



The Japanese Institute of Certified Public Accountants
Overview of the Quality Control Review 2019



Engage in the Public Interest

Contents

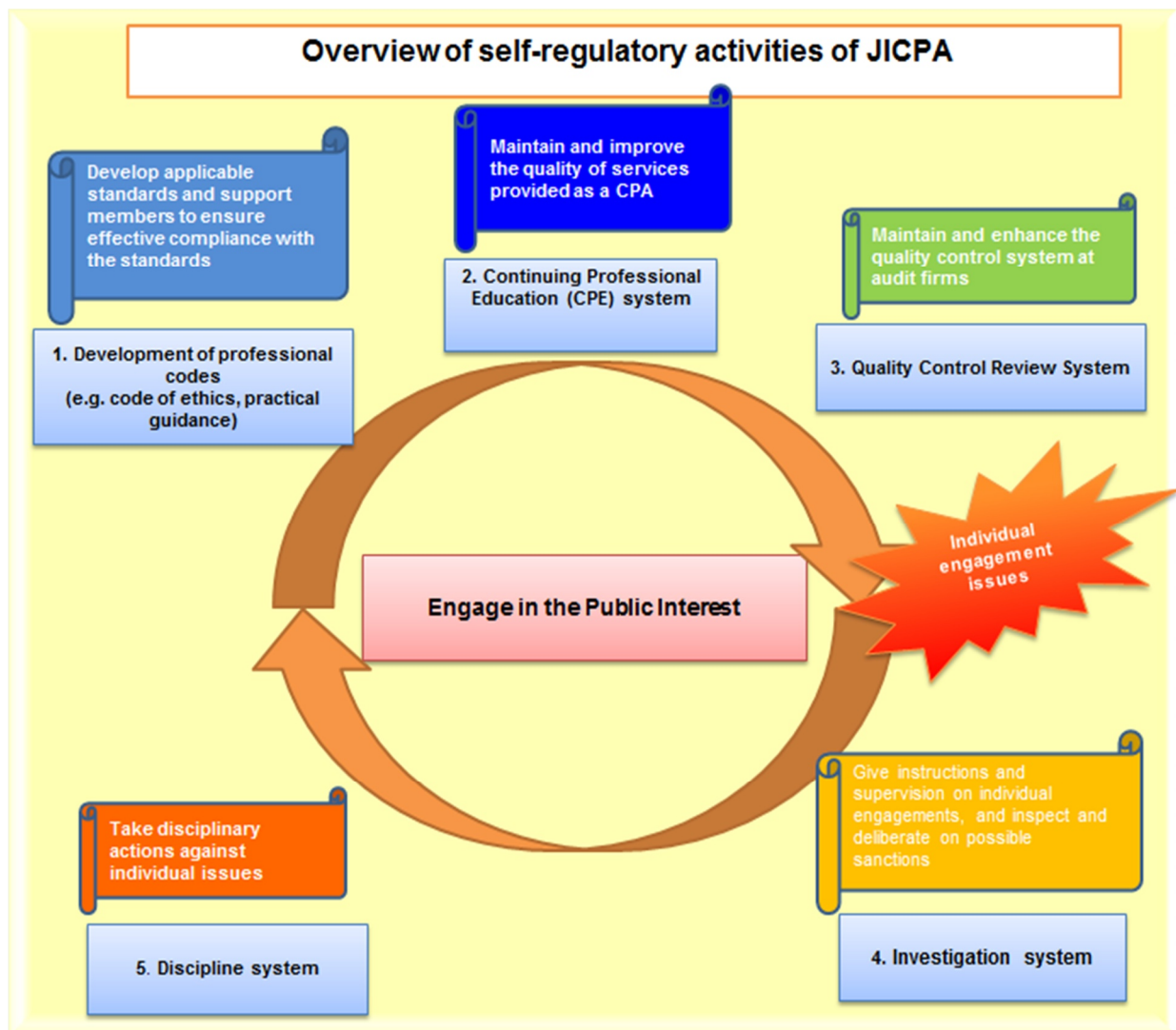
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1. Activities of JICPA as a self-regulatory organization

The Japanese Institute of Certified Public Accountants (or “JICPA”) is a self-regulatory organization, aiming to maintain and improve the quality of auditing, accounting and other related fields of professional services and enhance social confidence in those services, summarized in the following diagram.

The “Quality Control Review System” is considered as one of the most significant self-regulatory activities of JICPA.



2. Quality Control Review System

2.1 Overview of the Quality Control Review System and the Registration System for Listed Company Audit Firms

Given the nature of public interest in audit engagements, JICPA has implemented and conducted a system for quality control reviews (the “Quality Control Review System”) for audit engagements conducted by audit firms and CPAs (collectively as “audit firms”) since 1999, which is a self-regulatory activity of JICPA under the Certified Public Accountants Act (the “CPA Act”), for the purpose of maintaining and enhancing an appropriate quality level of audit engagements and ensuring social confidence in auditing.

The purpose of the Quality Control Review System is to maintain and enhance the appropriate quality level of audits conducted by audit firms by conducting reviews for design and operation of accounting firms’ quality control system, providing recommendation for improvement and determining appropriate measures, if needed. The reviews are conducted in compliance with the Quality Control Review Standards and the Quality Control Review Procedures based on JICPA’s rules and regulations.

A quality control review has the characteristics of instructing or supervising and are not intended to detect or discipline or to intervene in audit opinions expressed by audit firms.

Furthermore, JICPA has introduced the “Registration System for Listed Company Audit Firms” in 2007 to enhance the quality control of audit firms engaged in audits of listed companies. This system is incorporated into the Quality Control Review System. Center for Listed Company Audit Firms is established under the Quality Control Committee, which is responsible for preparing lists of registered firms and associated registered firms. The lists are published on JICPA’s website. The center is also responsible for determining whether or not audit firms can be registered on the lists and whether necessary measures should be taken for registration purposes.

According to the Securities Listing Regulations of each stock exchange, audit firms engaged in an audit of a listed company must be a member of the list of registered firms or associated registered firms.

For details of “Registration System for Listed Company Audit Firms,” please refer to “6. Registration System for Listed Company Audit Firms.”

2.2 The relationship between the Quality Control Review System and inspections by the Certified Public Accountants and Auditing Oversight Board (“CPA AOB”)

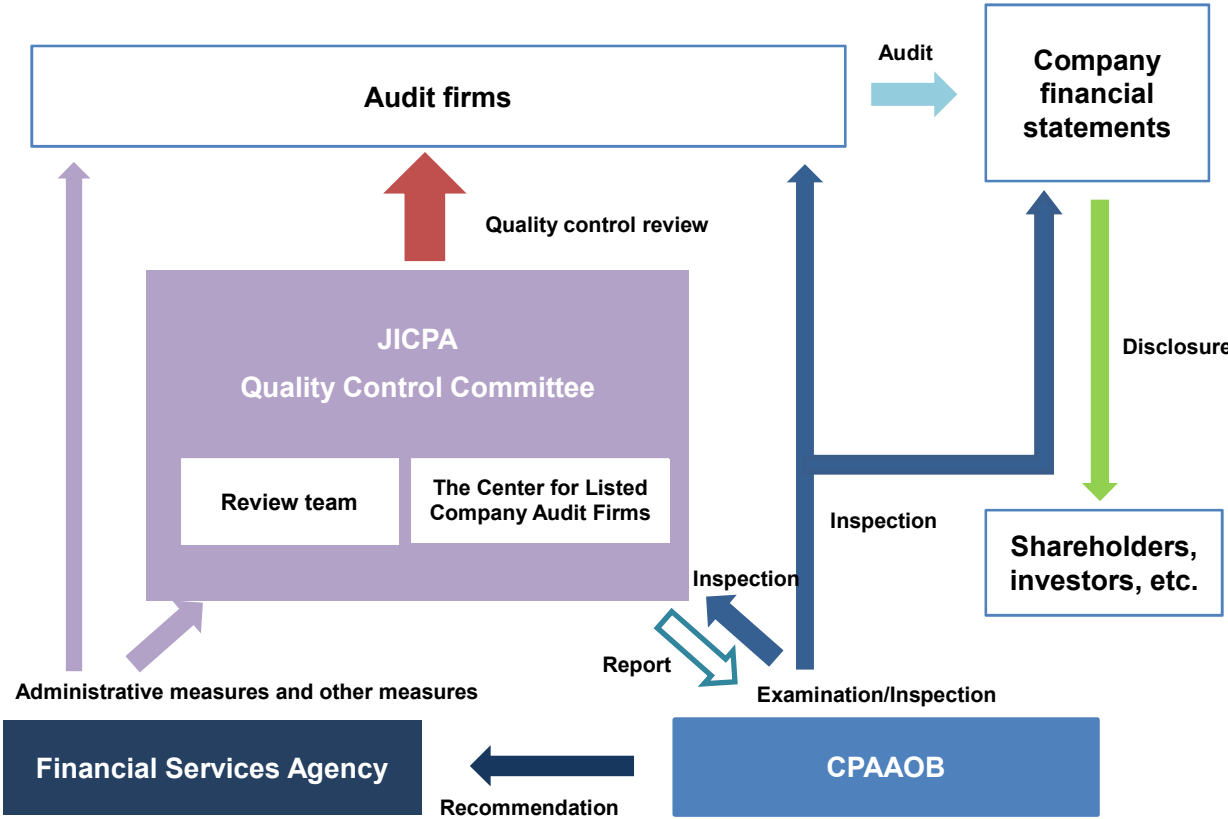
The Quality Control Review System conducted by JICPA has been monitored by the Certified Public Accountants and Auditing Oversight Board (the “CPA AOB”) under the CPA Act since 2004.

The CPAAOB is a government council formed within the Financial Services Agency under the CPA Act and the Act for Establishment of the Financial Services Agency. The key responsibilities of the CPAAOB are 1) inspection of CPAs, audit firms, foreign audit firms and JICPA, 2) implementation of CPA examinations, and 3) deliberation of disciplinary actions against CPAs and audit firms.

JICPA reports the status of quality control reviews to the CPAAOB on a monthly and annual basis.

The following diagram shows the relationship between the Financial Services Agency, the CPAAOB, audit firms and JICPA.

