.



By considering the environment surrounding an audit firm, the level of individual engagement risks, the nature of audit engagements and other factors, individual engagements are carefully selected for a review so that the audit firm's overall quality management can be examined.

Also, if significant or a large number of recommendations for improvement are identified in the review of individual engagements, the impact on the system of quality management on a firm-wide basis is assessed.

(ii) Special review

Audit firms subject to a special review are selected when an annual quality control review plan is developed. Also, whenever it is deemed necessary to conduct a special review immediately, audit firms are selected for such review even during the middle of the fiscal year.

In accordance with the purpose of a special review, the review scope for selected audit firms is determined by considering certain areas of concern or specific audit engagements.

(iii) Review for the examination of registration

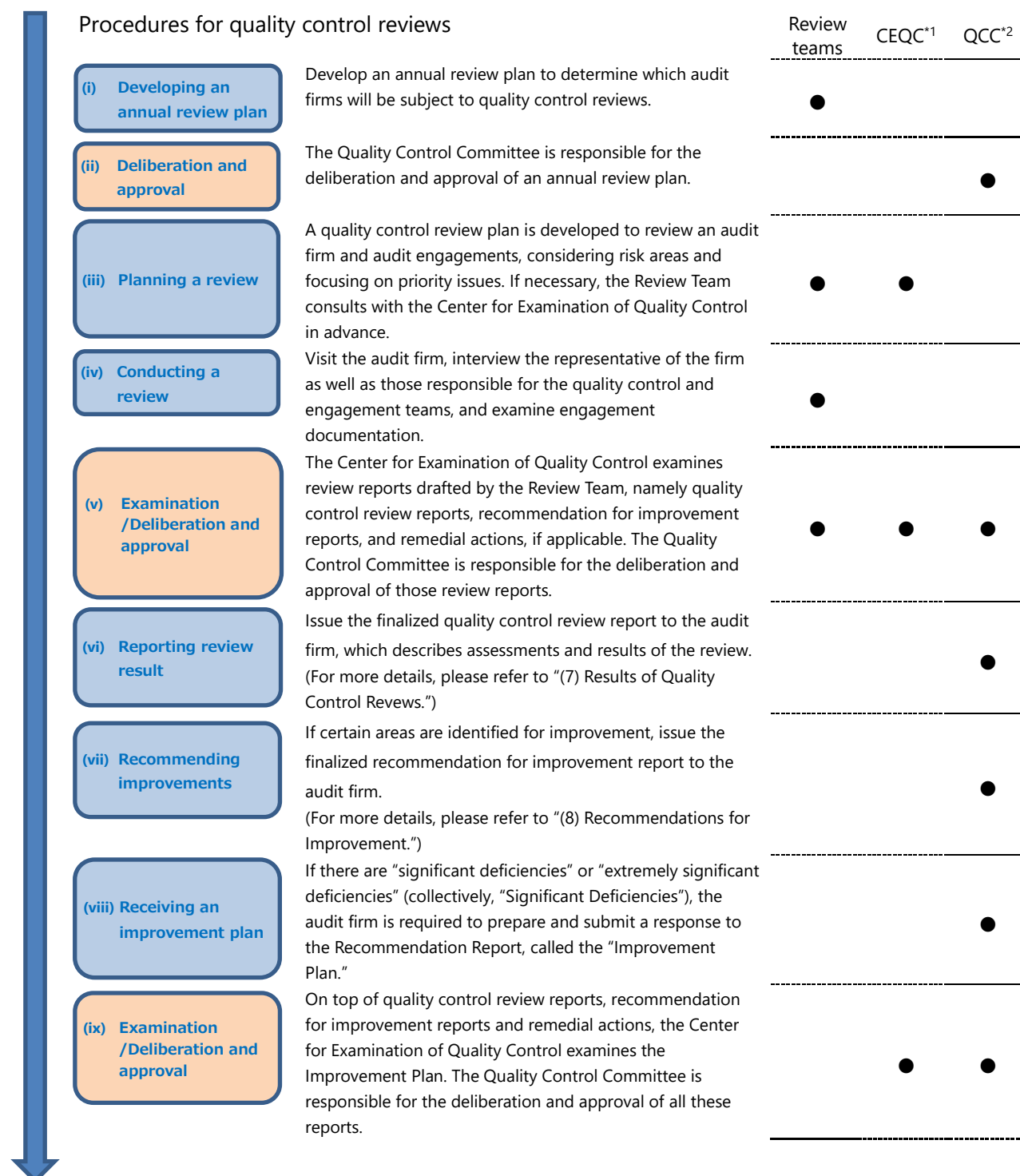
In order to confirm the eligibility of audit firms which have applied for registration on the official roster of auditors that engage in audits of listed companies and similar companies and registered auditors of listed companies and similar companies which have not engaged in audits subject to regular review, JICPA mainly assesses the design and implementation status of an audit firm's system of quality management. When assessing the state of an the design of audit firm, we take

into full consideration the actual state of the firm's operations and the state of application to audit work.

(6) Detailed Procedures for Quality Control Reviews

The basic flow of the procedures for quality control reviews is as follows:

[The basic flow of the procedures for quality control reviews and responsible organization]



(x) Notifying measures

Notify the audit firm regarding measures to be taken based on the review results. (For more details, please refer to “(11) Measures Taken under the Quality Control Review System.”)

JICPA notifies audit firms after approval by the Quality Control Committee

*1: Center for Examination of Quality Control *2: Quality Control Committee

- * In parallel with the above, the Quality Control Review Team also confirms remedial actions taken by an audit firm in response to improvement recommendations pointed out in previous years. In certain cases, the Quality Control Review Team may need to change the review plan for the year and visit an audit firm to confirm its improvement status. (For more details, please refer to “(10) Confirmation of Remedial Actions.”)

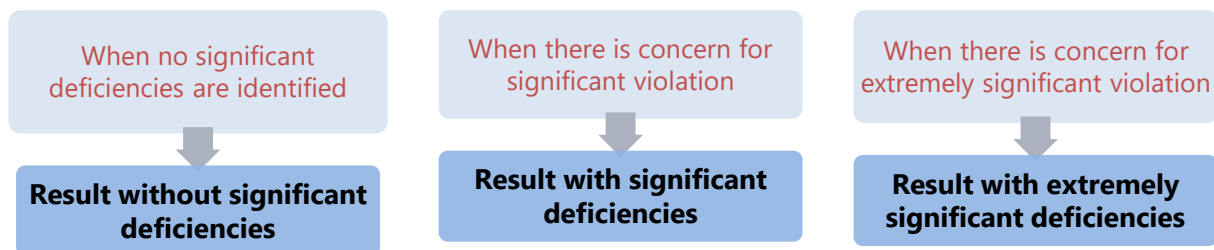
(7) Result of Quality Control Review

(i) Types of implementation results

JICPA issues quality control review reports to audit firms, which contain the result of the quality control review for the audit firm.

Quality control review results are classified into the following three types based on whether there are any concern for significant violations, or any concerns for extremely significant violations of professional standards or applicable laws and regulations in the design and operation status of the systems of quality management of audit firms.

[Types of quality control reviews]



(*1) The results of special reviews provide an opinion as to whether or not there are significant deficiencies for non-compliance with quality management standards or system of quality management from the viewpoint of the design and operation status of a system of quality management for certain areas of concern or specific audit engagements, depending on issues subject to the special review.

(*2) The results of reviews for the examination of registration provide an opinion as to whether or not there are significant deficiencies for non-compliance with quality management standards or a failure to comply with matters prescribed by laws and regulations as a system for auditing the financial statements of listed companies and similar companies fairly and appropriately.

Results with significant deficiencies are given to audit firms under certain circumstances, including the following:

- when the design or operation of the system of quality management is significantly inappropriate or insufficient
- when there is concern that material misstatements may have been overlooked in key accounting areas (e.g., accounting estimates, revenue recognition)
- when an audit firm has not obtained appropriate and sufficient evidence to reduce audit risks to an acceptable low level for those key accounting areas (e.g., accounting estimates, revenue recognition)

(ii) No statement of results

When a reasonable basis cannot be obtained to form results for a quality control review report because major review procedures cannot be conducted on important components of items subject to the quality control review, no result is given in the report (i.e., "no statement of results").

(8) Recommendations for Improvement

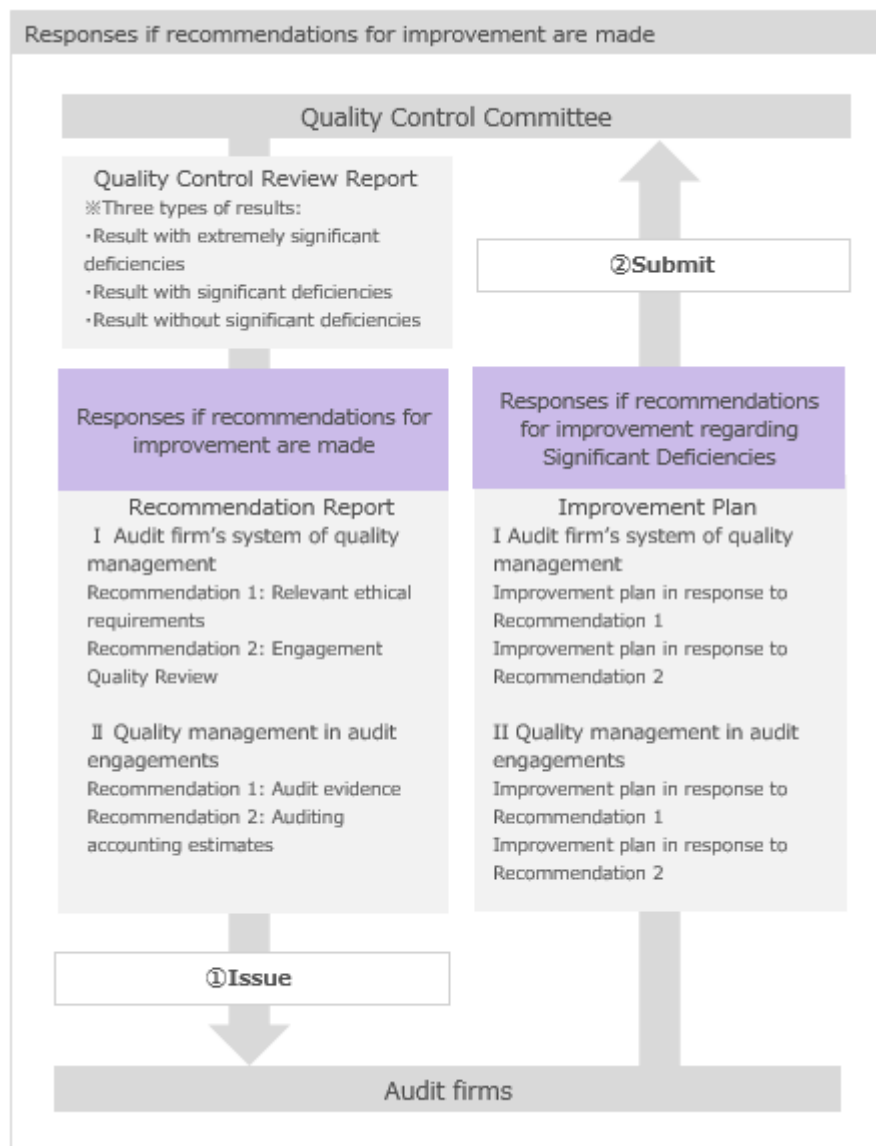
Regardless of the result of a quality control review, if recommendations for improvement are identified, a Recommendation Report which describes such recommendations for improvement will be prepared and issued to an audit firm together with the quality control review report. Recommendations for improvement are divided into two categories under the Recommendation Report, namely recommendations for audit firm's system of quality management and recommendations for quality management in audit engagements.

Classification of recommendations for improvement:

- Extremely significant deficiencies
- Significant deficiencies
- Deficiencies

Audit firms that have received recommendations for improvement are required to make voluntary improvements, and among these firms, those that have received recommendations for improvement for Significant Deficiencies are required to prepare and submit an Improvement Plan in response to the recommendations by describing remedial actions against the Significant Deficiencies.

In addition, if any extremely significant or significant deficiencies are found in the registered auditors that engage in audits of listed companies and similar companies, JICPA publishes their overview on its website under "Information on registered auditors that engage in audits of listed companies and similar companies".



(9) Analysis of the Causes Leading to Recommendation for Improvement (Root Cause)

To develop and implement more effective and appropriate remedial actions, it is essential for audit firms to identify where recommendations for improvement are coming from. Therefore, if JICPA issued Quality Control Review Report that contains results with Significant Deficiencies, Quality Control Review Team described the cause and stated to require improvement to address the root cause at the beginning of the Recommendation Report.

