



The Japanese Institute of Certified Public Accountants

Overview of the Quality Control Review 2020



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1. The Japanese Institute of Certified Public Accountants

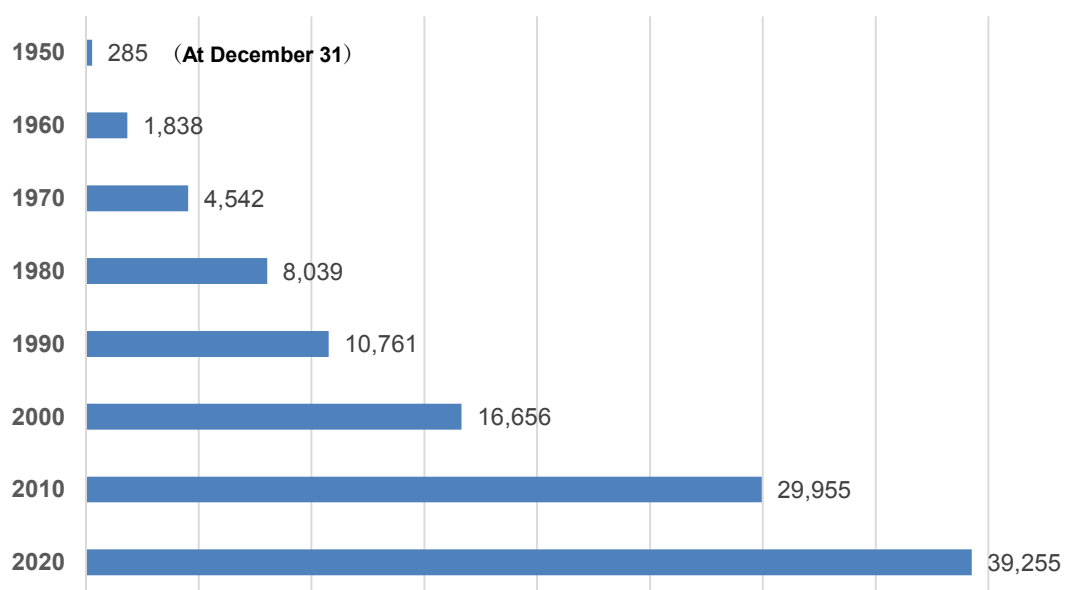
The Japanese Institute of Certified Public Accountants (“JICPA”) is dedicated to provide instruction and oversight of CPAs to improve their qualifications to fulfill their mission as a CPA.

JICPA is the sole organization for CPAs in Japan. Founded in 1949, JICPA started as a voluntary organization and later became a corporation under the Certified Public Accountants Act (the “CPA Act”) in 1966. Further, it became a special private corporation under a special law in April 2004.

Members of JICPA consist of CPAs of Japan, CPAs of other countries in Japan and audit firms. Associate members of JICPA mainly consist of junior accountants and successful candidates of the CPA examination. As of March 31, 2020, the total number of members, including associate members, stood at 39,255, which consisted of the following: the number of members totaled 32,040, including 31,795 of Japanese CPAs and CPAs of other countries in Japan as well as 245 audit firms; and the number of associate members, including junior accountants and successful candidates of the CPA examination, stood at 7,215.

As a self-regulatory organization of accounting profession, JICPA is engaged in various activities, including maintaining professional ethics, retaining and improving qualifications of the members, and ensuring the quality of their work.

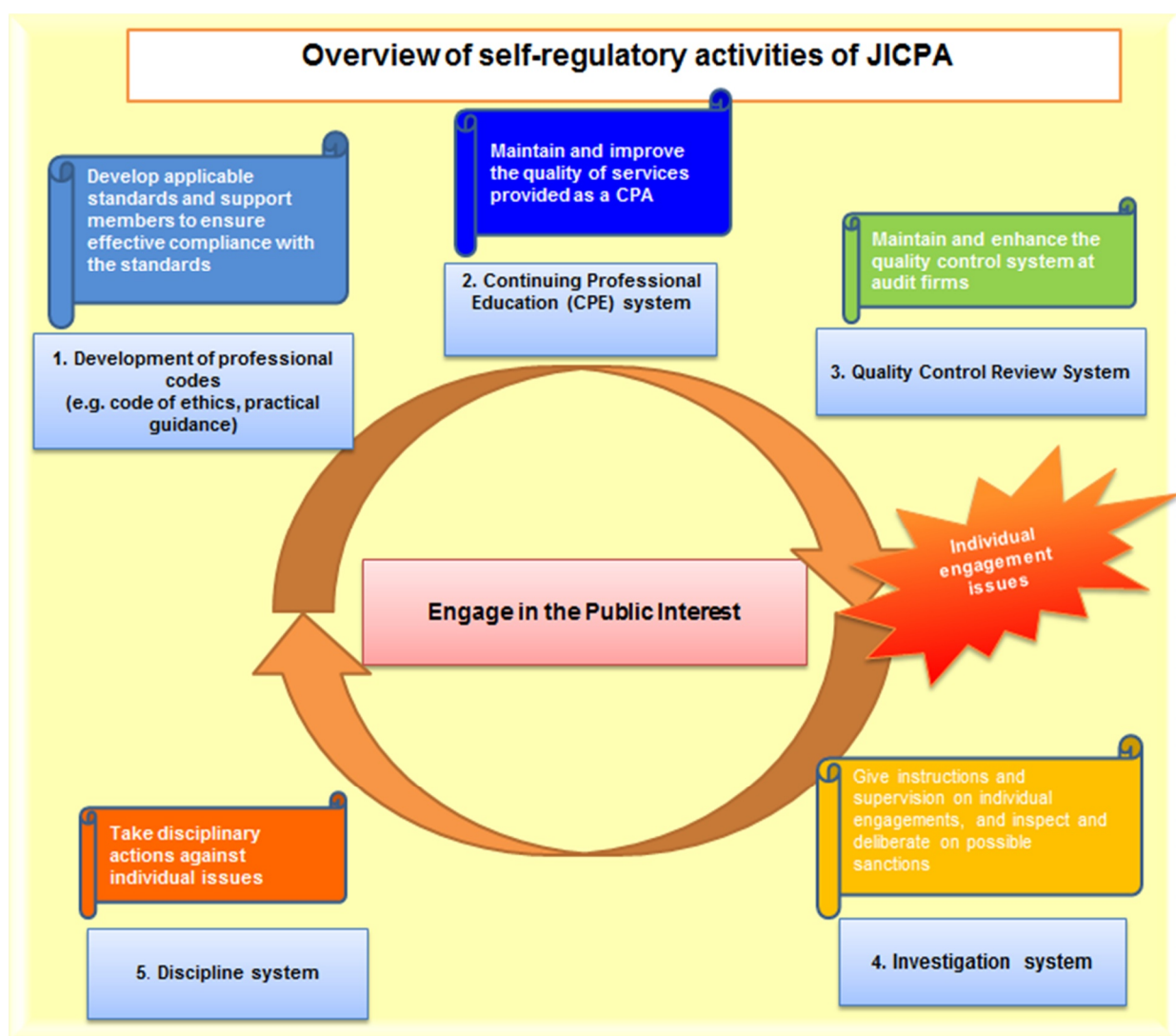
[Number of members, including associate members (At March 31)]