[The relationship between the Financial Services Agency, the CPAAOB, audit firms and JICPA]



2.3 Quality control system of audit firms

In order to reasonably ensure quality of audit work, audit firms have to design and implement a quality control system for the following matters stipulated in the "Quality Control for Audit Firms" (Quality Control Standards Committee Statement No. 1).

- (1) Audit firms, all partners and professional staff belonging to audit firms (hereinafter referred to as "professional personnel") shall comply with the professional standards and applicable laws and regulations.
- (2) Audit firms or engagement partners issue an appropriate audit report according to the situation.

An audit firm's quality control system mainly consists of the following policies and procedures. Audit firms must design and implement these policies and procedures. Engagement partners must conduct audits in compliance with the quality control system.

[Quality Control System of Audit Firms]

Responsibility for Quality Control

- Cultivate a culture under which quality is emphasized

Professional Ethics and Independence

- Maintain independence from audit clients

Acceptance and Continuance of Engagements

- Assess the size, complexity and integrity of audit clients as well as the acceptance capability of audit firms (including resource management of professional personnel), and determine whether the audit firm can conduct an appropriate audit

Human Resources

- Develop and maintain appropriate competence and capabilities required for professional personnel

Engagement Performance

- Build up information and techniques for audits (e.g. audit manual, guidance, audit practice aid)
- Engagement partners to provide instruction, supervision and review
- Prepare audit documentation in appropriate and timely manner

Engagement Quality Control Review

- Ensure adequate knowledge, experience and capability of reviewers and objectivity from the audit engagement
- Conduct a thorough review in assessing audit procedures

Monitoring the System of Quality Control

- Evaluate the impact of deficiencies identified through the process of ongoing monitoring and periodic inspections, and communicate and correct the deficiencies as necessary

Documentation of Quality Control System

- Appropriately record and retain the status of design and implementation of the quality control system

2.4 Type of ordinary quality control reviews and target audit firms

Ordinary quality control review is process of reviewing the quality control status of audits

conducted by audit firms, reporting the results to audit firms, providing recommendations for improvements as necessary and receiving the status of their improvements. Ordinary quality control reviews consist of “Regular quality control review” and “Additional quality control review.”

[Type of ordinary quality control reviews]

Type of review	Details
Regular quality control review	A review for audit firms subject to ordinary quality control reviews. As a general rule, the review is conducted systematically every three years. (Every two years for large-sized audit firms. Please refer to below.)
Additional quality control review	A review for audit firms subject to ordinary quality control reviews. This review is conducted flexibly in case the Quality Control Committee determines it is necessary to supplement the regular quality control review, such as when the previous review resulted in a “Qualified” conclusion.”

* Large-sized audit firms are defined as audit firms engaged in more than 100 listed company audits in a certain period or audit firms with more than 1,000 professional personnel. This definition will be revised in FY2019.

Audit firms auditing Public Interest Entities defined under the CPA Act as well as large-sized Shinkin Banks (credit associations) and other financial institutions are usually audit firms subject to ordinary quality control reviews.

[Audit firms subject to ordinary quality control review]

As of March 31, 2019

	Audit Firms	CPAs	Total
Audit firms subject to quality control review	140	50	190
Of which, Listed Company Audit Firms	120	11	131

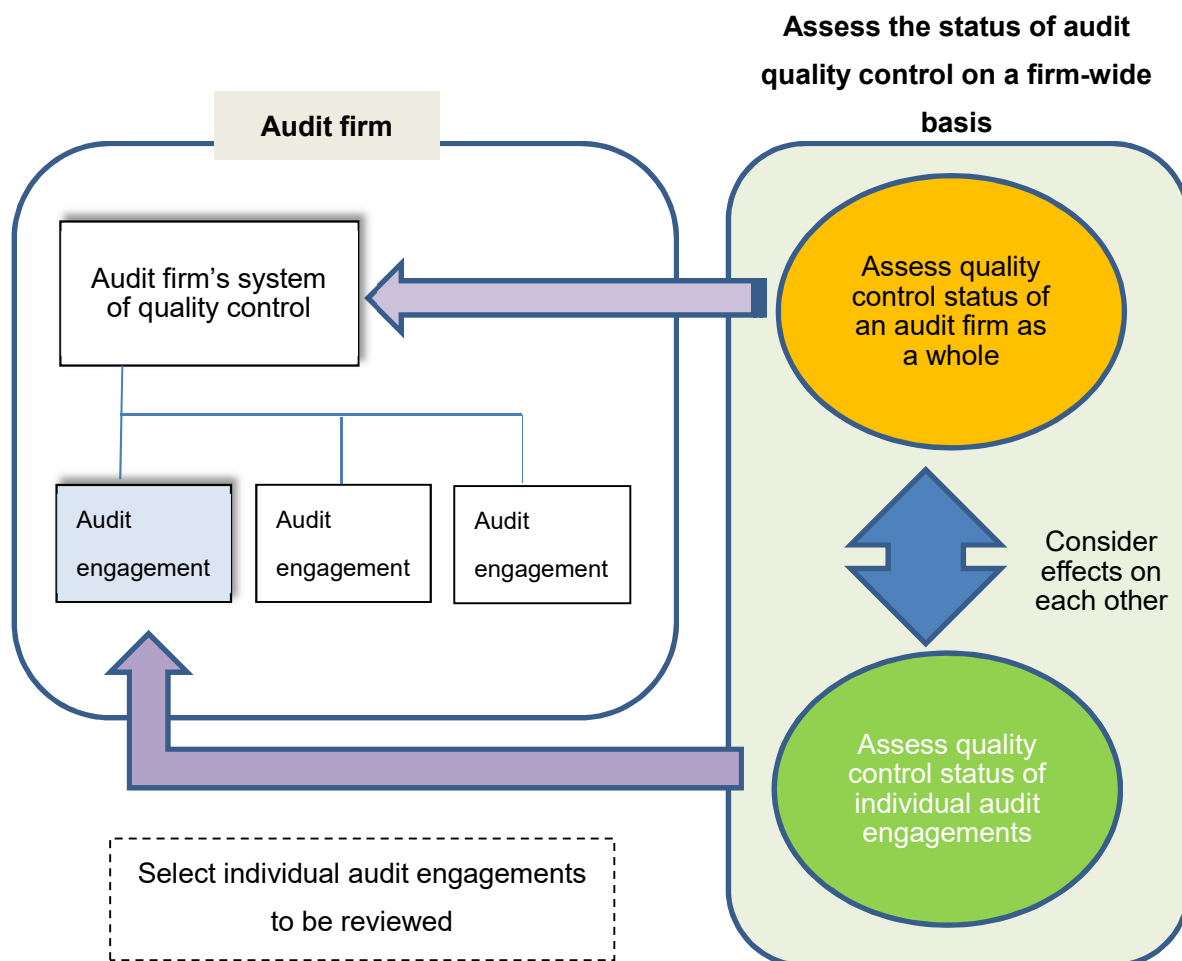
* “Listed Company Audit Firms” represent firms that are registered in the list of registered firms or the list of associate registered firms. For details of “Registration System for Listed Company Audit Firms,” please refer to “6. Registration System for Listed Company Audit Firms” and “7. The list of registered firms.”

2.5 Process of ordinary quality control reviews

In order to assess the status of quality control on a firm-wide basis, ordinary quality control review is conducted mainly through the following procedures.

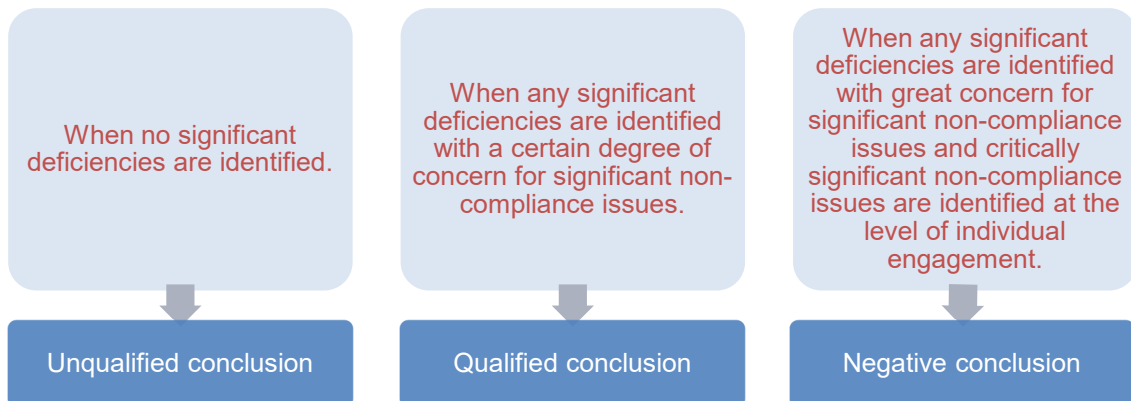
- Assess quality control status of an audit firm as a whole
Review whether the system of audit quality control is appropriately designed and implemented on a firm-wide basis to support individual audit engagements.
- Assess quality control status of individual audit engagements
Review whether the firm-wide system of audit quality control is appropriately applied to individual audit engagements. Audit engagements should be carefully selected for review so that they reflect the quality control status of the audit firm as a whole, by considering the level of risks in each engagement as well as situations of the audit firm. When any significant findings or a large number of findings are identified in a quality control review, the effect on quality control on a firm-wide basis should also be assessed.

[Items to be reviewed in ordinary quality control reviews and their relationship]



2.6 Result of ordinary quality control reviews (Quality control review reports)

As a result of quality control reviews, JICPA issues a “Quality control review report” to audit firms, which contains conclusion for the design and implementation of a quality control system for the audit firm. Conclusions of quality control reviews are categorized into the following three types.



Qualified conclusion is expressed, for example, in case there is a considerable concern for an audit firm overlooking material misstatements or not obtaining appropriate and sufficient evidence to reduce audit risks to an acceptable low level in key areas (e.g. accounting estimates, revenue recognition).

When reasonable bases could not be obtained to form an opinion for a quality control review report under certain circumstances, such as when part or all of major review procedures could not be conducted, no conclusion is expressed in the report.