In many cases, causes of recommendation for improvement include not only direct causes but also root causes (e.g., Poor audit culture and weak management of audit firms) and that is common to multiple recommendations for improvement. Therefore, if an audit firm receives a Quality Control

Review Report with Significant Deficiencies, it is required that the audit firm describe in the Improvement Plan both the causes and root causes that led to deficiencies after discussion between its chief executive officer and the Quality Control Review Team.

Even when an audit firm ends up receiving a result without significant deficiencies, if there appears to be concerns about the audit firm's voluntary improvement, the Quality Control Review Team describes the cause and states to require improvement to address the root cause at the beginning of the Recommendation Report, as needed, after communicating with the audit firm as described above.

(10) Confirmation of Remedial Actions

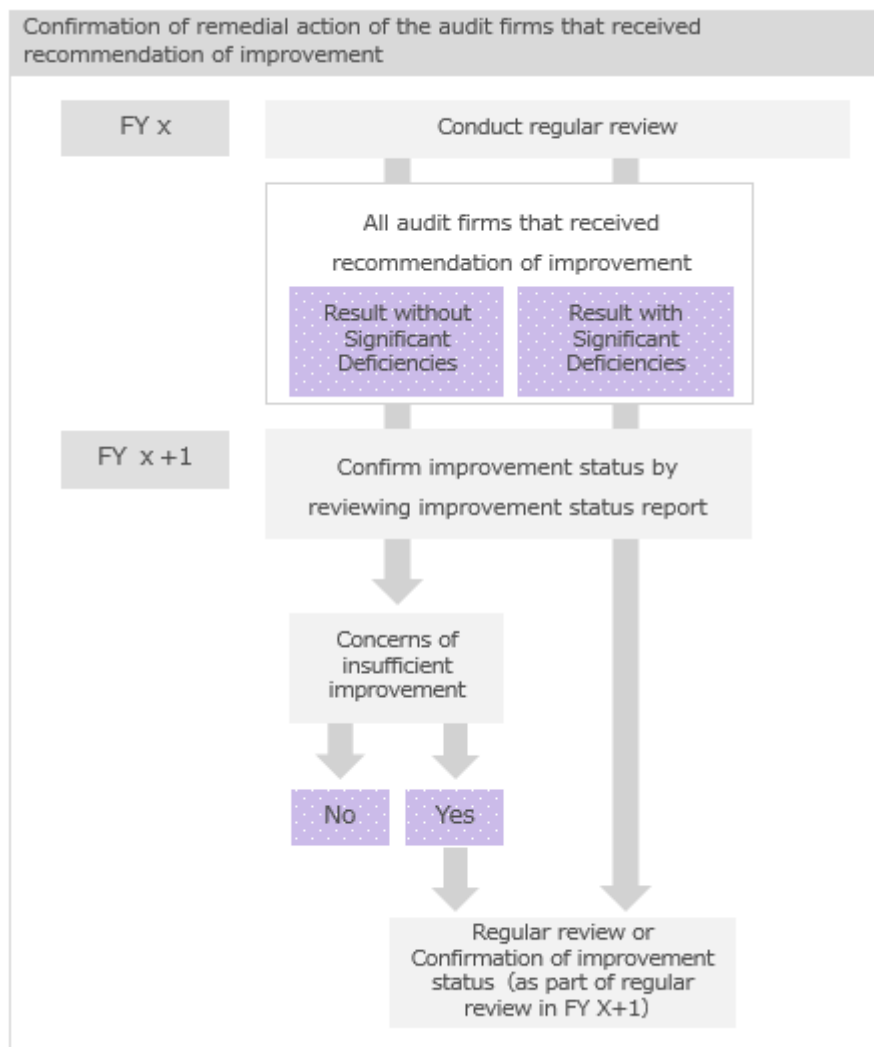
In the fiscal year following a quality control review, all audit firms that received recommendations for improvement as a result of the quality control review are required to submit an improvement status report describing the remedial actions taken. The Quality Control Review Team provides the necessary guidance to encourage audit firms to make improvements and confirms the remedial actions as follows:

(i) Audit firms that receive a result with Significant Deficiencies:

After confirming an audit firm's remedial actions through their improvement status report in the following fiscal year, the audit firm is subject to another regular review or confirmation of improvement status with a site visit to physically confirm remedial actions.

(ii) Audit firms that receive a result without significant deficiencies:

After confirming an audit firm's remedial actions through their improvement status report in the following fiscal year, if improvements seem to be insufficient, the audit firm is subject to regular review or confirmation of improvement status with a site visit to physically confirm remedial actions. When performing the confirmation of the improvement status, the Quality Control Committee issues a confirmation result report of the improvement status describing results of confirming whether there are any items that have not been sufficiently improved to audit firms.



* If an audit firm receives a result of deficiencies as a result of a special review (it is conducted based on the Quality Control Committee's judgement), it is in principle subject to confirmation of improvement status in the fiscal year following the special review.

(11) Measures Taken under the Quality Control Review System

Measures to be taken against audit firms that need encouragement to implement voluntary improvement due to an insufficient level of quality managements and must be monitored on their improvement status are determined based on the results of quality control reviews.

Types of measures under the Quality Control Review System:

- Warning
- Severe warning
- Recommendation to withdraw (entire or specific audit engagements conducted by an audit firm)

In general, measures determined by the Quality Control Committee based on recommendations for improvement identified through quality control reviews, including confirmation of improvement status, are as follows: recommendation to withdraw (for entire or specific audit engagements conducted by an audit firm) when extremely significant deficiencies are identified; severe warning when significant deficiencies are identified; and warning when deficiencies are identified again. However, when recommendations for improvement from previous quality control reviews remain unresolved and are recognized again as recommendations for improvement in the current fiscal year, the Quality Control Committee may toughen measures on top of the general measures described above.

| Measures taken under the Quality Control Review System | | | |
|--|-------------------------------|-------------------------------|------------------------------|
| Findings | Number of times conducted | | |
| | (1 st time) | (2 nd time) | (3 rd and beyond) |
| Extremely significant deficiencies | Recommendation to withdraw(*) | Recommendation to withdraw | Recommendation to withdraw |
| Significant deficiencies | Severe warning(*) | Recommendation to withdraw(*) | Recommendation to withdraw |
| Deficiencies | None | Warning | Severe warning |

(*) Mitigated measures can be taken based on individual circumstances, such as the size of the audit firm, history of audit engagements with listed companies, frequency of quality control reviews, and results of previous reviews.

If an audit firm unreasonably refuses or does not cooperate with quality control reviews, the Quality Control Committee issues a recommendation to withdraw from audit engagements regardless of the frequency of quality control reviews. Furthermore, when an audit firm refuses or does not cooperate with a quality control review, or when an audit firm fails to improve previous recommendations for improvement, the Chairperson of the Quality Control Committee, upon receiving such a report, will report such facts to the Chairman of the Audit Practice Review and Investigatory Committee when the Quality Control Committee deems it necessary.

In addition, when a recommendation to withdraw from audit engagement is issued to a registered auditor that engages in audits of listed companies and similar companies, their registration on the official roster of auditors that engage in audits of listed companies and similar companies may be revoked.

(12) Collaboration with the System for Individual Case Review

The Quality Control Committee under the Quality Control Review System collaborates as necessary with the Audit Practice Review and Investigatory Committee under the System for Individual Case Review to improve the quality of audit work. When significant issues are identified as a result of examinations and reviews under each system, necessary measures are taken by sharing information in a timely manner as needed. For example, if any doubts arise through quality control reviews about the appropriateness of audit opinions expressed by an audit firm or compliance with the Constitution or regulations of JICPA, the JICPA Constitution stipulated that the Chairperson of the Quality Control Committee reports such concerns to the Chairman of the Audit Practice Review and Investigatory Committee.

(13) Disclosure of Quality Control Review Results to Third Parties

In principle, audit firms are not allowed to disclose quality control review reports, Recommendation Reports, Improvement Plans, or the confirmation result report of the improvement status (collectively, "Quality Control Review Reports") to third parties. However, audit firms are allowed to disclose the outline of the latest quality control review results to third parties in their own reports, such as Audit Quality Reports. Here, in the case of registered auditors that engage in audits of listed companies and similar companies, notwithstanding the above, they may disclose to third parties matters based on the Listed Company Auditor Registration Bylaws through their own reports, such as Audit Quality Reports.

(14) Communication with Company Auditors regarding Quality Control Review Results

Company auditors (or the Board of company auditors), Audit and Supervisory Committees or Audit Committees (collectively, "Company Auditors") are responsible for understanding the overall design and operation status of audit firms' system of quality management when they assess appropriateness of the audit method and results of audit procedures conducted by the audit firms, as well as when entering into new audit engagements.

Therefore, if any of the following kinds of audits are conducted, audit firms are required to communicate to the Company Auditors in writing or in the form of electromagnetic records about quality control review results and associated measures to be taken in response to the results. Such information may include whether or not recommendations for improvement were issued for quality managements of individual engagements and also their issue areas as well as general trends. Audit

firms should communicate such information on or after receiving the Quality Control Review Reports.

- Audits of large companies, etc. under the CPA Act
- Audits of companies with accounting auditors
- Audits of Shinkin banks, credit cooperatives and labor banks

2. Our Organization

(1) Organizations That Manage Quality Control Reviews

Quality control reviews are managed mainly by the Quality Control Committee. Its subordinate organizations are the Center for Examination of Quality Control, the Working Group on Revision of Quality Control Review Standards, etc., and the Quality Control Review Team. The main roles and members (as of March 31, 2025) of each organization managing quality control reviews are as shown in the table below.

(i) Quality Control Committee

[Duties and members of the Quality Control Committee]

| Organization | Quality Control Committee |
|--------------|---|
| Duties | <ul style="list-style-type: none"> • Deliberates on the results of quality control reviews and measures based on their results • Develops standards and procedures for quality control reviews • Reports opinions on common issues related to audit firms or audit standards that have been identified through quality control reviews to Chairman and President of JICPA • Reports opinions on the system and operation of quality control reviews to Chairman and President of JICPA • Deliberates on other matters necessary for the operation of the quality control review system, etc. |
| Members | <ul style="list-style-type: none"> • Chairperson (1, Deputy President of JICPA) • Committee members (10, 7 are members of JICPA and the other 3 are academic experts who are not members of JICPA. 5 out of 7 are members of the Center for Examination of Quality Control.) |

(ii) Subordinate organization of the Quality Control Committee

i. Center for Examination of Quality Control

[Duties and members of the Center for Examination of Quality Control]

| Organization | Center for Examination of Quality Control |
|--------------|--|
| Duties | <ul style="list-style-type: none"> • Examines the implementation status and results of quality control reviews, as well as measures based on those results, and reports the results of the examination to the Quality Control Committee |
| Members | <ul style="list-style-type: none"> • Composed of 6 parts • Each part has 5 or more members (including 1 head of each) who are members of JICPA |

ii. Working Group on Revision of Quality Control Review Standards, etc.

[Duties and members of the Working Group on Revision of Quality Control Review Standards, etc.]

| | |
|---------------|--|
| Organizations | Working Group on Revision of Quality Control Review Standards, etc. |
| Duties | <ul style="list-style-type: none"> • Develops standards and procedures for the quality control reviews, as well as matters related to the revision or abolition of quality management review tools, and reports them to the Quality Control Committee |
| Members | <ul style="list-style-type: none"> • Chairperson (a member of the Quality Control Committee) • 11 (all are members of JICPA) |

iii. Quality Control Review Team

[Duties and members of the Quality Control Review Team]

| | |
|--------------|--|
| Organization | Quality Control Review Team |
| Duties | <ul style="list-style-type: none"> • Investigates the status of audit firm's system of quality management and reports the findings to the Center for Examination of Quality Control |
| Members | <ul style="list-style-type: none"> • 1 chief executive reviewer • 7 vice chief executive reviewers • 21 chief reviewers • 13 staff reviewers^(*) (including 3 IT expert reviewers) |