2. Activities of JICPA as a self-regulatory organization

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. Overview of self-regulatory activities of JICPA is summarized in the following diagram.

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



3. Quality Control Review System

3.1 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 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 CPA Act, for the purpose of maintaining and enhancing an appropriate quality level of audit engagements and ensuring social confidence in auditing.

JICPA pursues the aim by reviewing the design and operation of accounting firms’ quality control system, providing recommendations for improvement and determining appropriate measures, if needed. The reviews are conducted in compliance with the quality control review standards as well as procedures based on the JICPA’s Constitution.

A quality control review has the characteristics of instructing and supervising audit firms; it is not intended to detect issues or take disciplinary actions, nor 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 systems of audit firms engaged in audits of listed companies (the “Listed Company Audit Firms”), which is incorporated into the Quality Control Review System. Within the Quality Control Committee, a team called the “Center for Listed Company Audit Firms” is established, which is responsible for preparing lists of registered firms and associated registered firms, and publishing the lists on JICPA’s website. The center is also responsible for determining whether or not audit firms can be registered on the lists and taking actions as necessary.

According to the Securities Listing Regulations of stock exchanges, an accounting firm engaged in an audit of listed company must be an audit firm registered either in the list of registered firms or associated registered firms (or “Listed Company Audit Firms”).

For details of the Registration System for Listed Company Audit Firms, please refer to “7. Registration System for Listed Company Audit Firms.”

(Note)

Aiming for a better Quality Control Review System, JICPA amended part of the JICPA Constitution at its Annual General Assembly in July 2019 in order to implement a new system smoothly. Effective July 1, 2020, JICPA’s quality control reviews are conducted based on the new system. For details, please refer to “10. Changes in organization structure to improve self-regulatory functions.”

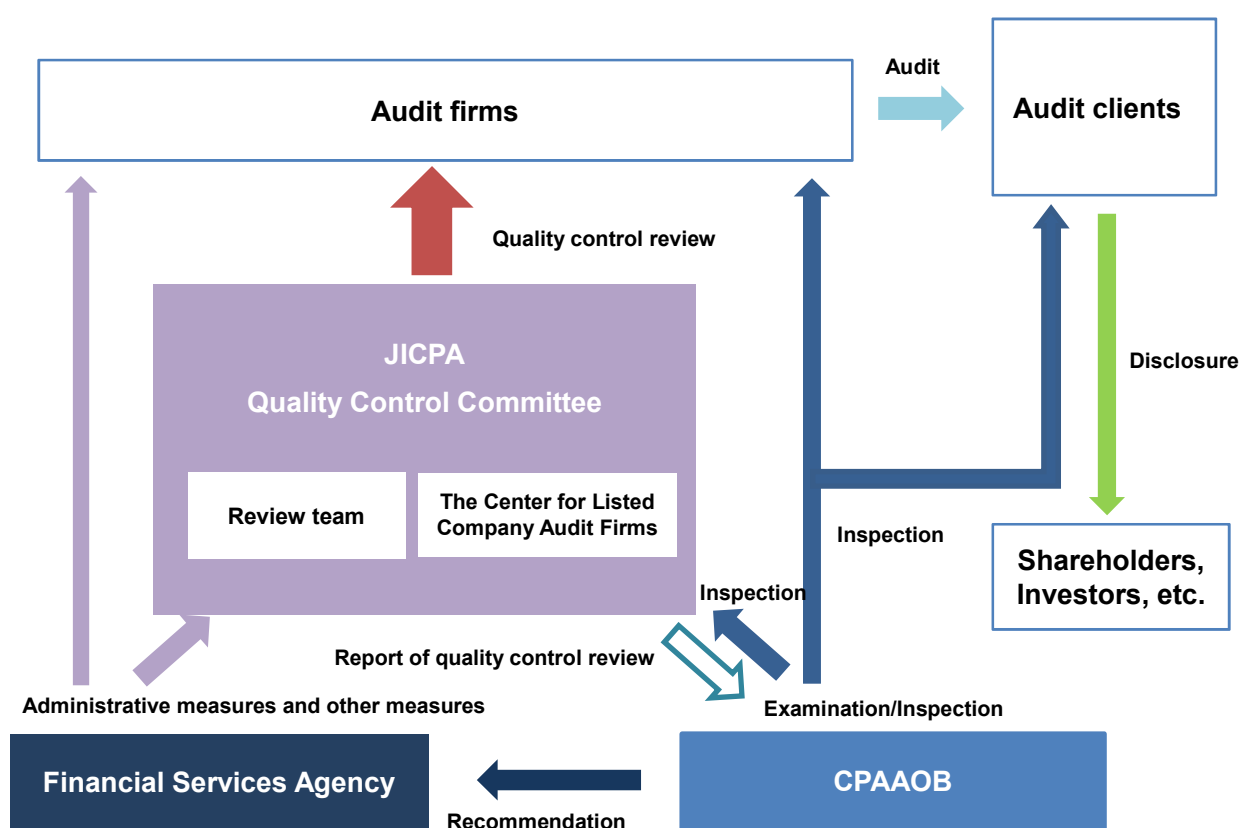
3.2 The relationship between the Quality Control Review System and inspections by the Certified Public Accountants and Auditing Oversight Board (“CPAAOB”)