2.7 Recommendation for improvement

Regardless of the conclusion in a quality control review report, when it is determined that an audit firm needs improvement in the quality control, a Recommendation Report is prepared and issued to the audit firm.

An audit firm receiving the Recommendation Report is required to submit a “Response to recommendation for improvement report” (hereinafter referred to as the “Improvement Plan”), which sets out corrective actions to be taken by the audit firm.

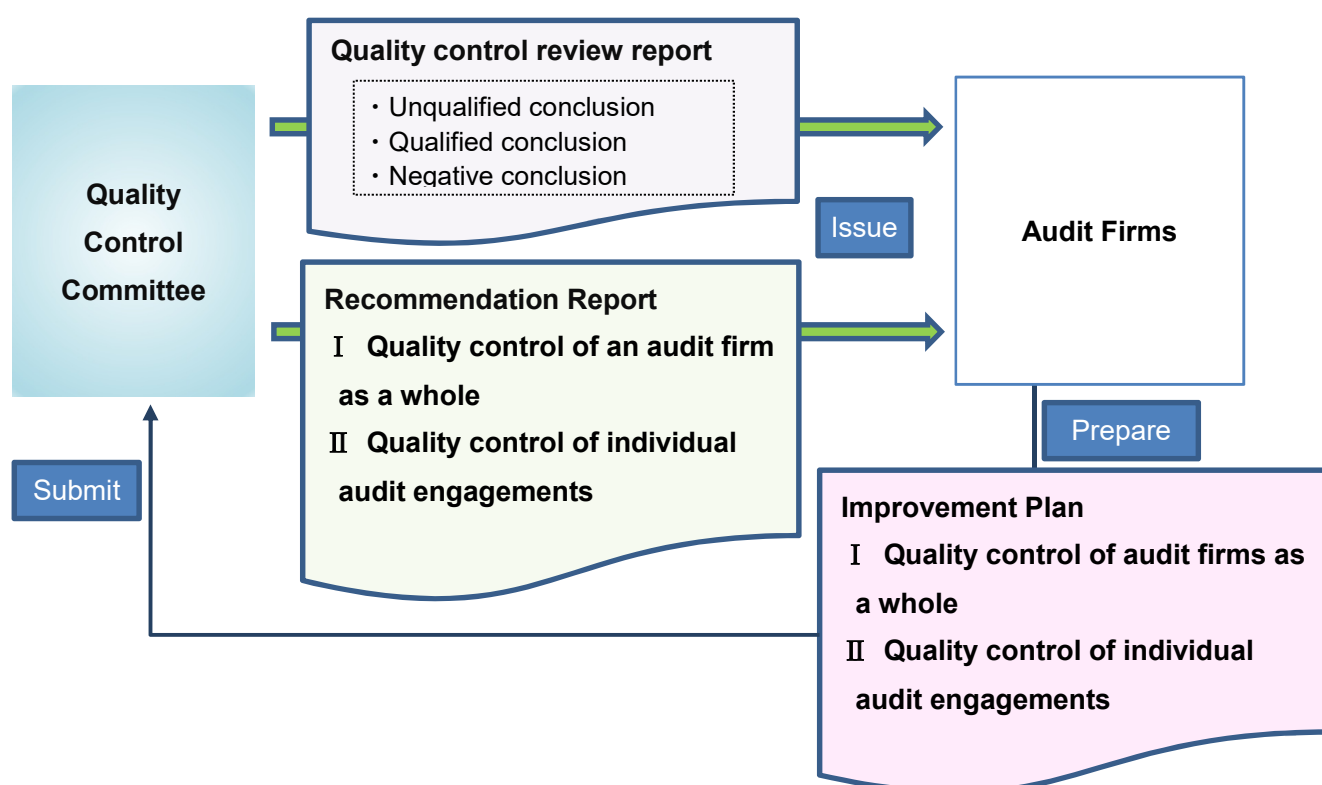
- Recommendation Report

Recommendations for improvement are described in the Recommendation Report, which is classified into sections 1) quality control status of an audit firm as a whole, and 2) quality control status of individual audit engagements.

- Improvement Plan

Audit firms that receive a Recommendation Report are required to prepare an Improvement Plan, describing their corrective actions for the recommendation, and submit it to the Quality Control Committee. The preparation of improvement plans is supported by reviewers in order to be practicable and efficient.

[Recommendation Report / Improvement Plan]



2.8 Assessment for the status of improvement (Follow-up review report)

When a Recommendation Report is provided to an audit firm by the Quality Control Committee as a result of an ordinary quality control review, a “follow-up review” is conducted in the following year to assess the status of corrective actions taken by the firm. As a result of the “follow-up review,” a “Follow-up review report” is prepared and issued to the audit firm. When corrective actions are insufficiently taken, the firm will be subject to another follow-up review in the next year.

In addition, an additional quality control review may be conducted instead of a follow-up review in the following year after receiving the Improvement Plan.

2.9 Measures taken as a result of ordinary quality control reviews

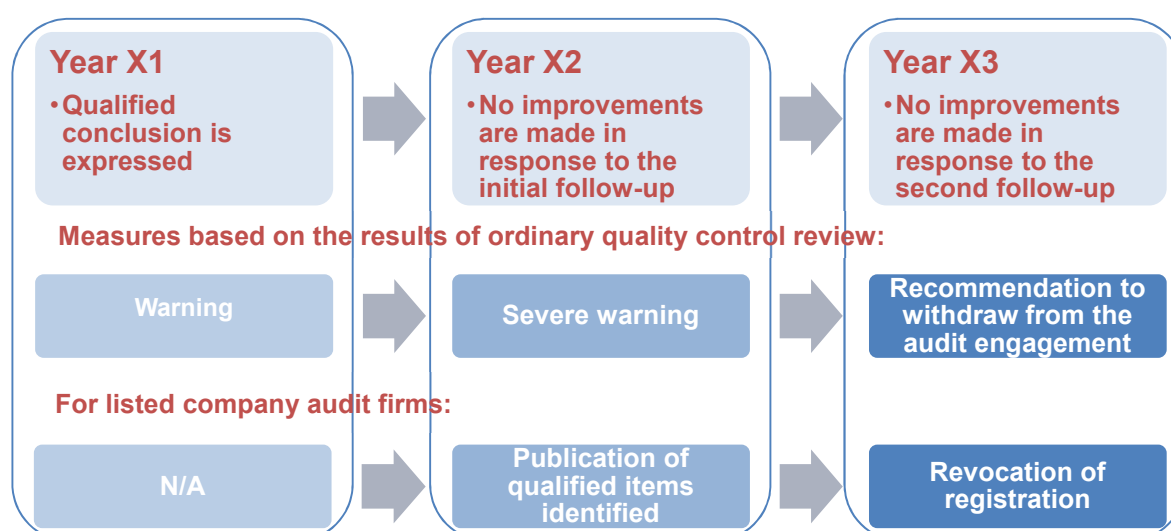
Depending on the results of an ordinary quality control review, JICPA as a self-regulatory organization determines the following measures against audit firms whose quality control deems to be insufficient, urging them to improve their quality control under the supervision of JICPA in order to ensure social confidence and to enhance the audit system.

Further, additional measures are taken for Listed Company Audit Firms, if necessary, regarding the registration status in the Registration System for Listed Company Audit Firms.

[Measures taken as a result of ordinary quality control reviews]

Results of ordinary quality control reviews	Measures taken as a result of reviews	Measures related to “Registration System for Listed Company Audit Firms”
Qualified conclusion	Warning	N/A
Qualified conclusion (with a great concern for significant non-compliance issues)	Severe warning	Publication of the outline of qualified items (Registration System for Listed Company Audit Firms)
Negative conclusion	Recommendation to withdraw from the audit engagement	Revocation of registration
Refusal of review Non-cooperative		

In case corrective actions taken by an audit firm in the following fiscal year is insufficient, more severe measures will be taken. For example, when an audit firm receives a “qualified conclusion” as a result of an ordinary quality control review in Year X1 and no appropriate measures are taken for improvement in Year X2 and thereafter, then the measures will be the following.



2.10 Disclosure of quality control review results to third parties

As a general rule, quality control review reports cannot be disclosed to third parties. However, in July 2018, JICPA made some changes to the Quality Control Committee rules, under which audit firms are now able to disclose the outline of quality control review results to third parties in the “Audit Quality Report” and other reports.

2.11 Communication with Company’s Auditors regarding quality control review results

Company's auditors, the Board of company auditors or the Audit Committee (hereinafter referred to as “Company’s Auditors”) shall understand the overall design and implementation of an audit firm’s quality control system in order to assess the validity of audit procedures conducted by the audit firm as well as their results.

That said, audit firms auditing listed companies are required to communicate to the Company’s Auditors in writing about the conclusion of quality control reviews and associated measures taken against the firm. The communication should be made after receiving the quality control review report.

In February 2019, JICPA revised the Audit Standards Board’s Report 260 “COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE” and clarified the matters to be communicated to Company’s Auditors when an audit firm receives a quality control review report on and after April 1, 2019. Matters to be communicated include 1) whether there are any qualified matters or matters for improvement for individual audit engagements and 2) areas for improvement as well as their general trend.

2.12 Monitoring by Quality Control Oversight Board

In order to ensure the proper operation of the Quality Control Committee, JICPA has established Quality Control Oversight Board that includes outside experts who is not a member of JICPA. The Quality Control Oversight Board reviews and assesses the operation status of the Quality Control Review System and report to the Quality Control Committee.

3. Implementation status and results of quality control reviews

3.1 Quality control review plan

Focus area in FY 2018

Focus areas that reviewers are required to check in conducting ordinary reviews are the following, which are the same as those for the previous year.

- Response to the Chairman and President Statement (No.1, 2016) titled “Commitment to high quality auditing to restore public confidence” and the Recommendations on Audits (Special Edition) titled “Auditor’s Response to Fraud in Audit of Financial Statements”
- Design and implementation of the quality control system of audit firms
 - Culture that emphasizes the quality of audit engagement
 - Governance and management of audit firms
 - Recruitment of professional personnel, education / training, evaluation and appointment

Main points considered in developing the ordinary review plan in FY 2018

Main points considered in developing the quality control review plan in FY 2018 were the following. The quality control review for FY 2018 was conducted by 39 reviewers.