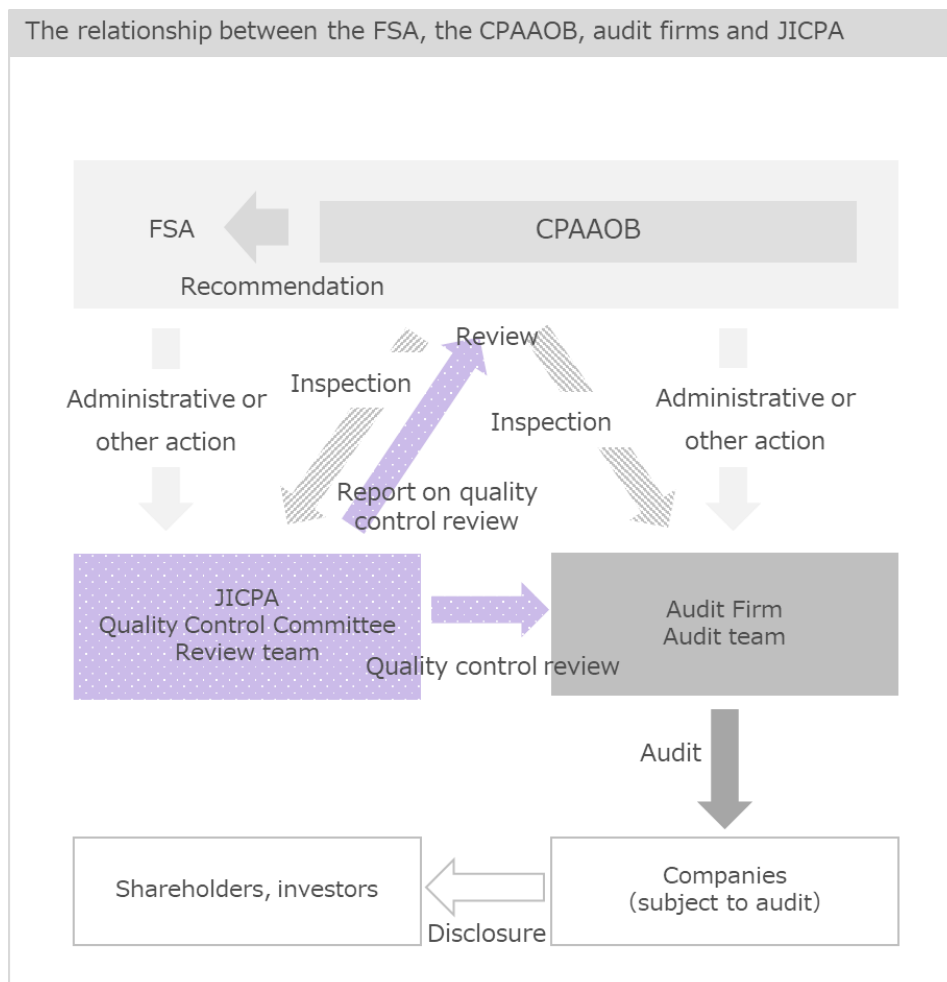
(*) The number of staff reviewers has decreased from 14 due to staff resignations during the term.

3. Relationship with the CPAAOB

(1) Monitoring by the CPAAOB

In accordance with the CPA Act 46-9-2, Paragraph 2, JICPA is monitored by the Certified Public Accountants and Auditing Oversight Board ("CPAAOB"), which is an administrative body serving as a council that was established within the Financial Services Agency ("FSA").

CPAAOB confirms whether a quality control review is appropriately conducted as well as whether audit firms appropriately conduct audits by examining reports from JICPA and by conducting inspections of audit firms, JICPA, etc. When CPAAOB deems it necessary, it recommends to the FSA the administrative dispositions or other measures necessary to ensure proper business operations.



(2) Cooperation with the CPAAOB

In order to improve the effectiveness of the Quality Control Review System, JICPA holds staff meetings with the CPAAOB several times throughout the year. Through analyses of specific cases with CPAAOB, issues and associated measures for quality control reviews are summarized to improve and enhance quality control reviews in the following fiscal years.

JICPA took the following actions in FY2024:

- JICPA reviewers and CPAAOB inspectors aligned perspectives and shared understanding of the issues based on the analysis of the results in individual cases derived from quality control reviews and CPAAOB inspections. Improvement areas and issues identified through the analyses were communicated to JICPA reviewers through announcements and training for the purpose of enhancing quality control reviews.
- JICPA reviewers and CPAAOB inspectors exchanged views on the approach for FY2024 based on the three-year Quality Control Review Basic Policy (FY2023–FY2025), the 2024 Quality Control Review Policy, and issues in FY2025 and beyond, focusing on confirmation of status of system of quality management that registered auditors that engage in audits of listed companies and similar companies operate and approaches to issues related to small and medium-sized audit firms that engage in audits of listed companies and similar companies (including response to prevention of inappropriate correction of engagement documentation and identifying the root cause of deficiencies).

Furthermore, CPAAOB held a workshop for JICPA reviewers where participants discussed the current state and issues of the quality control review and solutions for them. CPAAOB also communicated their expectations for the quality control review at the workshop.

Going forward, JICPA will expand efforts to have a closer and more effective collaborative relationship with the CPAAOB to build a better Quality Control Review System.

4. Operation Status of Quality Control Reviews in FY2024

(1) Initiatives Based on the Quality Control Review Policy

Quality Control Review Basic Policy (FY2023–FY2025)

In response to the introduction of the Registration System for Auditors that Engage in Audits of Listed Companies and Similar Companies and the application of the revised Quality Management Standards, JICPA developed and announced the three-year Quality Control Review Basic Policy (FY2023–FY2025) that includes actions and response policies to be prioritized for the three years from FY2023. Its response status in FY2024, the second year of the initiative, is outlined below.

| Responding to reformed systems and revised standards |
|---|
| <p><Appropriate operation of the Registration System for Auditors that Engage in Audits of Listed Companies and Similar Companies></p> <p>In response to new requirements such as the application of the revised Quality Management Standards and the establishment of an information disclosure system under laws and regulations, based on the results of discussions to date, JICPA revised the "Eligibility Confirmation Guidelines."</p> <p>In the first half of FY 2024, with the deadline for statutory transitional measures approaching, JICPA continued to focus on responding to confirming the design and operation status system for deemed registered auditors that engage in audits of listed companies and similar companies. Furthermore, in the regular review of registered auditors that engage in audits of listed companies and similar companies which began in FY 2024, JICPA confirmed not only the design status but also the operation status of their quality management systems for auditing listed companies and similar companies fairly and appropriately, from a new perspective as part of the high level of discipline.</p> <p>(For more details, please refer to "(3) Confirmation of Eligibility")</p> <p><Verifying the status of application of the revised Quality Management Standards></p> <p>For the audit firms subject to a regular review in FY2024, among those that have applied the revised Quality Management Standards, JICPA confirmed the status of application of the revised Management Standards.</p> |
| Thorough risk-based approach |
| <p>JICPA allocated resources for conducting guidance and supervision to small and medium-sized audit firms that engage in audits of listed companies and similar companies by decreasing the frequency of regular reviews of audit firms that do not engage in audits of listed companies and similar companies in order to thoroughly implement risk-based approach in human resource allocation.</p> <p>In addition, JICPA set focus areas in FY2024 by category of the "quality management at audit firms", "quality management for an audit of financial statements." and "operational control systems of auditors that engage in audits of listed companies and similar companies", considering previous recommendations for improvement and recent trends in quality control reviews, and checked them thoroughly. Since the characteristics and issues differ depending on</p> |

the size of the audit firm, JICPA sets focus areas according to the size classification of large-sized audit firms, second-tier audit firms, and small and medium-sized audit firms from FY2024.

Understanding and assessment of operational management systems

The following items, which were specifically confirmed in the regular reviews and the investigation of the examination of registration for deemed registered auditors that engage in audits of listed companies and similar companies, were confirmed in the regular reviews for registered auditors that engage in audits of listed companies and similar companies, including the operational status.

- The establishment of a dedicated department for quality management or the appointment of a certified public accountant to be primarily involved in quality management, clarification of responsibilities through appropriate division of duties, and the status of ensuring sufficient time for those responsible for the quality control to carry out quality management activities
- In cases when those responsible for the quality management are involved in audit engagements as an engagement partner, the number of audit engagements involved in as an engagement partner and the reasons for his/her involvement
- The design status of systems that enable members of audit firms to fully engage in capacity development

Improving audit quality of small and medium-sized audit firms (registered auditors that engage in audits of listed companies and similar companies)

<Enhancing instruction on electronic engagement documentation / Strict measures against forging engagement documentation>

JICPA provided small and medium-sized audit firms with guidance on engagement documentation by exchanging opinions on points to consider for the introduction of an electronic record audit documentation system as well as introducing the consulting service set up in its small and medium-sized audit firms support division.

Regarding inappropriate corrections of engagement documentation, including forgeries, JICPA has taken strict actions such as obtaining a declaration regarding the "assembly of engagement files and appropriate management and retention of engagement documentation" at the implementation of the regular reviews and raising awareness that inappropriate corrections of engagement documentation will be treated as a significant deficiency if identified. In response to recent administrative sanctions, JICPA has issued two "Notes on the 'assembly of engagement files and management and retention of engagement documentation'" to raise awareness. In the review from FY2025 onward, JICPA will provide guidance to ensure that the engagement documentation should not be forged, not only after the final assembly date of the engagement documentation, but also from the date of the audit report to the final assembly date of the engagement documentation.

<Enhancing initiatives related to IT>

For audit firms that were deemed to require instruction from an IT reviewer, JICPA provided individual instruction on information security, including cybersecurity, in accordance with the Eligibility Confirmation Guidelines, considering the firm's size and the technology used.

In addition, the Quality Control Review Team and the small and medium-sized audit firms support division of JICPA shared information and exchanged views on information security instruction.

<Enhancing instruction capability>

Of the audit firms that underwent regular reviews in FY2024, for some of the registered auditors that engage in audits of listed companies and similar companies, JICPA confirmed whether their measures for improvement were feasible and effective enough to address root causes (including their operational control systems) and strived to provide instruction by requiring these audit firms to reassess such measures for improvement as necessary at the end of on-site reviews and after on-site reviews. JICPA also has taken actions such as providing e-learning courses to help audit firms independently investigate root causes.

Furthermore, from FY2023 to FY2024, in preparation for applying for the registration in the official roster of auditors that engage in audits of listed companies and similar companies, JICPA gathered the latest information relating to deemed registered auditors that engage in audits of listed companies and similar companies which were not subject to quality control reviews, such as their deficiencies and improvement status mainly through off-site monitoring, and provided instruction.

Quality control review practices**<Review procedures in response to electronic engagement documentation>**

For one audit firm subject to a regular review in FY2024, JICPA conducted some review procedures, including the examination of digitized engagement documentation of individual engagements, at JICPA's office while taking thorough measures to ensure information security and management of the PC borrowed from the audit firm. As a result, the examination of engagement documentation for individual engagements was made more efficient to some extent.

<Clarification of quality control review reports>

JICPA has added a section to the quality control review report for regular reviews so that involved parties can understand the Quality Control Review System. Specifically, if there are any deficiencies that have been pointed out repeatedly, this will be stated in the quality control review report.

JICPA will continue to consider revising the quality control review report to improve its clarity and usefulness from FY2025 onward.

Strengthening the Quality Control Review System

With the introduction of the Registration System for Auditors that Engage in Audits of Listed Companies and Similar Companies, it will be necessary to conduct reviews for the examination of registration and verify and provide guidance on the design and operation status of systems of quality management with a new perspective accompanying high level of discipline for auditors that engage in audits of listed companies and similar companies and the revised Quality Control Standards will be gradually applied to small and medium-sized audit firms, JICPA increased the number of reviewers in the Quality Control Review Team and appointed senior personnel to provide guidance and training to audit firms and reviewers.

Cooperation with the CPAAOB

Refer to "3. (2) Cooperation with the CPAAOB".

Enhancement of disclosure regarding quality control reviews

JICPA publicly released Self-regulation Report, Quality Control Review System and the "Collection of Commentary on Recommendations for Improvement Made in the Quality Control Review,"

and gave a lecture at a seminar hosted by the Japan Audit & Supervisory Board Members Association as part of its efforts to raise awareness of the Quality Control Review System.

Focus areas in FY2024

Under the FY2024 Quality Control Review Policy, reviewers were required to consider the following focus areas determined by the Quality Control Committee when conducting regular reviews, based on previous recommendations for improvement and recent trends in quality control reviews.

- The audit firm's system of quality management
 1. The firm's risk assessment process
 2. Governance and leadership
 3. Relevant ethical requirements
 4. Acceptance of new engagements
 5. Human resources (education/training of professional personnel)
 6. Monitoring and remediation process of system of quality management
 7. Assembly of final engagement files and management and retention of engagement documentation

- The quality management in audit engagements
 1. Identifying, assessing and addressing the risk of material misstatements including fraud risk
 2. Auditing accounting estimates

- Operational management systems of audit firms that engage in audits of listed companies and similar companies
 1. Systems for conducting auditing work fairly and appropriately
 2. Evaluation and announcement of the status of business quality management, etc.
 3. Announcement of the status of business management, etc.
 4. Organized operation
 5. Areas and items of causes of significant deficiencies in the design and operation status of systems of quality management

(2) Quality Control Reviews in FY2024

The following table shows the result of quality control reviews in FY2024:

[Quality Control Reviews in FY2024]

| | Number of audit firms reviewed | Number of audit firms receiving review reports | Number of carried-over audit firms ^{(*)3} |
|--|--------------------------------|--|--|
| Regular reviews | 56 (81) | 53 (86) ^{(*)4} | 3 (0) |
| Of the above, number of audit firms that have applied the revised Quality Management Standards | 34 (1) | 32 (1) | 2 (0) |
| Confirmation of improvement status | 15 (9) | 15 (10) ^{(*)5} | 0 (0) |
| Total | 71 (90) | 68 (96) | 3 (0) |
| Number of audit firms subject to a regular review ^{(*)6} | 219 (222) | | |
| Percentage of audit firms reviewed under regular review | 26% (36%) | | |
| Percentage of audit firms reviewed | 32% (41%) | | |

(*)1 FY2023 numbers are shown in parentheses.