JICPA's Quality Control Review System has been monitored by the Certified Public Accountants and Auditing Oversight Board (the “CPAAOB”) under the CPA Act since 2004. The CPAAOB is a governmental 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]



3.3 Quality control system of audit firms

In order to reasonably ensure the 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 as well as all partners and professional staff belonging to audit firms (hereinafter referred to as "professional personnel") comply with the professional standards and applicable laws and regulations.
- (2) Audit firms or engagement partners issue audit reports in an appropriate manner.

An audit firm's quality control system mainly consists of the following policies and procedures. An audit firm is responsible for designing and implementing these policies and procedures under its quality control system, whereas engagement partners are responsible for conducting audits in accordance with the quality control system implemented by the audit firm.

[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

Hiring, training and evaluating professional personnel

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

Engagement performance

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

Engagement quality control review

- Ensure adequate knowledge, experience and capability of reviewers as well as objectivity from the audit engagement
- Conduct a thorough review

Monitoring the quality control system

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

Documentation of the quality control system

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

3.4 Types of ordinary quality control reviews and audit firms subject to the review

An ordinary quality control review is JICPA's process of reviewing the quality control status of audits conducted by audit firms, communicating the results to audit firms, providing recommendations for improvements as necessary and hearing from audit firms about the status of their improvements. Ordinary quality control reviews consist of "Regular quality control review" and "Additional quality control review."

[Types 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*)
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 firm is defined as an audit firm engaged in more than 100 listed company audits over a certain review period with more than 1,000 professional personnel working full-time. As of March 31, 2020, four audit firms qualified as large-sized audit firms.

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

[Audit firms subject to ordinary quality control reviews]

As of March 31, 2020

	Audit Firms	CPAs	Total
Audit firms subject to quality control reviews	144	62	206
Including: Listed Company Audit Firms	128	8	136

* For details regarding the registration system for Listed Company Audit Firms, please refer to "7. Registration System for Listed Company Audit Firms" and "8. Overview of the list of registered firms."

3.5 Process of ordinary quality control reviews

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

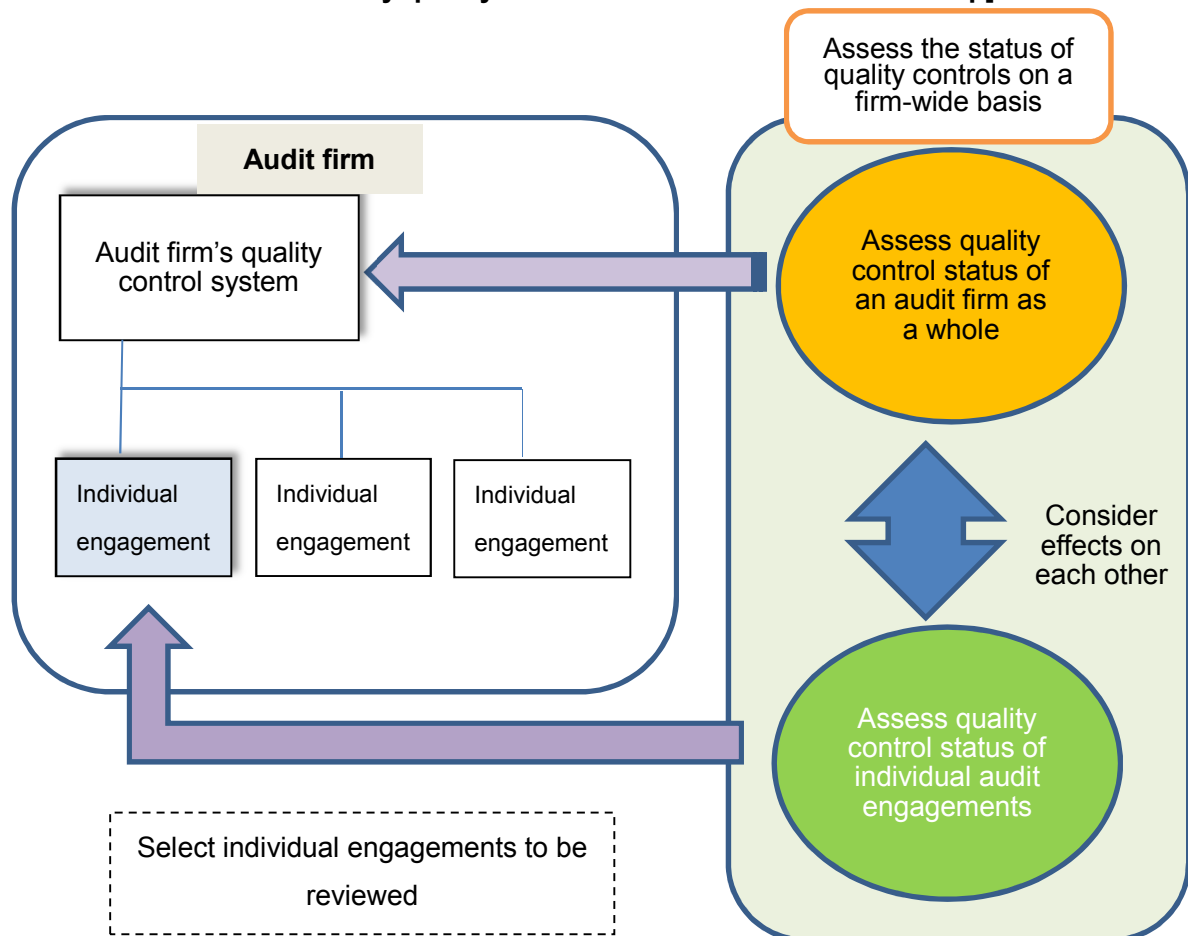
(1) Assess quality control status of an audit firm as a whole