1. Enhance information gathering and analysis, and focus on engagements for large-sized listed companies
 - Enhance information gathering and analysis related to audit firms and individual engagements.
 - When selecting engagements subject to review, focus more on engagements for large-sized listed companies.
 - Determine the number of engagements subject to review based on the risk assessment of individual engagements as well as the result of monitoring effectiveness conducted by audit firms.

2. Strengthen risk approach in ordinary reviews
 - Focus on audit areas with a higher risk of material misstatement.
 - Determine the number of reviewers in charge of individual engagements depending on the size or engagement risk.

3. Communicate well with audit firms

- Communicate adequately with audit firms regarding the root cause of recommendations and effective action plans for correction.
- To improve the quality of audits, provide instruction to audit firms to document the root cause in their Improvement Plans.

4. Conduct additional quality control reviews

- Conduct additional quality control reviews for 14 firms that are still within the three-year period since the previous review.
- Assess the quality control system at an early stage for audit firms that received qualified conclusions in the previous review.

3.2 Quality control reviews in FY2018

Quality control reviews were conducted in FY2018 as follows:

	Number of audit firms reviewed in FY2018	Number of audit firms receiving review report in FY2018	Number of carried-over audit firms *3
Ordinary quality control reviews (A)	56	54	2
Regular quality control review	42	42	—
Additional quality control review	14	12	2
Follow-up review	78	78	—
Second follow-up review	2	2	—
Total (B)	136	134	2
Number of audit firms subject to ordinary quality control review (C) *2	198		
Percentage of firms reviewed under ordinary quality control review in FY 2018 (A/C)	28%		
Percentage of firms reviewed in FY 2018 (B/C)	69%		

*1 In addition to above, there is one audit firm subject to ordinary review in the previous year but whose review report was approved in FY2018. (i.e. the firm was subject to additional quality

control review)

*2 The amount represents the number of audit firms subject to ordinary quality control reviews as of April 1, 2018.

*3 The audit firms were subject to ordinary quality control review in FY2018; however, the deliberation and approval of quality control review reports were carried over to the next year (hereinafter referred to as the “carried-over audit firms”).

Breakdown of audit firms subject to ordinary quality control reviews and audit firms whose ordinary reviews and follow-up reviews were conducted in FY2018 is shown in the table below (classified by the number of audits of listed companies).

		Number of audit firms subject to ordinary quality control reviews	Number of audit firms reviewed in FY 2018		
			Ordinary quality control review *	Follow-up review	Second follow-up review
Registered audit firms in Registration System for Listed Company Audit Firms	Audits of listed companies (more than 100 companies)	5	3 (-)	2	–
	Audits of listed companies (20-99 companies)	9	3 (1)	3	–
	Audits of listed companies (10-19 companies)	13	5 (2)	5	–
	Audits of listed companies (less than 10 companies)	112	31 (7)	42	1
	Sub-total	139	42 (10)	52	1
Other audit firms		59	14 (4)	26	1
Total		198	56 (14)	78	2

*The number of firms in parentheses represents those for which additional quality control reviews were conducted on top of ordinary reviews.

3.3 Result of ordinary quality control reviews

Result of quality control reviews

In FY2018, 56 audit firms were reviewed under ordinary quality control reviews. Based on the review, there were 48 firms with “Unqualified conclusion,” four firms with “Qualified conclusion,” and two firms with “Negative conclusion.” There were two carried-over audit firms and no firms with

“Disclaimer of conclusion.”



* In addition to the above, there was one audit firm subject to ordinary review in the previous year but whose review report was approved and issued in FY2018 with “Unqualified conclusion.” Therefore, the total number of audit firms to which an unqualified report was issued in FY 2018 was 49.

The breakdown of review reports issued to audit firms (56 audit firms in FY2018) is shown in the table below (classified by the number of audits of listed companies).

(Unit: Number of audit firms)		Breakdown of review reports by type of conclusions				
		Unqualified conclusion	Qualified conclusion	Negative conclusion	Carried-over	Total
Registered audit firms in Registration System for Listed Company Audit Firms	Audits of listed companies (more than 100 companies)	3 (-)	- (-)	- (-)	- (-)	3 (-)
	Audits of listed companies (20-99 companies)	2 (-)	- (-)	- (-)	1 (1)	3 (1)
	Audits of listed companies (10-19 companies)	5 (2)	- (-)	- (-)	- (-)	5 (2)
	Audits of listed companies (less than 10 companies)	27 (6)	1 (-)	2 (-)	1 (1)	31 (7)
	Sub-total	37 (8)	1 (-)	2 (-)	2 (2)	42 (10)
Other audit firms		11 (2)	3 (2)	- (-)	- (-)	14 (4)
Total		48 (10)	4 (2)	2 (-)	2 (2)	56 (14)

*The number of firms in parentheses represents those for which additional quality control reviews were conducted on top of ordinary reviews.

! “Qualified conclusion” is expressed when any significant deficiencies are identified with a certain degree of concern for significant non-compliance issues in the area of quality control system of an audit firm or individual audit engagements. It does not automatically mean there is a significant compliance violation in auditing engagements or a doubt in the reasonableness of audit opinions.

Focus area in FY 2018 and review results

Reviewers are required to check focus areas for ordinary quality control reviews before conducting any reviews to provide instruction to audit firms as necessary and enhance their understanding.

In response to the Chairman and President Statement, seven items were identified as focus areas which need special consideration. The following represents the number of audit firms that received recommendation for improvement in the areas.

Focus area	Number of audit firms *
1. Audits based on a risk approach	4
2. Professional skepticism	4
3. Risk of management override of internal control	19
4. Auditing accounting estimates	14
5. Sharing of information within the engagement team	9
6. Engagement quality control review	1
7. Securing adequate time and period for auditing	2

*Audit firms may receive on or more recommendations for improvement.

In addition, three items were also identified as focus areas regarding the design and implementation of quality control system in accordance with recommendations from the "Advisory Council on the Systems of Accounting and Auditing" (March 8, 2016). Through ordinary quality control reviews, design and implementation of the quality control system were assessed for their appropriateness and effectiveness. The following represents the number of audit firms that received recommendation for improvement in the areas.

Focus area	Number of audit firms *
1. Culture that emphasizes the quality of audit engagements	2
2. Governance and management of audit firms	5
3. Recruitment of professional personnel, education / training, evaluation and appointment	1

*Audit firms may receive on or more recommendations for improvement.

3.4 Result of follow-up reviews

The following represents the result of 80 audit firms subject to follow-up reviews in FY 2018 (classified by the number of audits of listed companies).

(Unit: Number of audit firms)		Results					
		Improvement measures sufficiently completed		Improvement measures insufficiently conducted		Total	
Registered audit firms in Registration System for Listed Company Audit Firms	Audits of listed companies (more than 100 companies)	2	(-)	-	(-)	2	(-)
	Audits of listed companies (20-99 companies)	3	(-)	-	(-)	3	(-)
	Audits of listed companies (10-19 companies)	4	(-)	1	(-)	5	(-)
	Audits of listed companies (less than 10 companies)	41	(1)	1	(-)	42	(1)
	Sub-total	50	(1)	2	(-)	52	(1)
Other audit firms		26	(1)	2	(-)	28	(1)
Total		76	(2)	4	(-)	80	(2)

*1 Two audit firms in parentheses represent those that were reviewed under the second follow-up review.

*2 If there is an item for which the scheduled date for implementing corrective actions have not yet arrived as of the start date of a follow-up review, the status will be reviewed at another follow-up review in the next fiscal year. In FY2018, there were no audit firms whose corrective actions have not yet arrived as of the start date of the follow-up review.

3.5 Measures taken as a result of quality control reviews

The following table represents measures taken as a result of ordinary quality control reviews and follow-up reviews in FY 2018.

Conclusion of quality control reviews and related measures (Unit: number of audit firms)		
Conclusion of quality control reviews	Measures*2	FY2018 *1
Negative conclusion	Recommendation to withdraw	2 (2)
Qualified conclusion	Recommendation to withdraw (Insufficient improvement)	2 (-)
	Warning	2 (1)
	Sub-total	4 (1)
Recommendation for improvement under unqualified conclusion *3	Warning (Insufficient improvement)	5 (3)
Total		11 (6)

*1 The number of firms in parentheses represents Listed Company Audit Firms to which measures are taken based on the results of the quality control review.

*2 "Recommendation to withdraw (Insufficient improvement)" and "Warning (Insufficient improvement)" were determined as a result of insufficient improvement identified in the FY 2018 follow-up review or additional quality control review.

*3 Among the firms that received "Warning (Insufficient improvement)" related to recommendation for improvement under unqualified conclusion, there are four firms subject to follow-up reviews (including two Listed Company Audit Firms).

*4 In addition to the above table, there is one audit firm subject to ordinary quality control review in the previous year but whose review report was approved in FY2018 (a Listed Company Audit Firm). The conclusion and measures taken against this audit firm were unqualified conclusion with a warning.

*5 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 measure taken against each firm. Therefore, the number in the table above does not agree with the total number of measures taken against each firm in FY 2018.

4. Recommendation for improvement in ordinary quality control reviews

Recommendation for improvement are classified into those related to "Quality control of an audit firm as a whole" and those related to "Quality control of individual audit engagements."