(*)2 The number of audit firms that underwent special review and review for the examination of registration is not included in the table.

(*)3 The audit firms were subject to a regular review and confirmation of improvement status in FY2023; however, the deliberation and approval of quality control review reports and Confirmation Result Reports of the Improvement Status were carried over to the next fiscal year (hereinafter referred to as "carried-over audit firms").

(*)4 The number includes five audit firms carried over from FY2022.

(*)5 The number includes one audit firm carried over from FY2022.

(*)6 The number represents audit firms subject to regular review as of April 1, 2024 (the number in parentheses is as of April 1, 2023).

In principle, regular reviews are conducted every three years. The Quality Control Committee can decide to increase or decrease the frequency of regular reviews considering the improvement of the effectiveness and efficiency of a quality control review. However, even when decreasing the frequency of a regular review, it is conducted at least once every five years based on the JICPA Constitution. The number of audit firms in each fiscal year that went through a regular review less than three years from the previous review, as well as the number of audit firms for whom more than three years have passed but whose regular review schedule is extended are presented below.

[Number of audit firms for which the regular review interval has been shortened or expanded]

| | FY2022 | FY2023 | FY2024 |
|---|--------------------|-------------------|-------------------|
| Number of audit firms with shorter review interval | 10 | 17 | 4 ^{(*)2} |
| Number of audit firms with extended review interval | 14 ^{(*)1} | 5 ^{(*)1} | 16 |

(*1) All firms underwent regular reviews in the following fiscal year, except for those that were no longer subject to regular reviews due to reasons such as the dissolution of the audit firm or the termination of all audit engagements with the company subject to regular reviews and audit firms correspond to note 2.

(*2) The number of audit firms that have shortened their regular reviews has decreased compared to the previous fiscal year because, in principle, confirmation of improvement status was conducted for audit firms that undergo reviews for examination of registration instead of shortening the regular review interval.

The main reasons for the decrease in the number of audit firms reviewed in FY2024 and the increase in the number of audit firms with an extended review interval are as follows.

- It is necessary to secure resources for "Confirmation of Eligibility" under the Registration System for Auditors that Engage in Audits of Listed Companies and Similar Companies. (Mainly dealing with deemed registered auditors that engage in audits of listed companies and similar companies whose registration application deadline is at the end of September 2024)

- Due to the review cycle, there are more large-sized and second-tier audit firms that require more resources than in FY2023.

- In order to secure the above-mentioned resources, JICPA focused on increasing the frequency of regular reviews for audit firms such as do not audit listed companies and similar companies upon consideration of risks.

The breakdown of audit firms by size for those subjects to regular reviews as well as those that underwent regular reviews or confirmation of improvement status is as follows:

[Breakdown of audit firms by size]

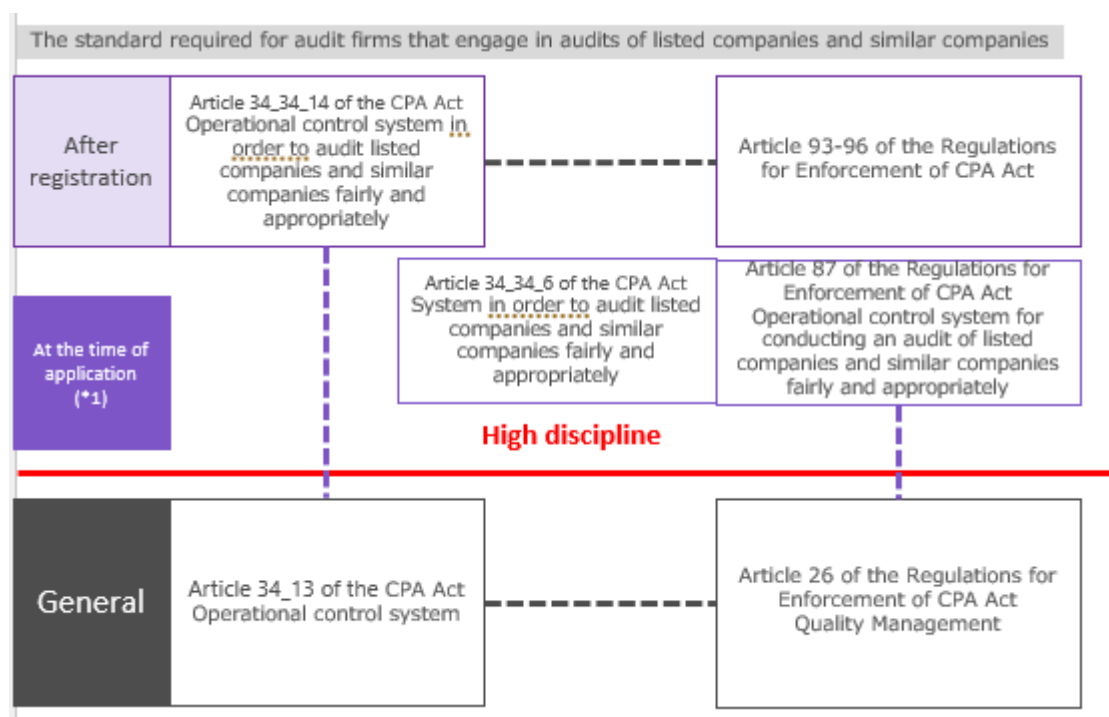
| | | | Number of audit firms subject to regular review | Number of audit firms that underwent: | |
|---|--|-------------------|---|---------------------------------------|------------------------------------|
| | | | | Regular review | Confirmation of improvement status |
| Registered auditors that engage in audits of listed companies and similar companies | Large-sized/second-tier | | 8 (9) | 4 (2) | 0 (0) |
| | Audit firms by the number of listed company audits | Over 10 companies | 35 (29) | 11 (7) | 4 (4) |
| | | 5–9 companies | 32 (30) | 6 (14) | 4 (1) |
| | | 2–4 companies | 39 (44) | 9 (17) | 1 (1) |
| | | 0–1 companies | 19 (21) | 6 (11) | 1 (0) |
| | Sub-total ^(*3) ^(*4) | | 133 (133) | 36 (51) | 10 (6) |
| | Other audit firms ^(*4) | | 86 (89) | 20 (30) | 5 (3) |
| Total | | | 219 (222) | 56 (81) | 15 (9) |

(*1) The number of audit firms in FY2023 is shown in parentheses.

- (*2) Registered auditors that engage in audits of listed companies and similar companies include audit firms that do not audit listed companies.
- (*3) In the "registered auditors that engage in audits of listed companies and similar companies" lines, the number of audit firms subject to regular review in FY2023 represents the number of audit firms after the period for submitting notifications to be subject to the statutory transitional measures, and those in FY2024 represents the number of firms registered in the official roster of auditors that engage in audits of listed companies and similar companies and deemed registered auditors that engage in audits of listed companies and similar companies (as of April 1, 2024).
- (*4) Some deemed registered auditors that engage in audits of listed companies and similar companies did not apply to be registered in the official roster of auditors that engage in audits of listed companies and similar companies in FY2024. These audit firms are represented as "registered auditors that engage in audits of listed companies and similar companies " in the "Number of audit firms subject to regular review" as of April 1, 2024, and are represented as "Other audit firms" in the "Number of audit firms that underwent" because these audit firms didn't apply for the registration after the application period of the statutory transitional measures.

(3) Confirmation of Eligibility

Based on the amendment of the CPA Act in May 2022, JICPA conducted “Confirmation of Eligibility” on the applicant for the registration and registered auditors that engage in audits of listed companies and similar companies to confirm that they have a system to conduct an audit of listed companies and similar companies fairly and appropriately. Basically, all audit firms must establish an operational control system, including a personnel system, and audit firms that engage in audits of listed companies and similar companies are required to have an operational control system with high level of discipline to carry out the audit work fairly and accurately.



(*1) Audit firms are required not only to have a system in place at the time of application for registration, but also to maintain it continuously after registration.

JICPA took the following actions in FY2024 related to Confirmation of Eligibility:

(i) Revision of the Eligibility Confirmation Guidelines

In undertaking a quality control review for Confirmation of Eligibility, in June 2023, JICPA developed the Eligibility Confirmation Guidelines to clarify viewpoints and criteria in order to confirm whether auditors that engage in audits of listed companies and similar companies have established operational control systems to audit the financial statements of listed companies and similar

companies fairly and appropriately, as stipulated by the CPA Act and its Enforcement Regulations and JICPA revised it in August 2024.

The main points of the revision are as follows:

- JICPA arranged the items in the Eligibility Confirmation Guidelines with a reference to revision to the Standards on Quality Management and revision of "Quality Management Standards Report 1:Quality Management at Audit Firm" etc.
- JICPA added new viewpoints and criteria in light of the fact that it will be required to address the matters stipulated in the articles 93 to 96 of the Enforcement Regulations of CPA Act gradually after July 1, 2024.
- JICPA added or expanded viewpoints and criteria for the items which the viewpoints and criteria did not exist or which the viewpoints and criteria considered in need of refinement or enhancement such as matters related to professional ethics and independence in light of discussions at the Review Board for Registration on Auditors that Engage in Audits of Listed Companies and Similar Companies and result of quality control review in FY2023.
- JICPA specified the viewpoints and criteria with addition of examples to serve as a reference for audit firms that use the guideline to improve their system.

(ii) Implementation status of Confirmation of Eligibility

Based on the revised Supplementary Provision, Article 3, Paragraph 1, out of the deemed registered auditors that engage in audits of listed companies and similar companies, those that continue to audit listed companies and similar companies in the future must apply to be registered on the official roster of auditors that engage in audits of listed companies and similar companies by September 30, 2024, when the transitional period ends. Implementation status of Confirmation Eligibility in FY2024 is as follows:

[Fact-finding survey using documents]

For deemed registered auditors that engage in audits of listed companies and similar companies which meet certain conditions, a review for the examination of registration is not required. Instead, the Review Board for Registration on Auditors that Engage in Audits of Listed Companies and Similar Companies conducts review for the examination of registration based on (a) the results of regular reviews conducted within the past three fiscal years and (b) the results of a written survey of quality management systems status.

In FY2024, the Quality Control Committee conducted a written survey to the 69 deemed registered auditors that engage in audits of listed companies and similar companies (to 32 in FY2023), which had applied to be registered on official roster of auditors that engage in audits of listed companies

and similar companies, to confirm whether they have established quality management systems and the status at the following items.

- Matters described in the procedures based on the JICPA's Constitution, Paragraph 590-7
- Operational control system stipulated in Article 34-13 of the CPA Act
- Quality management system to ensure that audits of listed companies and similar companies are conducted fairly and appropriately, as stipulated in Article 87-2 of the Enforcement Regulations of the CPA Act

[Review for the examination of registration]

- In FY2024, the second year of implementation, reviews for the examination of registration were conducted for 21 firms of the applicants (In addition, for one carried-over firm from the previous year) at the request of the Review Board for Registration on Auditors that Engage in Audits of Listed Companies and Similar Companies to the Quality Control Committee. (Details are provided in "(6) Status and Results of Reviews for the Registration Examination.")