Review whether the system of audit quality control is appropriately designed and implemented on a firm-wide basis to support individual audit engagements (or “individual engagements”).

(2) Assess quality control status of individual engagements

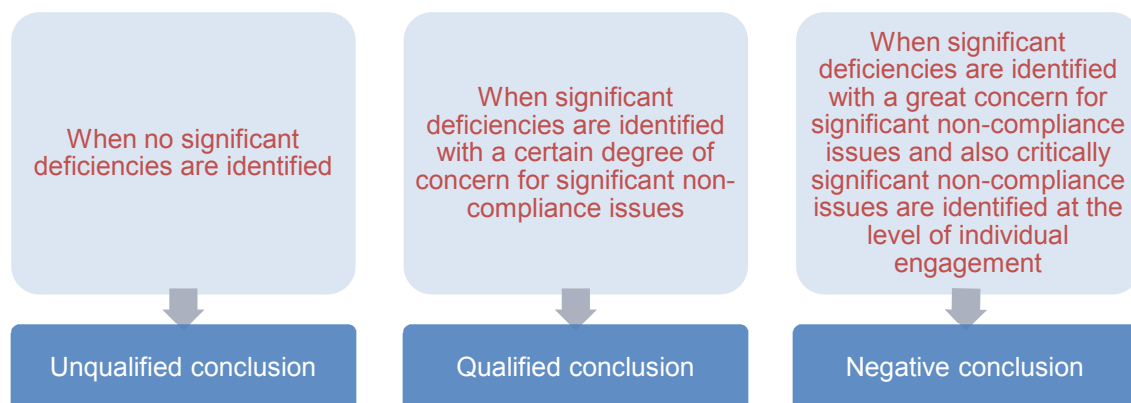
Review whether the firm-wide system of audit quality control is appropriately applied to individual engagements. Individual engagements should be carefully selected for review to reflect the quality control status of an audit firm as a whole by considering the level of risks in each engagement as well the environment surrounding the audit firm. When significant findings or a large number of findings are identified in the review, an assessment should be made for the impact on the quality control system on a firm-wide basis.

[Areas reviewed in an ordinary quality control review and their relationship]



3.6 Results of ordinary quality control reviews (Quality control review report)

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



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

When reasonable basis 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 (i.e. “Disclaimer of conclusion”).

3.7 Recommendations for improvement (Recommendation Report and Improvement Plan)

Regardless of the conclusion in a quality control review report, when it is determined that an audit firm needs to improve certain areas to enhance quality control (or “recommendations for improvement”), a Recommendation Report is prepared and issued to the audit firm.

An audit firm receiving the Recommendation Report is required to submit an “Improvement Plan,” which sets out corrective actions to be taken by the audit firm in response to the recommendations for improvement.

(1) Recommendation Report

Recommendations for improvement are put into two sections under the Recommendation Report:

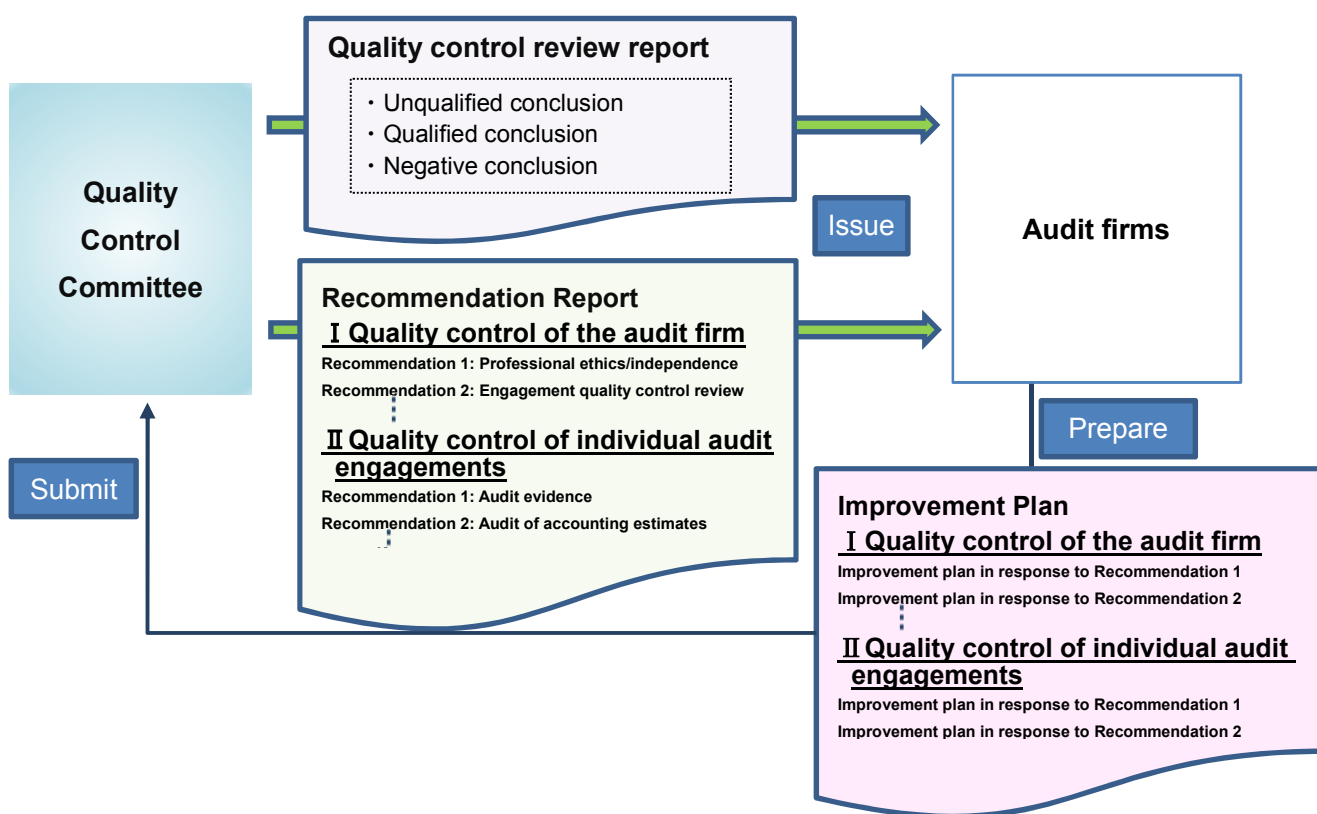
1) “Quality control of the audit firm,” focusing on the design and operation of quality control system

implemented by the audit firm; and 2) “Quality control of individual audit engagements,” focusing on the operation of quality control system implemented at the level of individual engagements.

(2) Improvement Plan

An audit firm receiving a Recommendation Report is required to prepare an Improvement Plan, which sets out corrective actions to be taken by the audit firm in response to the recommendations for improvement, which should be submitted to the Quality Control Committee. Reviewers at the Quality Control Committee provide instruction to audit firms to make the Improvement Plans more effective.

[Recommendations for improvement / Improvement Plan]



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

The Quality Control Committee conducts a follow-up review in the following year of receiving an Improvement Plan to assess the status of corrective actions taken by the firm. A “Follow-up review report” is prepared as a result of the follow-up review and issued to the audit firm. When corrective actions are insufficiently taken, the firm will be subject to another follow-up review in the following

year. There are cases when an additional quality control review, instead of a follow-up review, is conducted in the following year of receiving an Improvement Plan.

3.9 Measures taken as a result of ordinary quality control reviews

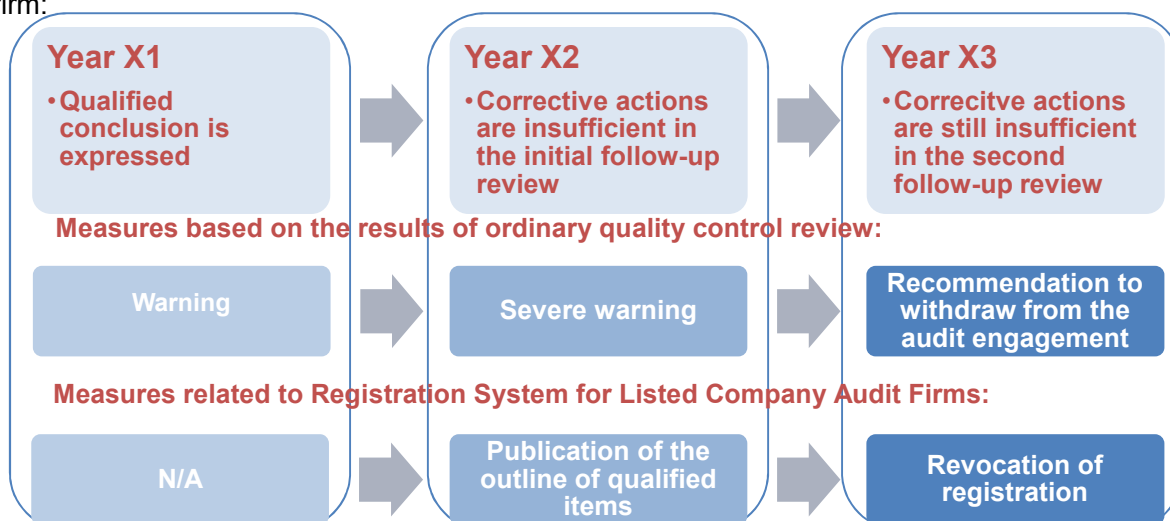
Depending on the results of an ordinary quality control review, JICPA, as a self-regulatory organization for CPAs, determines the following measures against audit firms whose level of quality control deems to be insufficient, urging them to improve their quality control under the supervision of JICPA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