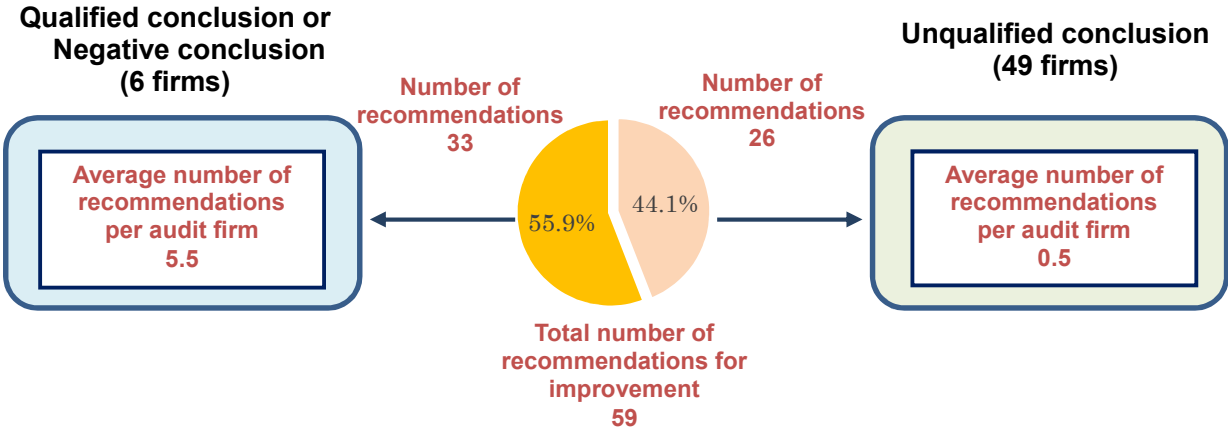
4.1 Recommendation for improvement related to "Quality control of an audit firm as a whole"

The following table shows the number of recommendations for improvement related to "Quality control of an audit firm as a whole" that were provided to 55 audit firms to which quality control reports were issued in FY2018.

Result of reviews	Number of audit firms (A)	Number of recommendation for improvement (B)	Average per audit firm (B/A)	Number and percentage of audit firms provided with recommendation for improvement
Qualified conclusion or Negative conclusion	6	33 (*1)	5.5	6 (100%)
Unqualified conclusion	49	26	0.5	13 (27%)
Total	55 (*2)	59	1.1	19 (35%)

*1 Out of the 33 recommendations, 19 led to qualified conclusions or negative conclusions.

*2 The number includes one audit firm whose review report was carried over to FY 2018, but excludes two audit firms whose review reports were carried over to FY 2019.

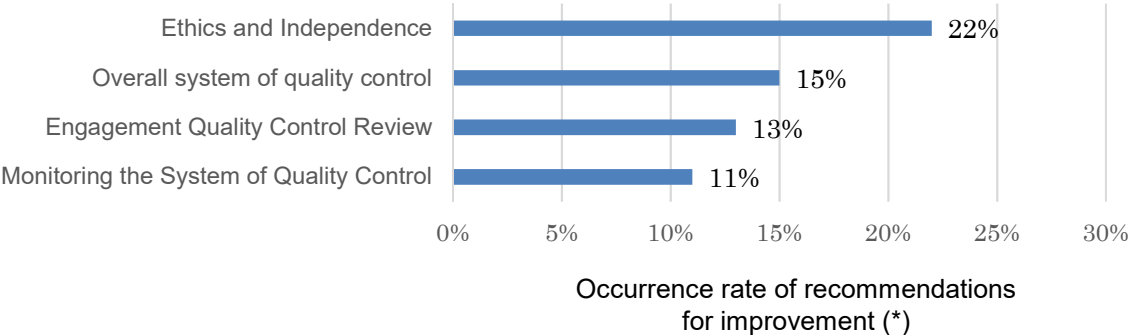


! Recommendations for improvement represent matters with a certain degree of concern for significant non-compliance issues. Some are more severe leading to qualified conclusions, however most of the recommendations are described in the Recommendation Report as matters for improvement for the purpose of enhancement of audit quality control.

Major recommendations for improvement (Quality control of an audit firm as a whole)

Major recommendations related to quality control of an audit firm as a whole include “Ethics and independence” and “Overall system of quality control.”

[Major recommendations for improvement (Quality control of an audit firm as a whole)]



* Occurrence rate of recommendations for improvement = $\frac{\text{Number of audit firms provided with recommendations for each item}}{\text{Number of audit firms to which quality control review reports were issued}}$

Example of recommendations for improvement

Case1 Ethics and independence
 <Example>
 In order to confirm the independence of professional personnel, an audit firm distributes checklists to professional personnel and confirms their responses. However, the completeness of target companies to confirm independence is not assured because the firm does not clearly indicate the parent company or subsidiary of the audited company.

Case2 Overall system of quality control
 <Example>
 Many deficiencies have been identified in multiple audit engagements, including those related to audit procedures for significant accounting estimates. It appears that the engagement partner is not providing adequate supervision, instruction and audit documentation review. Further, the deficiency related to audit procedures for significant accounting estimates has not been pointed out by the engagement quality control reviewers.

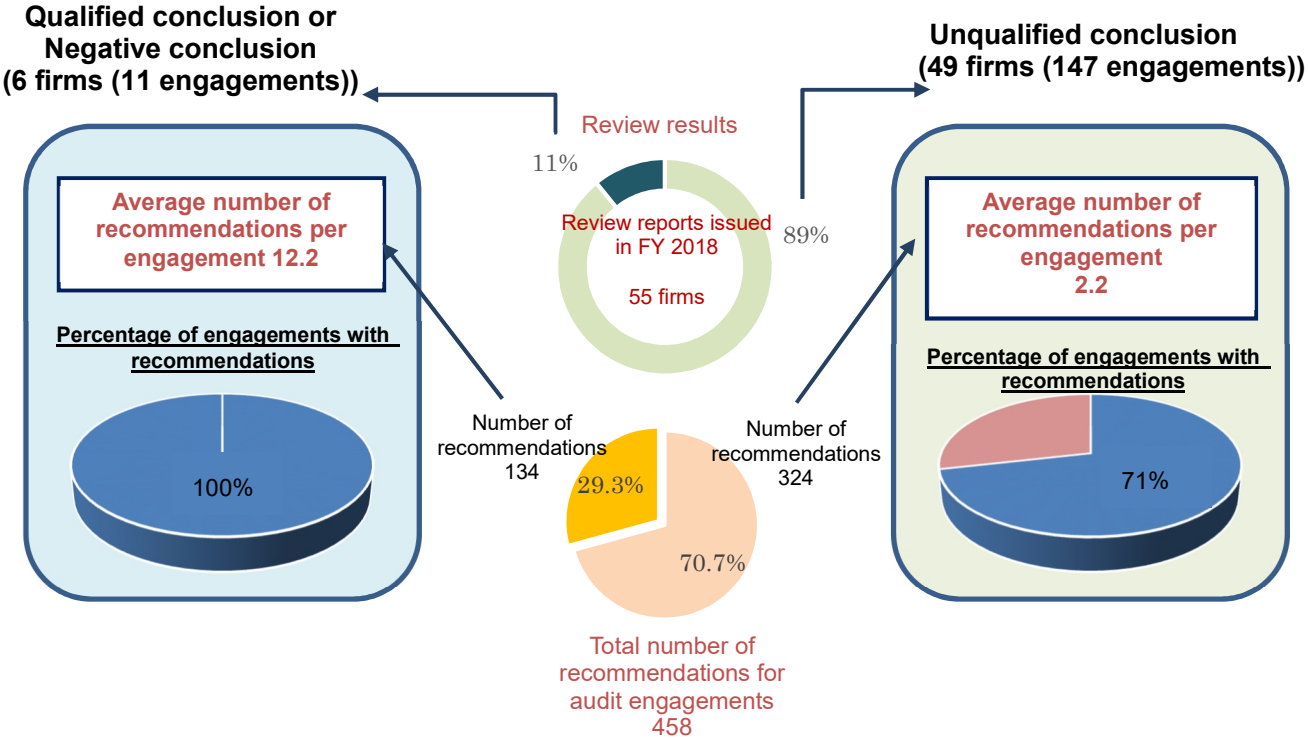
4.2 Recommendation for improvement related to “Quality control of individual audit engagements”

The following table shows the number of recommendations for improvement related to “Quality control of individual audit engagements” that were provided to 55 audit firms to which quality control reports were issued in FY2018.

Result of reviews	Number of audit firms	Number of selected engagement (A)	Number of recommendation for improvement (B)	Average per audit engagement (B/A)	Number and percentage of engagements provided with recommendation for improvement
Qualified conclusion or Negative conclusion	6	11	134 (*1)	12.2	11 (100%)
Unqualified conclusion	49	147	324	2.2	105 (71%)
Total	55 (*2)	158	458	2.9	116 (73%)

*1 Out of the 134 recommendations, 25 led to qualified conclusions or negative conclusions.

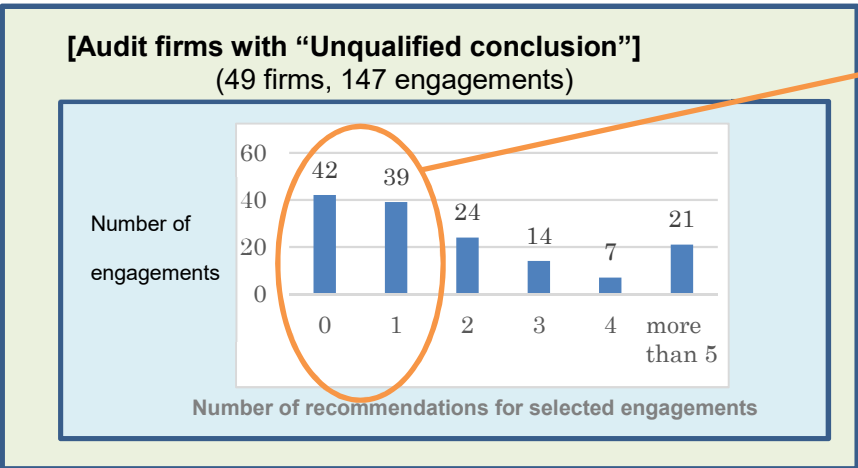
*2 The number includes one audit firm whose review report was carried over to FY 2018, but excludes two audit firms whose review reports were carried over to FY 2019.