[Regular review to registered auditors that engage in audits of listed companies and similar companies that have audit services subject to regular reviews]

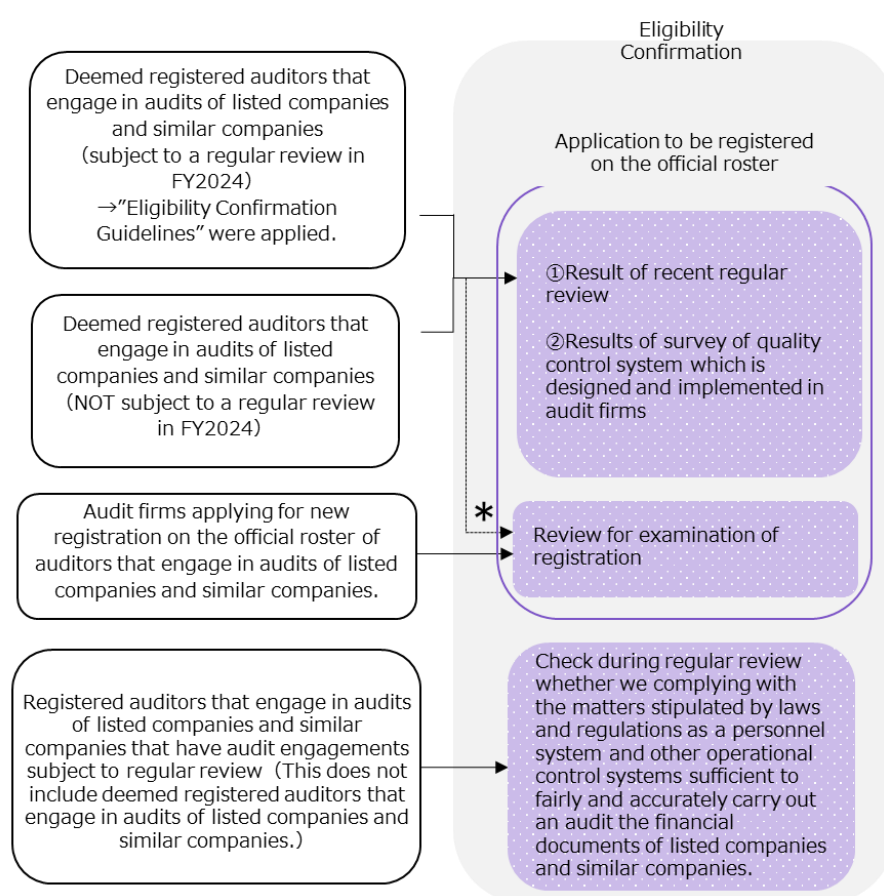
JICPA conducted the Confirmation of Eligibility to the 32 registered auditors that engage in audits of listed companies and similar companies that have audit services subject to regular reviews (audit firms that are registered in the official roster of auditors that engage in audits of listed companies and similar companies at the time of conducting the review, and do not include deemed registered auditors that engage in audits of listed companies and similar companies) in conjunction with the regular review in FY2024 by confirming whether they are complying with the matters stipulated by laws and regulations as a personnel system and other operational control systems sufficient to fairly and accurately carry out an audit the financial documents of listed companies and similar companies.

As a result, the following areas are identified as recommendations for improvement.

- Audit engagements that fall under items judged to require review by the senior-level quality control review committee established at the firm were not reviewed by that committee (In "Engagement quality control review")
- The firm's specific policies and procedures regarding engagement partner evaluation are not established. (In "Resources")
- The revision to the standard on ethics are not reflected in the firms' policies and procedures regarding reward dependence (In "Professional ethics and independence")

In addition, since the examples of "factors of significant deficiencies in quality control review conducted for Confirmation of Eligibility" are based on registered auditors that engage in audits of listed companies and similar companies, JICPA treated as deficiencies even if it falls under the above examples in the regular review on the deemed registered auditors that engage in audits of listed companies and similar companies who are not registered in the official roster of auditors that engage in audits of listed companies and similar companies at the time of the regular review.

Methodology for Confirmation of Eligibility in FY 2024



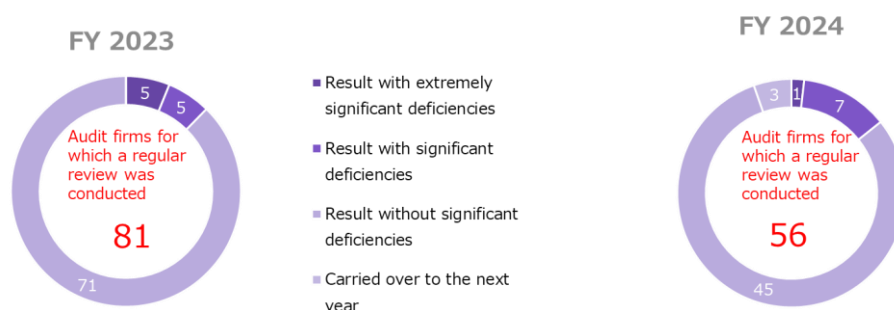
- * When the Review Board for Registration on Auditors that Engage in Audits of Listed Companies and Similar Companies deems it necessary, JICPA conducts a review for the examination of registration.

(4) Results of Regular Reviews

FY2024 results of quality control reviews and associated measures represent those deliberated and approved by the Quality Control Committee during the period from May 2024 to April 2025.

(i) Results of regular reviews

Regular reviews were conducted for 56 audit firms in FY2024. Of these, 45 audit firms received a result without significant deficiencies, 7 received a result with significant deficiencies, and 1 received a result with extremely significant deficiencies. In addition, there were 3 carried-over audit firms, and no audit firms received no result.



The number of audit firms that received a result with Significant Deficiencies was 8. (10 in FY2023, of which three firms underwent regular reviews, and five firms underwent Confirmation of improvement status in FY2024. In addition, the remaining two firms are no longer subject to regular reviews due to changes in auditors.)

Due to the fundamental cause of the belief that the engagement partner or assistants to the engagement partner understood the audit standards or that there would be no problem if they followed the previous practices, fact that the CEO was not able to demonstrate leadership to improve the quality of audits, and the engagement partner or assistants to the engagement partner fail to demonstrate professional skepticism, the eight firms that received a result with significant deficiencies were found to have deficiencies, mainly in the lack of direction and supervision by the engagement partner and in the ineffectiveness of the review and examination of audit work paper. In addition, for the registered auditors that engage in audits of listed companies and similar companies who received a result with Significant Deficiencies, the root cause lay mainly in their continued view of quality management as an extension of conventional quality management, despite high level of discipline has been required in the quality management.

As a result of the above, a number of recommendations for improvement in focus areas for individual engagements were also made, such as audit accounting estimates and identifying, assessing, and testing risks of material misstatements including fraud risks.

The following table shows the breakdown of audit firms receiving quality control review reports for regular reviews, categorized by size of audit firm and type of review results:

[Breakdown of audit firms receiving quality control review reports for regular reviews (by size of audit firms)]

(Unit: Number of audit firms)

| | | | Breakdown of review report type | | | | | |
|---|--|-------------------|---|--------------------------------------|--|----------------------|--------------------------|---------|
| | | | Result without significant deficiencies | Result with significant deficiencies | Result with extremely significant deficiencies | No result | Carried-over audit firms | Total |
| Registered auditors that engage in audits of listed companies and similar companies | Large-sized/ second-tier | | 4 (2) | 0 (0) | 0 (0) | 0 (0) | 0 (0) | 4 (2) |
| | Audit firms by the number of listed company audits | Over 10 companies | 10 (8) ^(*) | 0 (0) | 0 (0) | 0 (0) | 1 (0) | 11 (8) |
| | | 5–9 companies | 2 (13) | 3 (1) | 0 (0) | 0 (0) | 1 (0) | 6 (14) |
| | | 2–4 companies | 8 (18) ^(*) | 1 (0) | 0 (0) | 0 (1) ^(*) | 0 (0) | 9 (19) |
| | | 0-1 companies | 6 (11) | 0 (0) | 0 (0) | 0 (0) | 0 (0) | 6 (11) |
| | Sub-total | | 30 (52) | 4 (1) | 0 (0) | 0 (1) | 2 (0) | 36 (54) |
| Other audit firms | | | 15 (21) | 3 (4) | 1 (7) ^(*) | 0 (0) | 1 (0) | 20 (32) |
| Total | | | 45 (73) | 7 (5) | 1 (7) | 0 (1) | 3 (0) | 56 (86) |

(*) FY2023 numbers are shown in parentheses.

(*) Of the five audit firms that conducted regular reviews in FY2022 whose quality control review report issuance was carried over to FY2023, two audit firms are included in "Result without significant deficiencies," two audit firms are included in "Result with extremely significant deficiencies," and one audit firm is included in "No result."

! "Result with Significant Deficiencies" is expressed when it is concluded based on regular reviews that there is a concern for significant non-compliance with professional standards or applicable laws and regulations in the design and operation status of the system of quality management of an audit firm. It does not automatically mean there is a significant compliance violation in auditing engagements or a doubt in the reasonableness of audit opinions.

(ii) Focus areas and review results

Reviewers are required to check focus areas for regular reviews when conducting site visits to provide instruction to audit firms as necessary and enhance their understanding.

a. Design and operation status of the systems of quality management of audit firms

The following items regarding the design and operation status of the systems of quality management of audit firms were assessed for their appropriateness and effectiveness. As a result, the number of audit firms that received recommendations for improvement is shown in the table below.

Considering the intent of the May 2022 revision to the CPA Act, for the deemed registered auditors that engage in audits of listed companies and similar companies, JICPA conducted quality control reviews in FY2023 in accordance with the Eligibility Confirmation Guidelines with an aim to clarify the areas that need to be improved before applying for registration. It also treated some findings that were not considered deficiencies in FY2022 or earlier as deficiencies in FY2023 to further improve the quality of audits of listed companies and similar companies. As a result, the number of recommendations for improvement regarding design and operation status of the systems of quality management of audit firms in FY2023 had increased significantly compared to FY2022. In addition, the reason for the decrease in FY2024 compared to FY2023 is that the chief reviewer in charge of the audit firms provided guidance in preparation for the review of the registration in the official roster on auditors that engage in audits of listed companies and similar companies as a deemed registered auditors that engage in audits of listed companies and similar companies and the audit firm gained a proper understanding of a high level of discipline, which led to improvements in the quality management system.

[Number of audit firms that received recommendations for improvement in focus area]

(Unit: Number of audit firms)

| Focus areas | FY2022 | FY2023 | FY2024 |
|--|--------|--------|--------|
| 1. The firm's risk assessment process | — | — | 7 |
| 2. Governance and leadership | 2 | 50 | 8 |
| 3. Relevant ethical requirements | 2 | 6 | 1 |
| 4. Acceptance of new engagements | 7 | 26 | 2 |
| 5. Human resources (education/training of professional personnel) | 6 | 33 | 6 |
| 6. Monitoring and remediation process of the system of quality management | 5 | 16 | 4 |
| 7. Assembly of final engagement files and management and retention of engagement documentation | 21 | 54 | 9 |

(*1) Some audit firms received recommendations for improvement in multiple areas.

(*2) Only recommendations for improvement related to focus areas are tabulated.

Recommendations for improvement related to "1. The firm's risk assessment process" mainly include the following comments:

- The representatives of the audit firms did not maintain a record of the process for considering whether or not the firm should set additional quality objectives that it believes are necessary.
- The representatives of the audit firms did not establish a process for internal discussion and approval of the firm's response to the set quality objectives.

Recommendations for improvement related to "2. Governance and leadership" mainly include the following comments:

- The representatives of the audit firms did not clarify specific policies and procedures for confirming and assessing how well information regarding the importance of focusing on the audit quality was understood.
- The representatives of the audit firms did not clarify specific requirements that serve as a basis for determining eligibility of person responsible for quality management.
- The representatives of the audit firms did not adequately establish mechanisms to ensure that sufficient time was secured for conducting quality control activities.

Recommendations for improvement related to "3. Professional ethics and independence" include the following comments:

- The representatives of the audit firms did not establish specific policies and procedures regarding the long-term involvement of engagement partners and engagement quality control reviewers.
- The representatives of the audit firms did not establish specific policies and procedures regarding confidentiality.

Recommendations for improvement related to "4. Acceptance of new engagements" mainly include the following comments:

- The representatives of the audit firms did not establish specific policies and procedures regarding information to be obtained when accepting engagements.

Recommendations for improvement related to "5. Human resources (education/training of professional personnel)" mainly include the following comments:

- The representatives of the audit firms did not establish specific policies and procedures regarding education and training to reasonably secure sufficient professional personnel with the necessary aptitude, ability and experience as well as the required professional ethics for audit engagements.
- The representatives of the audit firms did not adequately establish training management system.

Recommendations for improvement related to “6. Monitoring and remediation process of the system of quality management” mainly include the following comments:

- The representatives of the audit firms did not clarify specific policies and procedures regarding ongoing monitoring.
- The representatives of the audit firms did not clarify specific requirements that serve as a basis for determining eligibility of person who verifies the system on a regular basis were not established.

Recommendations for improvement related to “7. Assembly of final engagement files and management and retention of engagement documentation” mainly include the following comments:

- The representatives of the audit firms did not develop adequate mechanisms to prevent inappropriate amendments or additions to engagement documentation after the final wrapping up of the engagement documentation.
- The representatives of the audit firms did not clarify specific policies and procedures regarding storage of engagement documentation and stocktaking.

Regarding any of the above focus areas, no recommendations for improvement were identified at large-sized or second-tier audit firms.

The Quality Control Review Team will provide instructions for audit firms to improve their audit quality and confirm remedial actions taken by the firms.

b. Individual engagements

The following items were identified as focus areas for individual engagements. The number of audit firms that received recommendations for improvement by each focus area is presented below.

[Number of audit firms that received recommendations for improvement in focus area]

(Unit: Number of audit firms)

| Focus areas | FY2022 | FY2023 | FY2024 |
|--|--------|--------|--------|
| 1. Identifying, assessing and addressing the risk of material misstatements including fraud risk | | | |
| • Revenue recognition | 28 | 56 | 30 |
| • Risk of management’s override of internal controls | 35 | 46 | 21 |
| 2. Auditing accounting estimates | 51 | 55 | 28 |

(*1) Some audit firms received recommendations for improvement in multiple areas.