Further, additional measures are taken for Listed Company Audit Firms, if necessary, by looking into the registration status in the list of registered 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 concern for <u>critically</u> significant non-compliance issues)	Severe warning	Publication of the outline of qualified items in the list of registered firms
Negative conclusion	Recommendation to withdraw from the audit engagement	Revocation of registration
Refusal of review		
Non-cooperative		

When corrective actions taken by an audit firm in the following year are insufficient, more severe measures will be taken. For example, when a “Qualified conclusion” is issued as a result of an ordinary quality control review in Year X1 and corrective actions taken for improvement in Year X2 and thereafter are insufficient, then JICPA is ready to take the following measures against the audit firm:



3.10 Disclosure of quality control review results to third parties

As a general rule, quality control review reports, Recommendation Reports and Improvement Plans (collectively as “Quality Control Review Reports”) cannot be disclosed to third parties. However, audit firms are able to disclose the outline of quality control review results to third parties in their own reports, including the “Audit Quality Report.”

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

Company auditors (or the Board of company auditors), Audit and Supervisory Committee or Audit Committee (hereinafter referred to as “Company’s Auditors”) are responsible for understanding the overall design and operation of an audit firm’s quality control system in order to assess the validity of audit procedures conducted by the audit firm as well the outcomes.

That said, audit firms auditing listed companies are required to communicate to the Company’s Auditors in writing about quality control review results and associated measures taken in response to the results. Such information may include whether there were any qualified matters identified for quality controls of an individual engagement, whether recommendations for improvement were received for the matter, and also areas for improvement as well as their general trend. Audit firms should communicate such information on or after receiving the Quality Control Review Reports.

3.12 Monitoring the work of the Quality Control Committee

In order to ensure the proper operation of the Quality Control Committee, JICPA established the Quality Control Oversight Board as a monitoring body that includes outside experts who are not members of JICPA.

For the most recent results monitored by the Quality Control Oversight Board and responses to the results, please refer to “9. Response to recommendations from the Quality Control Oversight Board.”

The JICPA Constitution was amended in July 2019 to modify the self-regulatory organization structure. Effective October 1, 2019, the Quality Control Oversight Board is replaced with the Self-Regulatory Monitoring Committee for monitoring purposes. Please refer to “10. Changes in organization structure to improve self-regulatory functions” for further details.

4. Implementation status and results of quality control reviews in FY2019

4.1 Quality control review plan

Focus area in FY2019

Reviewers were required to check the following focus areas in conducting ordinary reviews in FY2019, based on previous recommendations for improvement and recent trend in quality control reviews.

- Design and operation of the quality control system of audit firms
 - Culture that emphasizes the quality of audit engagement
 - Governance and management of audit firms
 - Hiring, education/training, evaluation and assignment of professional personnel
 - Professional ethics and independence (e.g. rotation of engagement partners)

- Auditing individual engagements
 - Auditing accounting estimates
 - Identifying, assessing and addressing the risk of material misstatement due to fraud (e.g. professional skepticism, revenue recognition, risk of management's override of internal controls)
 - Procedures for group audits

Major consideration points in developing the ordinary quality control review plan in FY2019

Major points considered in developing the quality control review plan in FY2019 were the following.

Quality control reviews in FY2019 were conducted by 40 reviewers.

1. Enhance information gathering/analysis and focus on engagements for large-sized listed companies
 - Strengthen information gathering and analysis related to audit firms and individual engagements.
 - When selecting individual engagements subject to review, focus 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. Reinforce risk approach in conducting ordinary quality control reviews
 - Focus on audit areas with higher risk of material misstatement.
 - Determine the number of reviewers in charge of individual engagements depending on the size or risk of the engagement.

3. Communicate effectively with audit firms

- Have a good communication with audit firms in identifying the root cause of recommendations for improvement as well as developing effective action plans for the purpose of enhancing hands-on, practical skills of audit firms.
- Improve the quality of audits by requiring all audit firms to document the root cause of recommendations for improvement 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.

4.2 Quality control reviews in FY2019

Quality control reviews were conducted in FY2019 as follows:

	Number of audit firms reviewed in FY2019	Number of audit firms receiving review report in FY2019	Number of carried-over audit firms ^{*3}
Ordinary quality control reviews (A)	84	82	2
Regular quality control review	70	70	—
Additional quality control review	14	12	2
Follow-up review	43	43	—
Second follow-up review	1	1	—
Total (B)	128	126	2
Number of audit firms subject to ordinary quality control review (C) ^{*2}	190		
Percentage of firms reviewed under ordinary quality control review in FY2019 (A/C)	44%		
Percentage of firms reviewed in FY2019(B/C)	67%		

*1 In addition to the above, there were two audit firms subject to an ordinary review in the previous year but whose review reports were approved in FY2019 (and the two firms were 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, 2019.

*3 The audit firms were subject to an ordinary quality control review in FY2019; 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 or follow-up reviews were conducted in FY2019 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 FY2019		
			Ordinary quality control review *1	Follow-up review	Second follow-up review
Listed Company Audit Firms	Audits of listed companies (more than 100 companies)	5	2 (-)	3	—
	Audits of listed companies (20-99 companies)	8	2 (-)	3	—
	Audits of listed companies (10-19 companies)	14	7 (4)	4	—
	Audits of listed companies (less than 10 companies)	104	44 (9)	23	—
	Sub-total	131	55 (13)	33 ^{*2}	—
Other audit firms		59	29 (1)	10	1
Total		190	84 (14)	43	1

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

*2 The number includes audit firms which were deregistered from the list of registered firms in FY2019.