Recommendations for improvement for audit firms with “Unqualified conclusion”

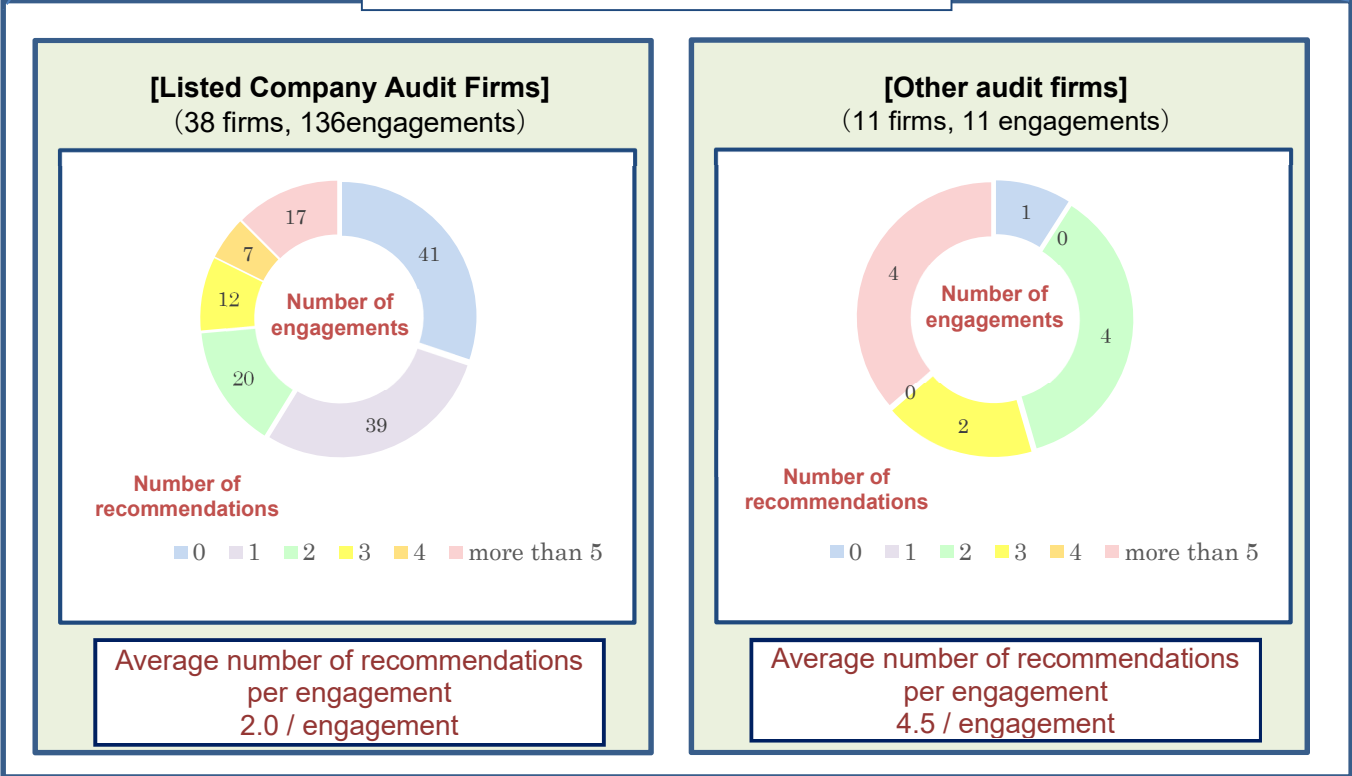
Regarding audit firms with “Unqualified conclusion,” the number of recommendations for selected engagements is represented as follows:

[Number of recommendations for improvement for selected engagement]



This indicates that there were 42 engagements with no recommendation and 39 engagements with one recommendation.

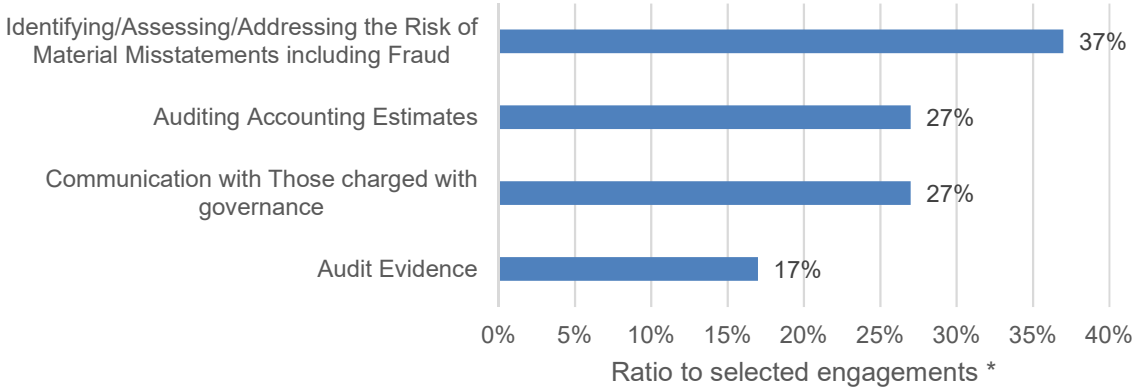
<Classification by registration status>



Major recommendations for improvement (Quality control of individual audit engagements)

Major recommendations related to quality control of individual audit engagements include “Identifying, assessing and addressing the risk of material misstatement including fraud,” “Auditing accounting estimates,” and “Communication with those in charge of governance.”

[Major recommendations for improvement (Quality control of individual audit engagements)]



Number of engagements provided with recommendations for each item

* Ratio to selected engagements

Number of selected engagements

Example of recommendations for improvement

Case1 Identifying/assessing/addressing the risks of material misstatements including fraud
 The auditor determined that there is a fraud risk in sales occurrence and the existence of accounts receivable, and conducted confirmation procedures to address the risk. Based on the confirmation, there were some customers with a significant difference between the confirmation request amount and the confirmed amount; however, no additional audit procedures were performed for the difference.

Case2 Auditing accounting estimates
 No impairment is recognized by the audit client for the valuation of its affiliated company with capital deficit, based on an assumption that the value of investment will recover to the acquisition cost within 5 years. However, it appears that the auditor has not critically reviewed the feasibility of the affiliate’s aggressive business plan.

Case3 Communication with Those charged with governance
 The auditor has not communicated with those in charge of governance regarding the following matters.

- Detail of significant risks and reasons for identifying such risks
- Results of a quality control review conducted by JICPA

5. Causes of recommendation for improvement and action plans (Corrective action)

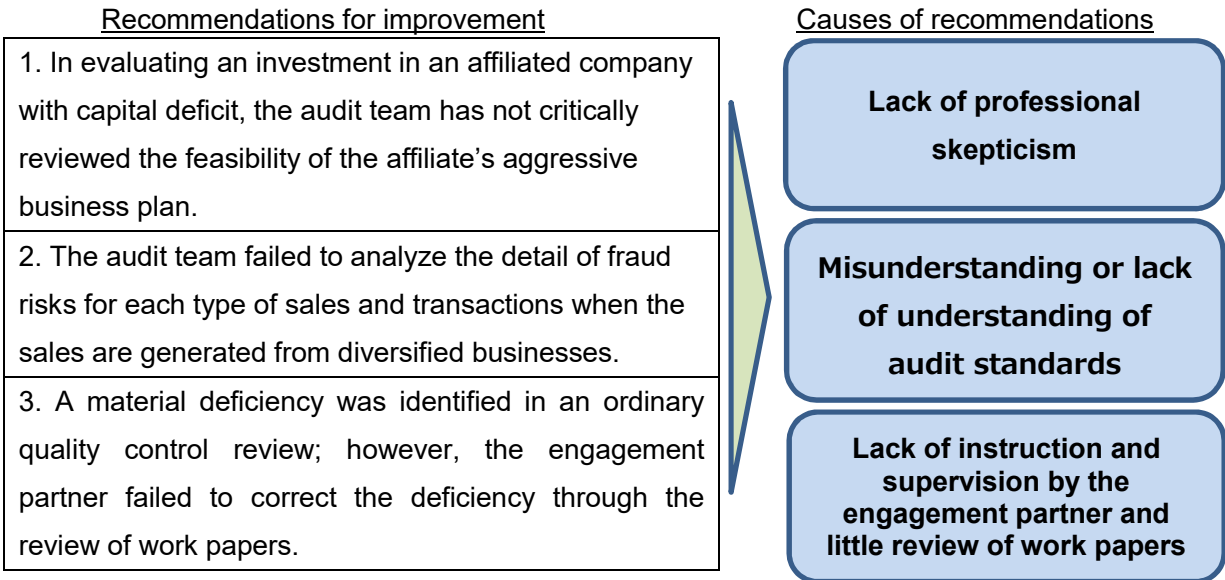
In order to plan and implement appropriate and effective improvement measures, it is important for audit firms to clarify causes of recommendations for improvement. Accordingly, for quality control reviews in and after FY 2018, audit firms are now required to include “Causes of recommendation for improvement” in the Improvement Plan.

“Causes of recommendation for improvement” may contain common root causes, which often result from the culture of audit firms or management’s behavior. It is already a requirement for audit firms to document “Causes of recommendation for improvement” in the Improvement Plan whenever qualified conclusions are issued through quality control reviews.

Reviewers provide guidance to enhance the quality of audits by appropriately communicating with audit firms regarding the causes of recommendation and supporting the preparation of Improvement Plans.

5.1 Causes of recommendation for improvement and action plans

The following are examples of “Causes of recommendation for improvement” described in Improvement Plans.