(*2) Only recommendations for improvement related to focus areas are tabulated.

As in FY2023, recommendations for improvement were mainly related to the following areas:

In "revenue recognition," which is included in "1. Identifying, assessing and addressing the risk of material misstatements including fraud risk," include the following comments:

- Audit teams did not sufficiently consider fraud risk scenarios.
- Audit teams did not sufficiently consider valid reasons for the case where risk requiring special consideration was not identified.
- Audit teams did not obtain more persuasive audit evidence compared to cases where fraud risks had not been identified.

In "risk of management's override of internal controls" include the following comments:

- Audit teams did not perform test of details to examine extracted journal entries.
- Audit teams did not sufficiently consider the conditions for extracting journal entries in response to fraud risk scenarios.

In addition, even among large-sized or second tier audit firms, there were issues about "audit teams did not sufficiently consider valid reasons for the case where risk requiring special consideration was not identified" and "audit teams did not obtain more persuasive audit evidence compared to cases where fraud risks had not been identified" in "revenue recognition".

Also, there were issues about "audit teams did not perform audit procedures to examine extracted journal entries" and "audit teams did not sufficiently consider the conditions for extracting journal entries in response to fraud risk scenarios" are seen in "risk of management's override of internal controls".

Regarding "2. Auditing accounting estimates," recommendations for improvements were mainly related to impairment accounting of long lived assets, as well as accounting estimates, including valuation of inventories, recoverability of deferred tax assets, allowance for doubtful accounts and valuation of shares. For example, comments included a lack of understanding and consideration of the company and its environment, the applicable financial reporting framework and the company's internal control system, which were related to accounting estimates, as well as insufficient procedures for responding to risks related to significant assumptions used by management in developing accounting estimates.

In addition, even among large-sized or second tier audit firms, "insufficient procedures for responding to risks related to significant assumptions used by management in developing accounting estimates" was a main issue in "impairment accounting of long lived assets" and "recoverability of deferred tax assets".

The Quality Control Review Team will provide instructions for audit firms to improve these recommendations and confirm remedial actions taken by the firms.

- c. Operational control systems of auditors that engage in audits of listed companies and similar companies

Regarding operational control systems of auditors that engage in audits of listed companies and similar companies, JICPA confirmed about the focus areas in FY2024 (refer to “Focus areas in FY2024”). As a result, there were no recommendations for improvement in “1. Systems for conducting auditing work fairly and appropriately”, “2. Evaluation and announcement of the status of business quality management, etc.”, “3. Announcement of the status of business management, etc.” and “4. Organizational operations”. In addition, for information of the recommendations for improvement regarding “5. Areas and items of causes of significant deficiencies in the design and operation status of systems of quality management”, please refer to the description on the [Regular review to registered auditors that engage in audits of listed companies and similar companies that have audit services subject to regular reviews] under the (ii) Implementation status of Confirmation of Eligibility of (3) Confirmation of Eligibility.

(5) Implementation Status and Results of Special Reviews

The implementation status and results of the special reviews, including the number of audit firms, are as follows.

In addition, special reviews were conducted for two audit firms in FY2024 for the following reasons, and the deliberation for both the firms has been carried over to the next fiscal year.

- It was deemed necessary to check the status of the establishment and operation of an organizational structure for the continuous improvement of audit firm’s system of quality management, as well as status of specific audit engagements.
- In order to proceed with the examination for registration, it was deemed necessary to confirm the status of the quality management in audit engagement as of the date of application for registration.

[The implementation status and results of the special reviews]

| | FY2022 | FY2023 | FY2024 |
|-----------------------|---|--------|-----------|
| Themes | Audit of amended annual securities report for previous fiscal years | – | See above |
| Number of audit firms | 1 | 0 | 2 |

| | | | |
|--------|---|---|-------------------------------------|
| Result | Result without significant deficiencies | – | Deliberation carried over to FY2025 |
|--------|---|---|-------------------------------------|

(6) Implementation Status and Results of Reviews for the Examination of Registration

In FY2024, JICPA conducted reviews for the examination of registration in response to requests from the Review Board for Registration on Auditors that Engage in Audits of Listed Companies and Similar Companies to the Quality Control Committee.

JICPA confirmed the design and implementation status of audit firm's systems of quality management including compliance with legal requirements to audit the financial statements of listed companies and similar companies fairly and appropriately.

When confirming, JICPA fully considered the design and implementation status of audit firms and application status of quality managements in audit engagements.

There were 6 audit firms that withdrew their applications for registration due to deficiencies related to operational management systems and quality management systems which were pointed out by quality control reviewers before the review for the examination of registration.

[The implementation status and results of the reviews for the examination of registration]

| Result | FY2023 | FY2024 |
|--|--------|-------------------|
| Result with extremely significant deficiencies | 0 | 2 |
| Result with significant deficiencies | 0 | 0 |
| Result without significant deficiencies | 4 | 19 ^(*) |
| Total | 4 | 21 |

* In addition to the table above, JICPA issued a review report for 1 audit firm of which the deliberation had been carried over from FY2023.

Audit firms that received results with extremely significant deficiencies were found to have the following deficiencies:

- The representatives of the audit firms did not establish personnel system required in article 87-1 and system to manage quality in audit engagement required in article 87-2 of Enforcement Regulations of CPA Act.
- The representatives of the audit firms did not establish training management system for registered auditors that engage in audits of listed companies and similar companies.

- The representatives of the audit firms did not specify training that should be taken by professional personnel.

(7) Confirmation of Remedial Actions

(i) Confirmation of improvement status

Results for the 15 audit firms that underwent a confirmation of improvement status in FY2024 are as follows:



As a result of the confirmation of improvement status in FY2024, out of the 7 audit firms without insufficient improvement, 3 audit firms showed improvement in all the recommendations for improvement identified in the previous fiscal year's quality control review but different new recommendations for improvement were identified in associated areas. Out of the 8 audit firms with insufficient improvement, improvement status for 2 audit firms was carried over from the previous fiscal year.

In addition, for those two firms, confirmation of improvement status was conducted again in FY2024 based on the situation at each audit firm.

The following represents a breakdown by the size of audit firms whose improvement status was confirmed.

[Breakdown by the size of audit firms]

(Unit : Number of audit firms)

| | | | Confirmation results | | | | | | | |
|---|--|----------------------|---|----------------------|--|-----|-----------------------------|-----|-------|-----|
| | | | Result without insufficient improvement | | Result with insufficient improvement | | Carried-over audit firms | | Total | |
| Deemed registered auditors that engage in audits of listed companies and similar companies | Large-sized/ second-tier | | 0 | (0) | 0 | (0) | 0 | (0) | 0 | (0) |
| | Audit firms by the number of listed company audits | Over 10 companies | 1 | (5) ^(*)2) | 3 | (0) | 0 | (0) | 4 | (5) |
| | | 5–9 companies | 2 | (0) | 2 | (1) | 0 | (0) | 4 | (1) |
| | | 2–4 companies | 1 | (0) | 0 | (1) | 0 | (0) | 1 | (1) |
| | | 0–1 companies | 1 | (0) | 0 | (0) | 0 | (0) | 1 | (0) |
| | Sub-total | | 5 | (5) | 5 | (2) | 0 | (0) | 10 | (7) |
| Other audit firms | | 2 | (3) | 3 | (0) | 0 | (0) | 5 | (3) | |
| Total | | 7 | (8) | 8 | (2) | 0 | (0) | 15 | (10) | |

(*)1 FY2023 numbers are shown in parentheses.

(*)2 The one audit firm that went through a confirmation of improvement status in FY2022 but whose issuance of the confirmation result report of the improvement status was carried over to FY2023 is included.

(ii) Confirmation of remedial actions in writing

In the fiscal year following a quality control review, all audit firms that received recommendations for improvement as a result of a quality control review are required to submit an improvement status report to the Quality Control Committee. The Quality Control Review Team confirms the implementation status of remedial actions.

Improvement status reports submitted by audit firms (excluding audit firms for which a regular review or confirmation of improvement status was conducted) showed the following results:

[Confirmation of remedial actions in writing]

(Unit : Number of audit firms)

| | | FY2022 | FY2023 | FY2024 |
|--|--------------|--------|--------|--------|
| Number of audit firms that are subject to the review of improvement status reports | | 56 | 76 | 64 |
| Number of audit firms with concerns of insufficient improvement | With concern | 0 | 0 | 0 |
| | No concern | 56 | 76 | 64 |

(8) Measures Taken as a Result of Quality Control Reviews

(i) Decision on measures

The following table shows measures taken as a result of regular reviews.

[Measures decided based on the result of Quality Control Reviews]

(Unit: Number of audit firms)

| Results of quality control reviews | Measures ^(*4) | FY2022 | FY2023 | FY2024 |
|---|--|--------|--------|--------|
| Results with extremely significant deficiencies | Recommendation to withdraw from audit engagements | 1 | 4 | 0 |
| | Recommendation to withdraw from audit engagements (Insufficient improvement) | 2 | 2 | 1 |
| | Severe warning | 0 | 1 | 0 |
| | Sub-total | 3 | 7 | 1 |
| Results with significant deficiencies | Recommendation to withdraw from audit engagements (Insufficient improvement) | 1 | 0 | 0 |
| | Severe warning | 1 | 2 | 7 |
| | Severe warning (Insufficient improvement) | 0 | 0 | 0 |
| | Warning | 0 | 1 | 0 |
| | Warning (Insufficient improvement) | 0 | 2 | 0 |
| | Sub-total | 2 | 5 | 7 |
| Results without significant deficiencies but with recommendations for improvement | Severe warning (Insufficient improvement) | 0 | 1 | 0 |
| | Warning (Insufficient improvement) | 6 | 7 | 6 |
| | Sub-total | 6 | 8 | 6 |
| No result | Warning (Insufficient improvement) | 0 | 1 | 0 |
| Total | | 11 | 21 | 14 |

(*1) More than one measure could be taken against an audit firm as a result of quality control reviews. With that in mind, audit firms are classified in the above table based on the most severe measures taken against them. Therefore, the number of measures in the table above does not correspond to the total number of measures taken against audit firms.

- (*2) There were two audit firms in FY2022, and three in FY2023, which were carried over from previous fiscal years and whose measures were determined in FY2022 and FY2023, respectively. The results of the quality control reviews and measures taken against those audit firms were "Results with extremely significant deficiencies and recommendation to withdraw from audit engagements (Insufficient improvement)" and "Results with significant deficiencies and recommendation to withdraw from audit engagements (Insufficient improvement)" in FY2022, "Results with extremely significant deficiencies and recommendation to withdraw from audit engagements"(two audit firms) and "No Result and warning (Insufficient improvement)"(one audit firm) in FY2023.
- (*3) In addition to the above, as a result of a review conducted in FY2024 for the examination of registration, measures were decided in one case of "Results with extremely significant deficiencies and recommendation to withdraw from audit engagements," one case of "Results with extremely significant deficiencies and recommendation to withdraw from audit engagement (Insufficient improvement)," and one case of "Results without significant deficiencies and warning (Insufficient improvement)."
- (*4) "Recommendation to withdraw from audit engagements (Insufficient improvement)," "Severe warning (Insufficient improvement)," and "Warning (Insufficient improvement)" in the "Measures" column are determined based on the confirmation of improvement status as a result of insufficient improvement in their remedial actions.

The following table shows measures taken as a result of confirmation of improvement status.

[Measures decided based on a result of confirmation of improvement status]

(Unit: Number of audit firms)

| Result of quality control reviews | Measures | FY2022 | FY2023 | FY2024 |
|--|--|-------------------|--------|--------|
| Confirmation results with insufficient improvement | Recommendation to withdraw from audit engagements (Insufficient improvement) | 1 | 0 | 0 |
| | Severe warning (Insufficient improvement) | 0 | 0 | 4 |
| | Warning (Insufficient improvement) | 3 ^(*2) | 2 | 4 |
| Total | | 4 | 2 | 8 |

(*1) More than one measure could be taken against an audit firm as a result of quality control reviews. With that in mind, audit firms are classified in the above table based on the most severe measures taken against them. Therefore, the number of measures in the table above does not correspond to the total number of measures taken against audit firms.

(*2) Includes one audit firm that underwent a confirmation of improvement status in FY2021 and for which the issuance of a confirmation result report of the improvement status and decision on measures were carried over to FY2022.

(ii) Reporting to the Chairman of the Audit Practice Review and Investigatory Committee

Through quality control reviews, when a significant doubt arises on the appropriateness of an audit opinion expressed by an audit firm or when a significant doubt arises as to the compliance with the regulation and Constitution of JICPA, the issue shall be reported to the Chairman of the Audit Practice Review and Investigatory Committee.