4.3 Results of ordinary quality control reviews

(1) Results of quality control reviews

In FY2019, 84 audit firms were reviewed under ordinary quality control reviews. Based on the review, there were 76 firms with "Unqualified conclusion" and six firms with "Qualified conclusion." There were two carried-over audit firms. No firms received "Negative conclusion" or "Disclaimer of conclusion."



* In addition to the above, there were two audit firms subject to ordinary review in the previous year but whose review reports were approved and issued in FY2019. Of those two, one firm received “Unqualified conclusion” and the other got “Qualified conclusion.” Therefore, the total number of audit firms to which review reports were issued in FY2019 consisted of 77 audit firms with “Unqualified conclusion” and seven with “Qualified conclusion.”

Types of conclusions issued to the 84 audit firms reviewed under the ordinary quality control review in FY2019 are 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
Listed Company Audit Firms	Audits of listed companies (more than 100 companies)	2 (-)	- (-)	- (-)	- (-)	2 (-)
	Audits of listed companies (20-99 companies)	2 (-)	- (-)	- (-)	- (-)	2 (-)
	Audits of listed companies (10-19 companies)	6 (3)	1 (1)	- (-)	- (-)	7 (4)
	Audits of listed companies (less than 10 companies)	40 (7)	2 (-)	- (-)	2 (2)	44 (9)
	Sub-total	50 (10)	3 (1)	- (-)	2 (2)	55 (13)
Other audit firms		26 (-)	3 (1)	- (-)	- (-)	29 (1)
Total		76 (10)	6 (2)	- (-)	2 (2)	84 (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 there is a certain degree of concern for significant non-compliance issues in an audit firm’s quality control system or individual engagements. It does not automatically mean there is a significant compliance violation in auditing engagements or a doubt in the reasonableness of audit opinions.

(2) Focus area in FY2019 and review results

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

Four items identified as focus areas in FY2019 for the design and operation of quality control system of audit firms were assessed for their appropriateness and effectiveness. The following represents the number of audit firms that received recommendations for improvement by each focus area.

I. Results of design and operation of quality control system of audit firms

Focus area	Number of audit firms*
1. Culture that emphasizes the quality of audit engagement	3
2. Governance and management of audit firms	3
3. Hiring, education/training, evaluation and assignment of professional personnel	1
4. Professional ethics and independence (Rotation of engagement partners)	3

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

The three items identified as focus areas in FY2019 for auditing individual engagements were assessed as well. The following represents the number of audit firms that received recommendations for improvement by each focus area.

Most of the recommendations for improvement regarding the risk of management's override of internal controls resulted from journal entry testing. Please refer to "5.2 Recommendations for improvement related to "Quality control of individual audit engagements" and look into "Example of recommendations for improvement" for further detail.

II Results of auditing individual engagements

Focus area	Number of audit firms*
1. Auditing accounting estimates	32
2. Identifying, assessing and addressing the risk of material misstatements due to fraud <ul style="list-style-type: none">• Professional skepticism• Revenue recognition• Risk of management's override of internal controls	3 19 46
3. Procedures for group audit	3

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

4.4 Results of follow-up reviews

The following represents a breakdown of the 44 audit firms subject to follow-up reviews in FY2019 (classified by the number of audits of listed companies).

(Unit: Number of audit firms)		Review results		
		Improvement measures sufficiently completed	Improvement measures insufficiently conducted	Total
Listed Company Audit Firms	Audits of listed companies (more than 100 companies)	3 (-)	- (-)	3 (-)
	Audits of listed companies (20-99 companies)	3 (-)	- (-)	3 (-)
	Audits of listed companies (10-19 companies)	4 (-)	- (-)	4 (-)
	Audits of listed companies (less than 10 companies)	21 (-)	2 (-)	23 (-)
	Sub-total	31 (-)	2 (-)	33 (-)
Other audit firms		9 (1)	2 (-)	11 (1)
Total		40 (1)	4 (-)	44 (1)

*1 The number in parentheses represents one audit firm that was subject to a second follow-up review.

*2 If the scheduled date for implementing corrective actions for certain items are not yet determined as of the start date of a follow-up review, such items need to be followed up next year at another follow-up review. In FY2019, two audit firms were identified as such.

*3 Audit firms deregistered from the list of registered audit firms in FY2019 are included in the total number of Listed Company Audit Firms.

4.5 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 FY2019:

(Unit: number of audit firms)

Conclusion of quality control reviews and related measures		
Conclusion of quality control reviews	Measures ^{*1}	FY2019 ^{*2}
Negative conclusion	Recommendation to withdraw	- (-)
Qualified conclusion	Recommendation to withdraw (Insufficient improvement)	1 (-)
	Severe warning	2 (1)
	Warning	3 (2)
	Sub-total	6 (3)
Recommendations for improvement with unqualified conclusion ^{*3}	Warning (Insufficient improvement)	5 (3)
Total		11 (6)

*1 "Recommendation to withdraw (Insufficient improvement)" and "Warning (Insufficient improvement)" were determined as a result of insufficient improvement identified in the FY2019 follow-up review or additional quality control review.

*2 The number of firms in parentheses represents Listed Company Audit Firms against which measures are taken based on the result of quality control reviews.

*3 Among the firms that received "Warning (Insufficient improvement)" as for recommendations for improvement with unqualified conclusion, four firms, including two Listed Company Audit Firms (one of which was deregistered from the list of registered audit firms in FY2019), were identified through follow-up reviews.

*4 In addition to the above table, there was one carried-over Listed Company Audit Firm from the previous year against which measures were taken in FY2019. Qualified conclusion with a warning was issued to this audit firm.