The followings are examples of corrective actions taken by audit firms regarding the above recommendations for improvement:

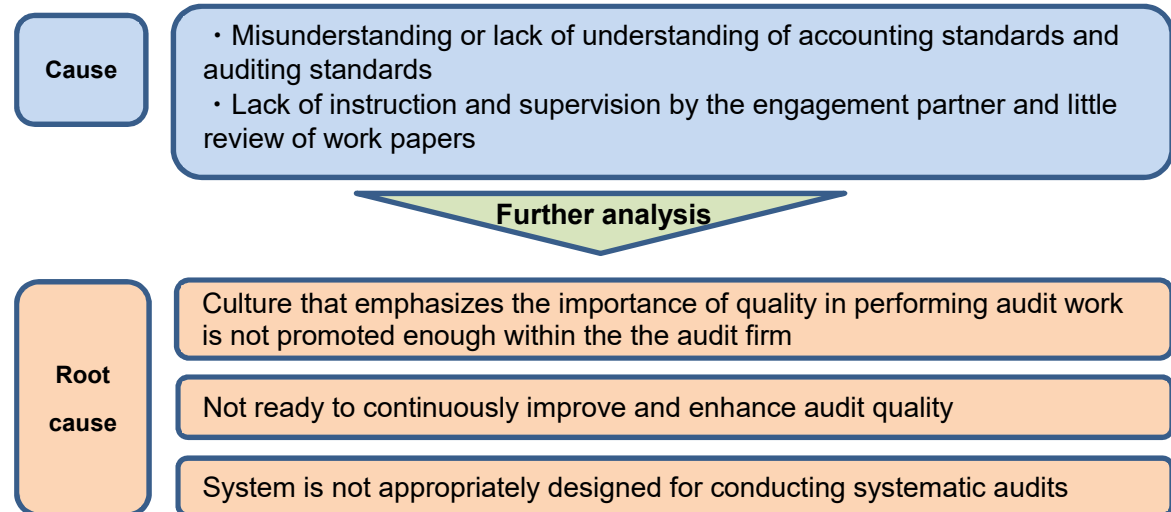
- | |
|---|
| 1. Exercise professional skepticism, evaluate the reasonableness of business plans, including the rationale of significant assumptions used by management for the purpose of evaluating investments in affiliated companies that have a significant impact on the financial statements. |
| 2. Based on a good understanding of the client business, plan and execute audit procedures by each type of sales transactions, which comply with fraud-related requirements in audit standards. |
| 3. After changing the engagement partner, make sure the new engagement partner spends sufficient time to instruct and supervise staff in a timely manner and properly reviews work papers. |

5.2 Root causes of recommendation for improvement and action plans

The following is an example of root causes of recommendations and corrective actions described in the Improvement Plan.

Recommendation for improvement

- | |
|---|
| 1. In evaluating investments in affiliated companies that have a significant effect on the financial statements, the audit firm failed to evaluate whether the accounting treatment is in compliance with related accounting standards. |
| 2. Since the quality control system of the audit firm has not been properly designed and implemented, corrective actions in response to prior year recommendations for the quality control review were not properly addressed. As a result, a number of improvement recommendations, including repetitive ones from prior year, were made in the current year's quality control review. |



The measures taken by audit firms regarding the above recommendations for improvement are as follows.

- | |
|--|
| 1. Encourage professional personnel to participate in external trainings related to accounting and auditing as well as internal trainings. In addition, promote discussions within the audit team under the leadership of experienced members, share project status, and have the engagement partner provide thorough instruction and supervision. |
| 2. Promote culture within the firm that emphasizes the importance of quality and conduct audits in a systematic manner. |

5.3 Response of JICPA

JICPA is committed to enhance the quality of audits through effective communication with audit firms, implementation of trainings that are useful for audit work, provision of audit tools, and other means.

On the other hand, when audit firms do not take corrective actions properly, such as the case in 5.2.2 above (i.e. many recommendations including repetitive ones from prior year came up), JICPA not only encourages the audit firm's own effort to enhance audit quality but also takes necessary measures as a result of the quality control review based on an understanding that JICPA is responsible for monitoring the status of such audit firms. In addition to above, JICPA supervises Listed Company Audit Firms by considering their registration status.

6. Registration System for Listed Company Audit Firms

6.1 Overview of the Registration System for Listed Company Audit Firms

JICPA has introduced the “Registration System for Listed Company Audit Firms,” which requires all audit firms engaged in audits of listed companies to register with the system for the purpose of enhancing the quality control of registered audit firms and ensuring trust in capital markets in relation to financial statement audits.

The list of registered firms contains information, such as a profile of audit firms, summary of qualified matters in quality control reviews, and disciplinary actions. The list of registered firms is disclosed on the JICPA's website.

<http://tms.jicpa.or.jp/offios/pub/> *

*Website only available in Japanese.

See the overview of registered firms, such as the number of listed company audits, presented in Appendix 1 “Overview of audit firms in the list of registered firms.”

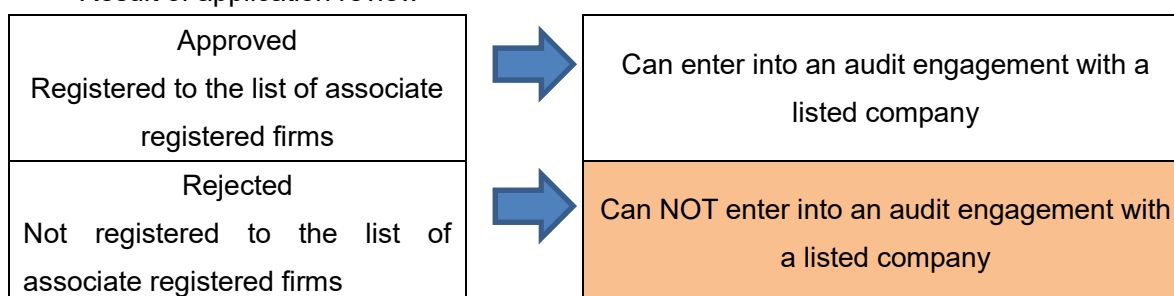
! According to the Securities Listing Regulations of each stock exchange, audit firms engaged in an audit of a listed company must be a member of the list of registered firms or associated registered firms. In addition, audit firms for IPO must be a member of the list of registered firms or associated registered firms which have been subject to quality control reviews. (In case of Tokyo Stock Exchange: Article 205, Item 7-2, Article 441-3, etc. of Securities Listing Regulations).

6.2 Application review for registration to the list of registered firms

Application review for registration to the list of associate registered firms

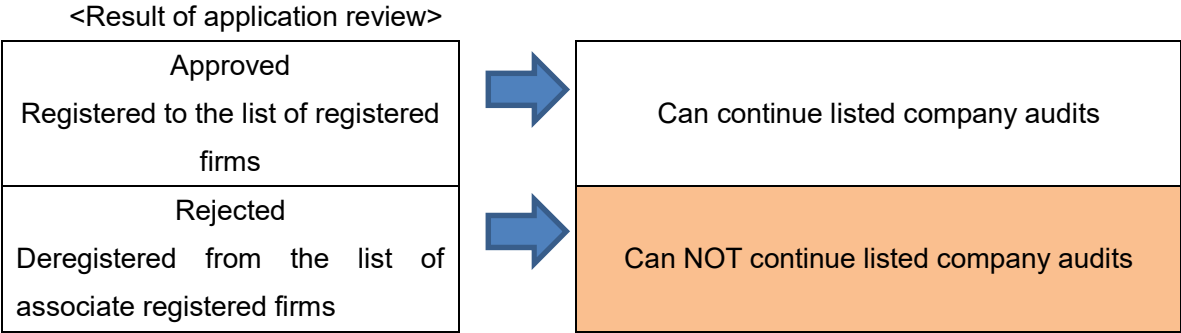
If an audit firm that is not yet registered plan to sign a new audit engagement with a listed company, the firm should submit an application to be added to the list of associate registered firms. An application review will be conducted thereafter.

<Result of application review>



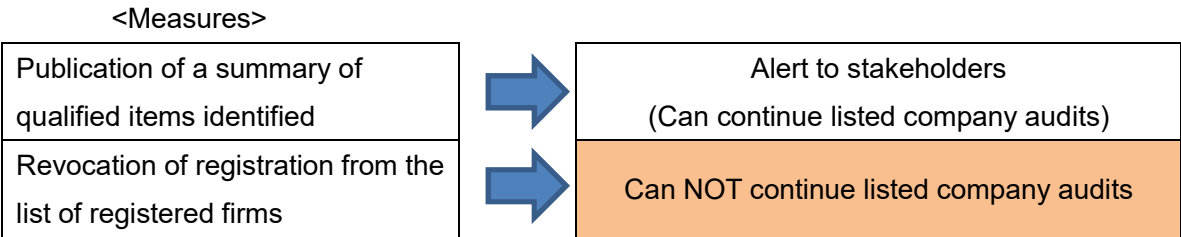
Application review for registration to the list of registered firms

Once approved as an associate registered firm, the firm can enter into audit engagements, provide audit service, and issue an audit report to a listed company. The associate registered firm can submit an application to be added to the list of registered firms only after it is reviewed under a quality control review. Based on the result of the quality control review, the application will be reviewed.



6.3 Measures related to the registration status in the list of registered firms

Based on the result of quality control reviews for Listed Company Audit Firms, both “Measures under the Quality Control Review System” and “Measures related to the registration in the list of registered firms” will be considered. If a revocation of registration is determined for an audit firm as a measure related to the registration status in the list of registered firms, the audit firm will no longer be able to continue the audit of listed companies.



! Application review is conducted strictly to ensure that audit firms have sufficient capability and an appropriate system to audit listed companies. Registration status in the list of registered firms and measures to be taken against registered firms are determined accordingly.

7. The list of registered firms

Between April 1, 2018 and March 31, 2019, nine audit firms were newly added to the list of registered firms after application reviews, and 12 audit firms were deregistered due to termination of audit engagements with listed companies or for other reasons.

As a result, there are 131 audit firms that can sign audit engagements with listed companies as of March 31, 2019.

There were two audit firms whose registration status was subject to “Measures related to the registration in the list of registered firms” based on the results of the quality control review in FY 2018.

[Breakdown of Listed Company Audit Firms]

As of March 31, 2019

	Audit Firms	CPAs	Total
Audit firms registered in the list of registered firms	112	6	118
Audit firms registered in the list of associate registered firms	8	5	13
Total	120	11	131

8. Response to recommendations from the Quality Control Oversight Board

The Quality Control Oversight Board is an organization that monitors activities of the Quality Control Committee and the Listed Company Audit Firm Registration and Appeals Committee. The Quality Control Committee received “2017 Recommendation for Quality Control Committee Activities” dated June 4, 2018 from the Quality Control Oversight Board. The response of the Quality Control Committee to the recommendations is summarized as follows.

8.1 Recommendation matter 1. Further enhancement of quality control review

(1) Chairman and President Statement (No.1, 2016) and Recommendations on Audits (Special Edition) (Continued)

Following FY2017, seven items which need special consideration under the Chairman and President Statement continue to be the focus areas in FY2018. We (= the Quality Control Committee) appropriately provide instruction and supervision by reviewing whether audit firms have taken appropriate actions. If not sufficient, Recommendation Reports are issued to audit firms. Please refer to section “3. 3 Focus area in FY 2018 and results” (page 17) for the results of the quality control review in FY2018.