The number of audit firms reported to the Chairman of the Audit Practice Review and Investigatory Committee is as follows:

[Table regarding reports to the Chairman of the Audit Practice Review and Investigatory Committee]

(Unit: Number of audit firms)

| Result of quality control reviews | FY2022 | FY2023 | FY2024 |
|---|--------|--------|--------|
| Results with extremely significant deficiencies | 3 | 6 | 1 |
| Results with significant deficiencies | 1 | 0 | 0 |

5. Recommendations for Improvement related to Regular Reviews in FY2024

The following table shows the breakdown of recommendations for improvement made to audit firms as a result of regular reviews, which are classified into those related to the system of quality management of the audit firm and the quality management of individual engagements. Recommendations for improvement related to carried-over audit firms from previous fiscal years are also included in the table.

[Breakdown of recommendations for improvement]

| Fiscal year | Number of recommendations for improvement | | | Number of audit firms that received quality control review reports | | Individual engagements selected for quality control review |
|-------------|--|--|--------------|--|--|--|
| | System of quality management of the audit firm | Quality management of individual engagements | Total | | Of which, number of audit firms with recommendations for improvement | |
| FY2023 | 460 | 684 | 1,144 | 86 | 86 | 176 |
| FY2024 | 96 (72) | 317 (228) | 413 (300) | 53 (32) | 51 (32) | 133 (109) |

(*1) The figures in [] are for audit firms that have applied the revised Quality Management Standards for FY2024.

(*2) Five carried-over audit firms from FY2022 are included in the FY2023 row and received recommendations for improvement. The number of those related to the audit firm's system of quality management and quality management in audit engagements are 17 and 60, respectively. 10 individual engagements are selected for quality control review.

(1) Recommendations for Improvement Related to the Audit Firm's System of Quality Management

The following table shows the number of recommendations for improvement related to the "system of quality management of audit firm" of audit firms that have received quality control review report.

The reason for the decrease in FY2024 compared to FY2023 is that the lead examiner in charge of the audit firms provided guidance in preparation for the review of registration as a deemed registered auditors that engage in audits of listed companies and similar companies and the audit firm gained a proper understanding of a high level of discipline, a which led to improvements in the system of quality management.

[Number of recommendations for improvement related to the system of quality management of the audit firm]

| Result of reviews | Number of recommendations for improvement | | Number of audit firms that received quality control review reports | | |
|---|---|------------------------------|--|--|-------------|
| | (A) | Average per audit firm (A/B) | (B) | Of which, number of audit firms with recommendations for improvement | |
| Result without significant deficiencies | 51 (378) | 1.1 (5.1) | 45 (74) | 21 (66) | 47% (89%) |
| Result with Significant Deficiencies | 45 (82) | 5.6 (6.8) | 8 (12) | 8 (12) | 100% (100%) |
| Total | 96 (460) | 1.8 (5.3) | 53 (86) | 29 (78) | 55% (91%) |

(*1) FY2023 figures are in parentheses.

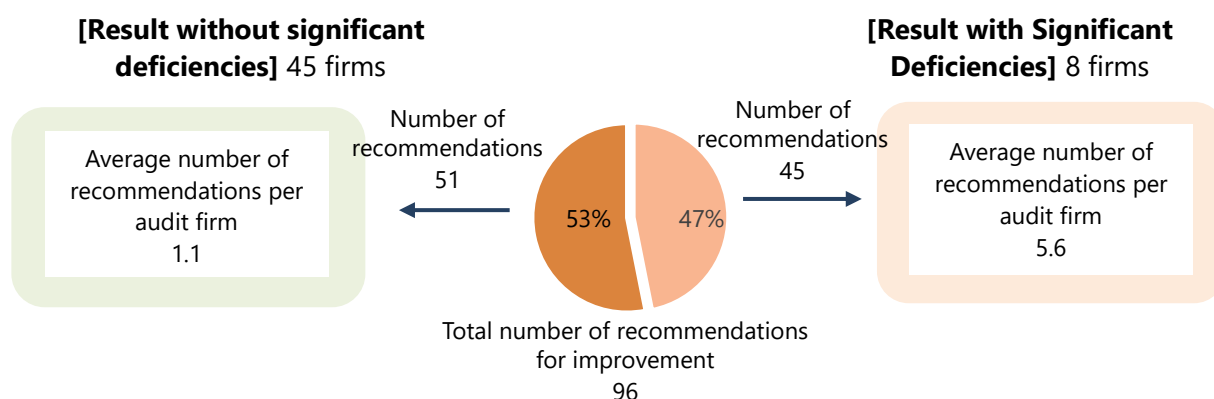
(*2) Of the five carried-over audit firms from FY2022, two audit firms that are included in FY2023 received results with Significant Deficiencies with 10 recommendations for improvement.

In addition, among audit firms that have received quality control review reports, the number of recommendations for improvement related to the system of quality management of the audit firm that have applied the revised Quality Management Standards, is as shown in the following table.

[The number of recommendations for improvement related to the "audit firm's system of quality management" of audit firms that have applied the revised Quality Management Standards]

| Result of reviews | Number of recommendations for improvement | | Number of audit firms that received quality control review reports | | |
|---|---|------------------------------|--|--|------|
| | (A) | Average per audit firm (A/B) | (B) | Of which, number of audit firms with recommendations for improvement | |
| Result without significant deficiencies | 34 | 1.3 | 26 | 14 | 54% |
| Result with Significant Deficiencies | 38 | 6.3 | 6 | 6 | 100% |
| Total | 72 | 2.3 | 32 | 20 | 63% |

[Audit firms that received quality control review reports in FY2024] 53 firms



- ❗ Recommendations for improvement represent matters with a certain degree of concern for significant non-compliance with professional standards as well as applicable laws and regulations. They are recommendations described in the Recommendation reports, representing matters requiring improvement for the purpose of enhancing audit quality control.
- ❗ Since the number of audit firms that undergo regular reviews varies from year to year, the number of recommendations for improvement cannot simply be compared year on year. Still, they should be able to provide some useful information about the trends in recommendations made. Hence, recommendations for information are broken down into those regarding the system of quality management of the audit firm and those regarding the quality management of individual engagements.

Most common recommendations for improvement (related to the system of quality management of the audit firm)

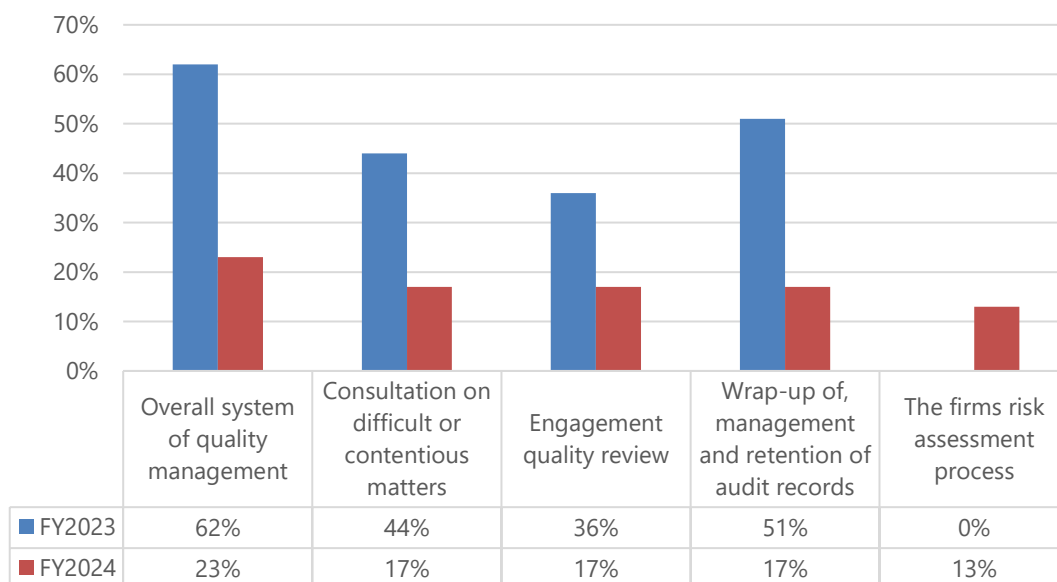
Of the improvement recommendations related to the audit firm's systems of quality management, the occurrence rate has decreased for all the top five most common areas compared to FY2023 excluding the new item "The firm's risk assessment process" due to the application of the revised Quality Management Standards.

The most common recommendations for improvement are as follows:

[Improvement recommendations related to the audit firm's systems of quality management]

| Top five recommendations for improvement | Typical example |
|--|--|
| Overall system of quality management | <ul style="list-style-type: none"> • The representatives of the audit firms did not clarify specific policies and procedures for confirming and assessing how well information regarding the importance of focusing on the audit quality was understood. • The representatives of the audit firms did not clarify specific requirements that serve as a basis for determining eligibility of person responsible for quality management. • The representatives of the audit firms did not adequately establish mechanisms to ensure that sufficient time was secured for conducting quality management activities. |
| Consultation on difficult or contentious matters | <p>The representatives of the audit firms did not clarify the following matters:</p> <ul style="list-style-type: none"> • Cases which require expert opinion • Experts whom the audit team can contact • Specific requirements on adequate knowledge, experience and capability of experts • Policy for assessing the suitability of experts |
| Engagement quality review | <ul style="list-style-type: none"> • There are numerous issues requiring improvement in audit engagement that have not been discovered or prevented through engagement quality reviews. • The representatives of the audit firms did not clarify specific requirements regarding adequate knowledge, experience and capability of the engagement quality reviewer. |
| Assembly, management and retention of engagement documentation | <ul style="list-style-type: none"> • The representatives of the audit firms did not develop adequate mechanisms to prevent inappropriate amendments or additions to engagement documentation after the assembly of the final engagement documentation. • The representatives of the audit firms did not clarify specific policies and procedures regarding storage of engagement files and stocktaking. |
| The firm's risk assessment process | <ul style="list-style-type: none"> • The representatives of the audit firms did not clarify specific policies and procedures regarding ongoing monitoring. • The representatives of the audit firms did not clarify specific requirements that serve as a basis for determining eligibility of person who verifies the system on a regular basis. |

[Occurrence rate of recommendations for improvement (regarding the system of quality management of the audit firm)]



(Note) Occurrence rate of recommendations for improvement =
$$\frac{\text{Number of audit firms provided with recommendations for each item}}{\text{Number of audit firms that received quality control review reports}}$$

In addition, the top three recommendations for improvement related to the "system of quality management of audit firms" of audit firms that have applied the revised Quality Management Standards are as follows:

[Recommendations for improvement related to the "audit firm's systems of quality management" of audit firms that have applied the revised Quality Management Standards]

| Top three recommendations for improvement (Occurrence rate of recommendations for improvement) | Typical example |
|---|---|
| Consultation on difficult or contentious matters (28%) | <p>The representatives of the audit firms did not clarify the following matters:</p> <ul style="list-style-type: none"> • Cases which require expert opinion • Experts whom the audit team can contact • Specific requirements on adequate knowledge, experience and capability of experts • Policy for assessing the suitability of experts |
| The firm's risk assessment process (22%) | <ul style="list-style-type: none"> • The representatives of the audit firms did not maintain a record of the process for considering whether or not the firm should set additional quality objectives that it believes are necessary. • The representatives of the audit firms did not establish a process for internal discussion and approval of the firm's response to the set quality objectives. |
| Overall system of quality management (16%) | <ul style="list-style-type: none"> • The representatives of the audit firms did not clarify specific requirements that serve as a basis for determining eligibility of person responsible for quality management. • The representatives of the audit firms did not adequately establish mechanisms to ensure that sufficient time was secured for conducting quality management activities. |

(2) Recommendations for Improvement Related to the Quality Management of Individual Engagements

The following table shows the number of recommendations for improvement related to the “quality management of individual engagements” of audit firms that have received quality control review reports.

[Number of recommendations for improvement related to “quality management of individual engagements”]

| Result of reviews | Number of recommendations for improvement | | Number of audit firms that received quality control review reports | Individual engagements selected for quality control review | | | |
|---|---|------------------------------------|--|--|---|--|-------------|
| | (A) | Average per audit engagement (A/B) | | (B) | Of which, number of engagements provided with recommendations for improvement | | |
| Result without significant deficiencies | 240 (528) | 2.0 (3.3) | 45 (74) | 121 (162) | 92 (137) | | 76% (85%) |
| Result with Significant Deficiencies | 77 (156) | 6.4 (11.1) | 8 (12) | 12 (14) | 12 (14) | | 100% (100%) |
| Total | 317 (684) | 2.4 (3.9) | 53 (86) | 133 (176) | 104 (151) | | 78% (86%) |

(*1) FY2023 figures are in parentheses.