(2) Design and operation status of the quality control system of audit firms (Continued)

Following FY2017, three items continue to be the focus areas in FY2018 based on the recommendations from the “Advisory Council on the Systems of Accounting and Auditing.” We appropriately provide instruction and supervision by reviewing whether audit firms have designed and implemented quality control system appropriately and effectively. If not, Recommendation Reports are issued to audit firms. Please refer to “3.3 Focus area in FY 2018 and results” (page 17) for the results of the quality control review in FY2018.

(3) Action plan to enhance quality control reviews and reviewer’s capability (New)

In order to conduct quality control reviews more diligently, we have effective communication with audit firms specifically for significant engagements and ensure proper operation of systems implemented in the previous year, including the cross-checking system among reviewers.

In addition to above, we have increased the frequency of reviewer’s meetings to create more opportunities for opinion exchanges and information sharing among reviewers regarding the review process and recommendations for improvement in order to enhance reviewers’ capability. Furthermore, we have had trainings with a clarified objective, focusing on skills and

capabilities required for reviewers.

- (4) Further information gathering and analysis through off-site monitoring, and enhancement of the effectiveness of quality control reviews (New)

In order to further enhance information gathering and analysis through off-site monitoring, we have implemented a robust system by increasing the number of project team personnel who are responsible for gathering information related to listed companies and audit firms and conducting risk assessments continuously. Accordingly, the review team is now able to obtain more useful information which will be used in selecting engagements for review purpose and carrying out detailed analysis effectively at the planning stage of reviews.

In addition, in order to carry out risk-focused ordinary quality control reviews to enhance the effectiveness, specialist staff are assigned to the Center for Listed Company Audit Firms to strengthen off-site monitoring, who are responsible for gathering and analyzing information about listed companies and audit firms and utilizing such information for reviews.

Furthermore, we plan to amend the rules regarding the Quality Control Review System to reassess major items in ordinary quality control reviews (i.e. frequency, conclusions, and response to recommendations for improvement) through deliberation at the JICPA Annual General Assembly in July 2019.

8.2 Recommendation Matter 2. Awareness of the Quality Control Review System and the Registration System for Listed Company Audit Firms

- (1) Actively inform the public about the Quality Control Review System and the Registration System for Listed Company Audit Firms, which are part of the self-regulatory activities of JICPA (Continued)

The following were conducted to inform the public about the Quality Control Review System and the Registration System for Listed Company Audit Firms:

- Distributed the “Overview of the Quality Control Review 2017” booklet that summarizes the Quality Control Review System and related activities in FY2017 to audit firms subject to ordinary review, Company Auditors of listed companies, and institutional investors.
- Published information on JICPA’s website about the outline of the “Quality Control Review System.”
- Newly published the “Casebook of Recommendation for Improvement in 2017 Quality Control Review,” which illustrates examples of recommendation for improvement in quality control reviews, for the purpose of distributing it to capital market participants,

especially Company Auditors who need to communicate with audit firms.

- Contributed to the “Company Auditors” (August 2018) about the Quality Control Review System (titled “Overview of the Quality Control Review System of JICPA (FY 2017)”).
- Provided lecture on the theme of “Explaining Quality Control Review Cases” hosted by the Public Interest Incorporated Association Japan Audit & Supervisory Board Members Association (February 2019).

9. Future action plan

The Quality Control Review System and the Registration System for Listed Company Audit Firms (collectively as the “Quality Control Review System”) have made a significant achievement as one of our self-regulatory functions under the current system. However, the reliability of CPA audits is being questioned over recent accounting scandals engulfing well-established companies in Japan. Under such circumstances, JICPA has been examining the ideal organization structure and the Quality Control Review System as a self-regulatory organization. Accordingly, JICPA plans to improve the structure as a self-regulatory organization and amend certain rules for the Quality Control Review System through deliberation at the JICPA Annual General Assembly in July 2019. The Quality Control Committee is ready to reflect part of the amendments for the Quality Control Review System as early as in FY2019, and is committed to fully reflect the amendments by the time of the FY2020 quality control review.

9.1 JICPA’s structure as a self-regulatory organization

JICPA established a project team to improve the organization structure for self-regulatory functions, so JICPA can better fulfill its accountability as a self-regulatory organization and mitigate any risks that could be a disadvantage to its members. Major areas to be improved as a self-regulatory organization is as follows:

- (1) Removal of the Quality Control Oversight Board, which is a monitoring organization under the Quality Control Review System, as well as the Auditing Monitoring Conference, which is a monitoring function for individual engagement reviews. As a replacement, the “Self-Regulatory Monitoring Conference” will be newly established.
- (2) Establishment of the “Review Board for Appropriate Procedures,” which will be responsible for examining system-related claims from members. Both the “Listed Company Audit firms Registration Measures Appeal Examination Board,” which is an appeal examination board for the Quality Control Review System, and the “Appeal Examination Board,” which is an appeal examination board for individual engagements, are integrated under the newly established “Review Board for Appropriate Procedures.”

9.2 Quality Control Review System

In November 2016, a project team for the Quality Control Review System was set up to examine the role that the Quality Control Review System should play as a core of JICPA's self-regulatory function, given the current environment surrounding CPA audits. Also, the team discussed about

detailed subjects, such as the type of framework, systems, and work plans required for the Quality Control Review System.

(1) For the Quality Control Review System

1. Type of quality control reviews
2. Frequency of quality control reviews
3. Conclusion of quality control reviews and response to recommendations for improvement
4. Method for confirming improvement status of recommendations for improvement
5. Criteria for determining measures in the Quality Control Review System
6. Conditions that require special reviews

(2) For the Registration System for Listed Company Audit Firms

1. Gathering and analyzing information on listed company audits
2. Examination of audit firms seeking approval for auditing listed companies for the first time
3. Publication of significant deficiencies within in the list of registered firms

Appendix 1. Overview of audit firms in the list of registered firms

The overview of 131 audit firms in the list of registered firms is as follows.

1. Breakdown based on the number of listed company audits

The table below shows the breakdown of registered firms by the number of listed company audits.

As of March 31, 2019

Number of listed company audits	Number of audit firms	Composition (%)	Total number of listed company audits	Composition (%)
More than 100	5	3.8%	2,847	76.1%
20 to 99	8	6.1%	392	10.5%
10 to 19	14	10.7%	189	5.0%
Less than 10	104	79.4%	315	8.4%
Total	131	100.0%	3,743	100.0%

2. Breakdown based on the number of CPAs (including other auditors other than CPAs)

The table below shows the breakdown of audit firms by the number of CPAs who belong to the audit firm (both full-time and part-time).

As of March 31, 2019

Number of CPAs, etc.	Number of audit firms	Composition (%)	Number of CPAs	Composition (%)
More than 1,000	4	3.1%	19,451	79.0%
100 to 999	7	5.3%	2,268	9.2%
20 to 99	60	45.8%	2,197	8.9%
Less than 20	60	45.8%	697	2.8%
Total	131	100.0%	24,613	100.0%

Appendix 2. Overview of the change in auditors of listed companies

JICPA is monitoring specific reasons for auditor changes and exchanging opinions with audit firms when conducting the quality control reviews for the purpose of enhancing disclosures required under the Financial Instruments and Exchange Act regarding the reason for changes in auditors.

1. Overview of the change in auditors

There were 115 cases of a change in auditors during the period from April 1, 2018 to March 31, 2019, which is an information gathered by JICPA based on timely disclosures made by listed companies pursuant to the Securities Listing Regulations of stock exchanges. This number does not include 55 changes due to merger of audit firms. The following table summarizes the change in auditors by the size of predecessor auditors and successor auditors.

[Number of changes in auditors]

		Predecessor auditors		
		Big 4 audit firms	Other than Big 4 audit firms	Total
Successor auditors	Big 4 audit firms	26	2	28
	Other than Big 4 audit firms	50	37	87
	Total	76	39	115

Out of the 115 changes in auditors, 76 predecessor auditors were from Big 4, accounting for more than half. On the other hand, only 28 successor auditors were from Big 4.

2. Reasons for the change in auditors

It is required to disclose reasons for the change in auditors in extraordinary reports under the Financial Instruments and Exchange Act and through timely disclosures pursuant to the Securities Listing Regulations, given that the reason could be an extremely important information for shareholders and investors (e.g. when the change is due to a disagreement between the company and the auditor regarding a specific accounting treatment). However, in many cases, reasons given by audit firms are described as “expiration of the audit term.” In the report published by the “Advisory Council on Enhancement of Information Provided by Audits” in January 2019, it was pointed out that such description is inappropriate as a reason for change, given that the audit term is generally one year.

In order to enhance the disclosure of reasons for the change in auditors, JICPA requires registered audit firms to describe specific reasons for the change in the document titled “Change Notification Form of current status of registered firms” (hereinafter referred to as the “Notification Form”) to monitor those reasons in a timely manner.

The table below summarizes 85 cases of a change in auditors, consisting of both predecessor and successor auditors as of April 30, 2019 who reported the reason of change in FY2018 by submitting the “Notification Form.”

[Reasons for change in auditors described in the Notification Form]

Reasons for change in auditors (Multiple selection is possible)	Number of responses	
	Predecessor auditors	Successor auditors
(1) Same auditors within in the consolidated group	10	10
(2) Change to an international firm for overseas expansion	1	4
(3) Not satisfied with the timely response and quality of auditors	2	27
(4) Audit fees	40	33
(5) Number of years serving as an auditor	11	13
(6) Difficult situations encountered during the audit period	2	0
(7) Disagreement on accounting and auditing issues	2	1
(8) Accounting scandals	5	5
(9) Increase in audit risk due to a change in business environment	4	3
(10) Other	12	8
Total	89	104

* Since multiple selection is possible, the total number reported above do not match with the actual number of change in auditors.

According to the summary, both predecessor and successor auditors reported “Audit fees” as the major reason for change. The two responded quite differently about “Not satisfied with the timely response and quality of auditors.” On the other hand, timely disclosure shows that 52 out of the 85 changes were due to “Expiration of the audit term,” followed by other reasons such as “Number of years serving as an auditor” and “Same auditors within the consolidated group.” For those 52 changes due to “Expiration of the audit term,” the mostly selected response in the Notification Form by both predecessor and successor auditors was “Audit fees.”