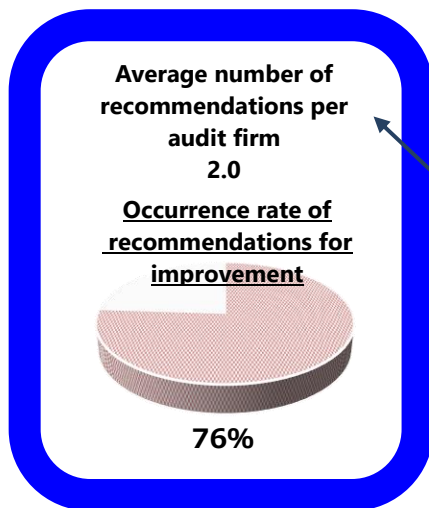
(*2) Of the five carried-over audit firms from FY2022, two audit firms that are included in FY2023 received results with Significant Deficiencies with 22 recommendations for improvement for two selected engagements.

[Audit firms that received quality control review reports in FY2024]

53 audit firms (133 engagements)

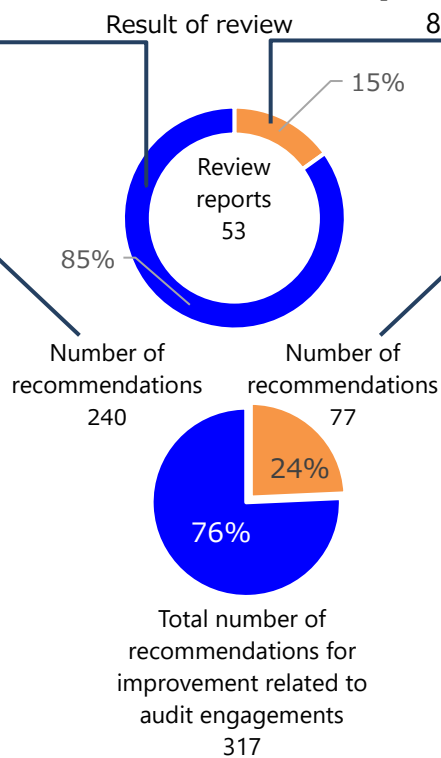
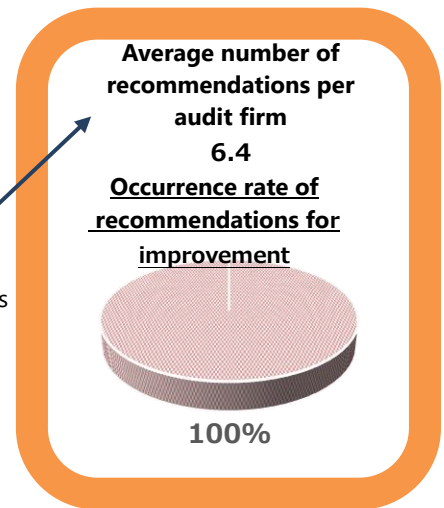
[Result without significant deficiencies]

45 audit firms (121 engagements)



[Result with Significant Deficiencies]

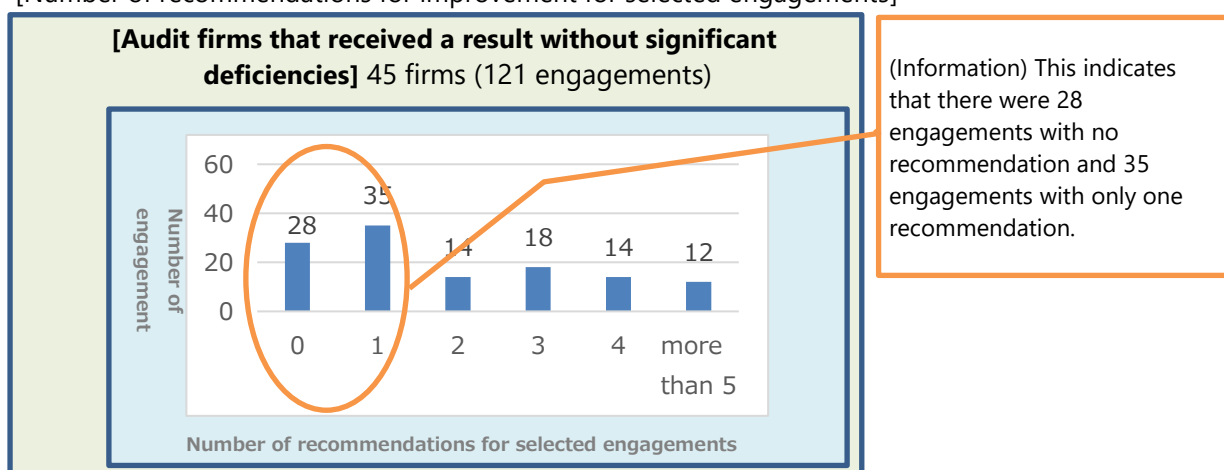
8 audit firms (12 engagements)



Recommendations for improvement for audit firms that received a result without significant deficiencies

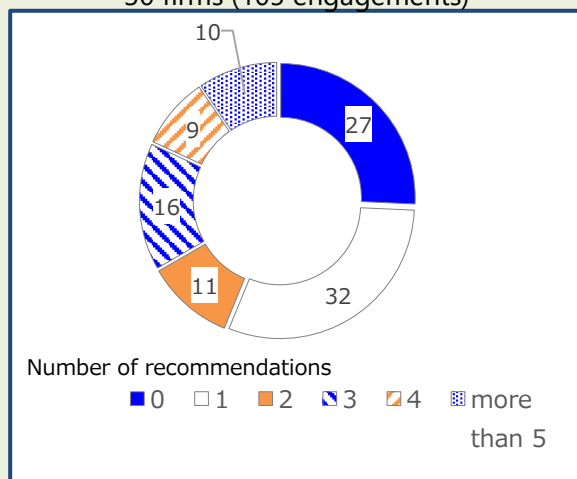
Regarding audit firms that received a result without significant deficiencies, the number of recommendations for selected individual engagements is represented as follows:

[Number of recommendations for improvement for selected engagements]



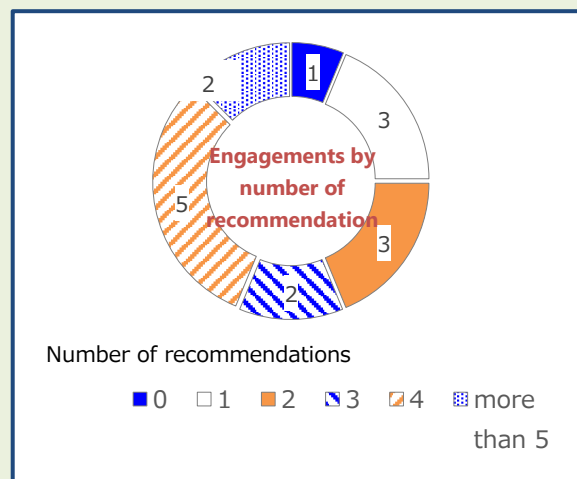
Classification by number of registration status

Registered auditors that engage in audits of listed companies and similar companies 30 firms (105 engagements)



Average number of recommendations per engagement: 1.9

Other audit firms 15 firms (16 engagements)



Average number of recommendations per engagement: 2.8

Most common recommendations for improvement (regarding quality management of individual engagements)

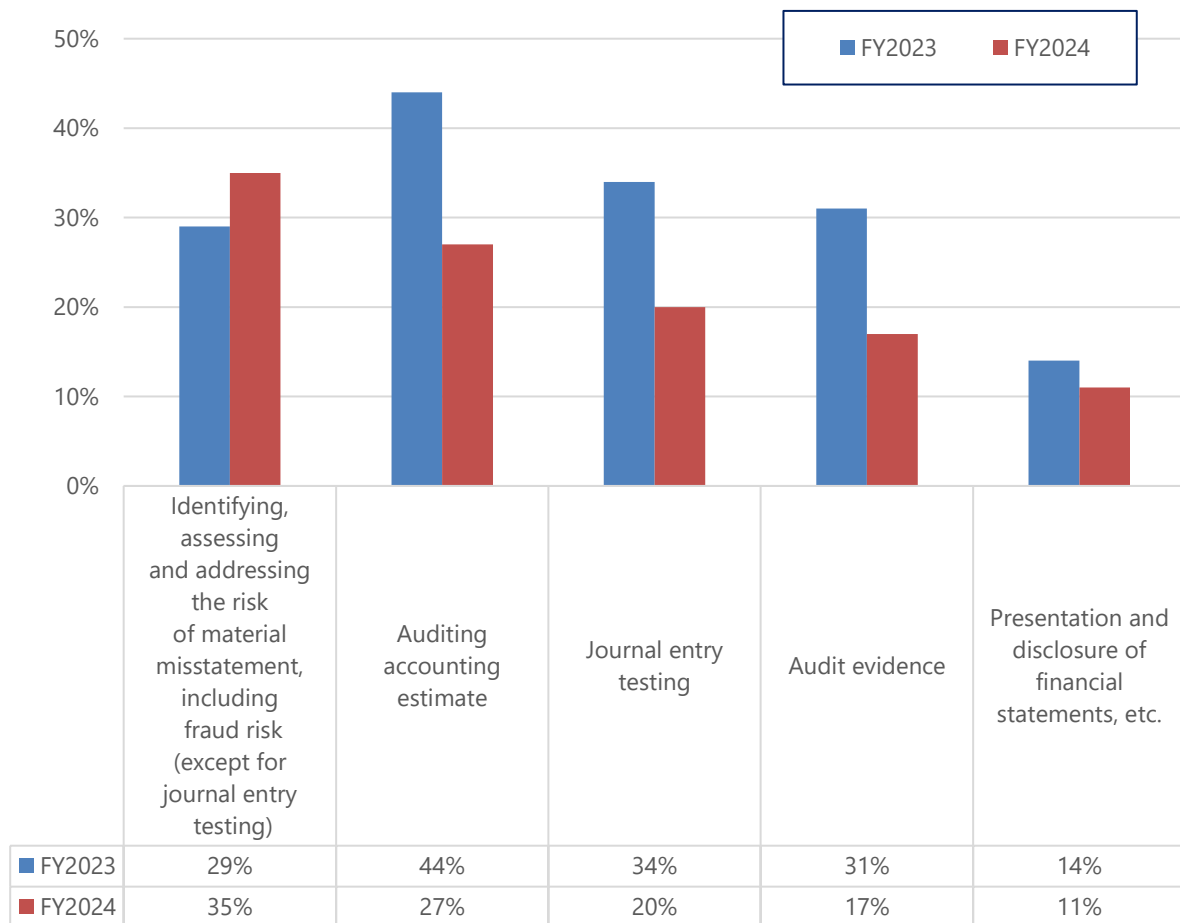
Of the improvement recommendations related to quality management in audit engagements, the occurrence rate has decreased for all of the top five most common areas compared to FY2023 excluding "Identifying, assessing and addressing the risk of material misstatements including fraud risk (except for journal entry testing)".

The top five most common recommendations for improvement are as follows:

[Most common recommendations for improvement (regarding quality management of individual engagements)]

| Top five recommendations for improvement | Typical example |
|--|---|
| Identifying, assessing and addressing the risk of material misstatements including fraud risk (except for journal entry testing) | <ul style="list-style-type: none"> • Audit teams did not sufficiently consider fraud risk scenarios. • Audit teams did not sufficiently consider valid reasons for the case where risk requiring special consideration was not identified. • Audit teams did not obtain more persuasive audit evidence compared to the case where fraud risks had not been identified. |
| Auditing accounting estimates | <ul style="list-style-type: none"> • Recommendations for improvements were mainly related to impairment accounting of long lived assets, as well as accounting estimates, including valuation of inventories, recoverability of deferred tax assets, allowance for doubtful accounts and valuation of shares. • For example, there was a lack of understanding and consideration of the company and its environment, the applicable financial reporting framework and the company's internal control system, which were related to accounting estimates, as well as insufficient procedures for responding to risks related to assumptions used by management in developing accounting estimates. |
| Journal entry testing | <ul style="list-style-type: none"> • Audit teams did not perform audit procedures to examine extracted journal entries. • Audit teams did not sufficiently consider conditions for extracting journal entries in response to fraud risk scenarios. |
| Audit evidence | Audit teams did not acquire evidence on accuracy and completeness of information produced by the entity. |
| Presentation and disclosure of financial statements | <ul style="list-style-type: none"> • Audit teams did not consider the fact that the notes don't include unearned lease payments regarding non-cancelable operating lease transaction. • Audit teams did not consider the necessity of disclosing segment information as major countries that account for 10% or more of the entire consolidated financial statements. |

[Most common recommendations for improvement (regarding quality management of individual engagements)]



(Note) Occurrence rate =
$$\frac{\text{Number of engagements provided with recommendations for each item}}{\text{Number of selected engagements}}$$