*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 them. Therefore, the number of measures in the table above does not agree with the total number of measures taken against audit firms in FY2019.

5. Recommendations for improvement in FY2019

Recommendations for improvement are classified into those related to "Quality control of the audit firm" and those related to "Quality control of individual audit engagements."

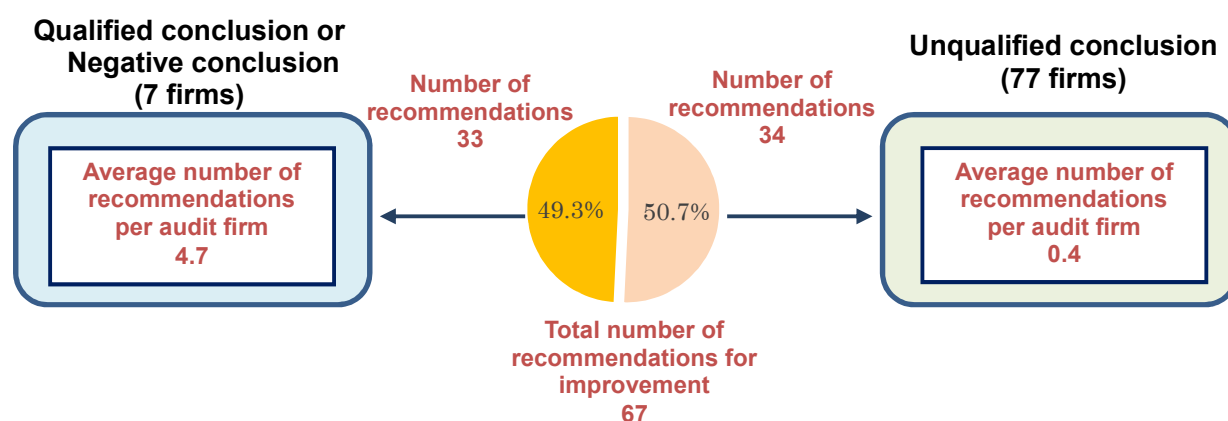
5.1 Recommendations for improvement related to "Quality control of the audit firm"

The following table shows the number of recommendations for improvement related to "Quality control of the audit firm" that were provided to 84 audit firms to which quality control reports were issued in FY2019.

Result of reviews	Number of audit firms (A)	Number of recommendations for improvement (B)	Average per audit firm (B/A)	Number and percentage of audit firms provided with recommendations for improvement
Qualified conclusion or Negative conclusion	7	33 ^{*1}	4.7	7 (100%)
Unqualified conclusion	77	34	0.4	19 (25%)
Total	84 ^{*2}	67	0.8	26 (31%)

*1 Out of the 33 recommendations, 18 led to qualified conclusions or negative conclusions.

*2 The number includes two audit firms whose review reports were carried over to FY2019, but excludes two audit firms whose review reports were carried over to FY2020.

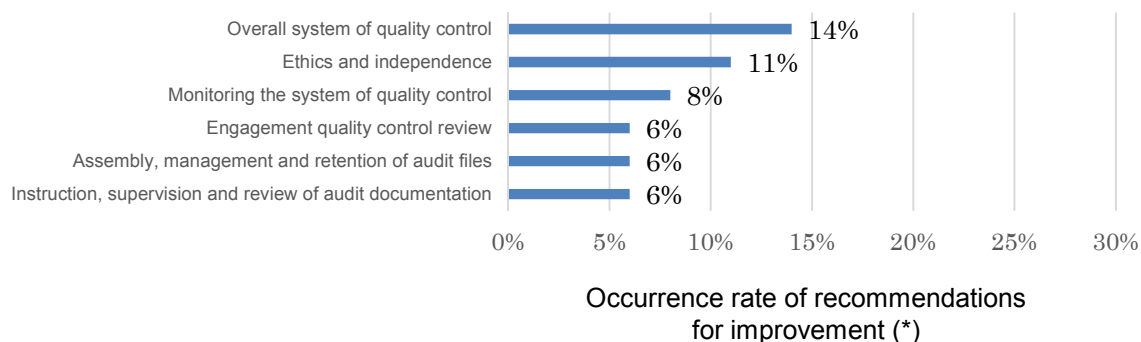


! Recommendations for improvement represent matters with a certain degree of concern for significant non-compliance against professional standards as well as applicable laws and regulations. Some are more severe leading to qualified conclusions or negative conclusions; however, most of the recommendations described in Recommendation Reports represent matters requiring improvement for the purpose of enhancing audit quality control.

Major recommendations for improvement (Quality control of the audit firm)

Recommendations for quality control of the audit firm are mainly related to “Overall system of quality control” and “Ethics and independence.”

[Major recommendations for improvement (Quality control of the audit firm)]



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

Example of recommendations for improvement

Example 1: Overall system of quality control

Many deficiencies have been identified in multiple audit engagements, including those related to audit procedures for significant accounting estimates. It appears that engagement partners are not providing adequate supervision, instruction and audit documentation review. Further, engagement quality control reviewers have failed to comment on deficiencies related to audit procedures for significant accounting estimates.

Example 2: Professional ethics and independence

To maintain relationship with a listed company, a representative of an audit firm, who had served as an engagement partner for seven years, was involved in the audit engagement as a member of the audit team during his interval period. Also, another partner, who had served as an engagement quality control reviewer for seven years, performed audit procedures for specific accounts during an interval period. Thus, it appears that the audit firm did not properly design and implement the rotation rule for key audit partners involved in an audit engagement.

! For more details on recommendations for improvement, please refer to “Illustrative Examples for Quality Control Reviews.”

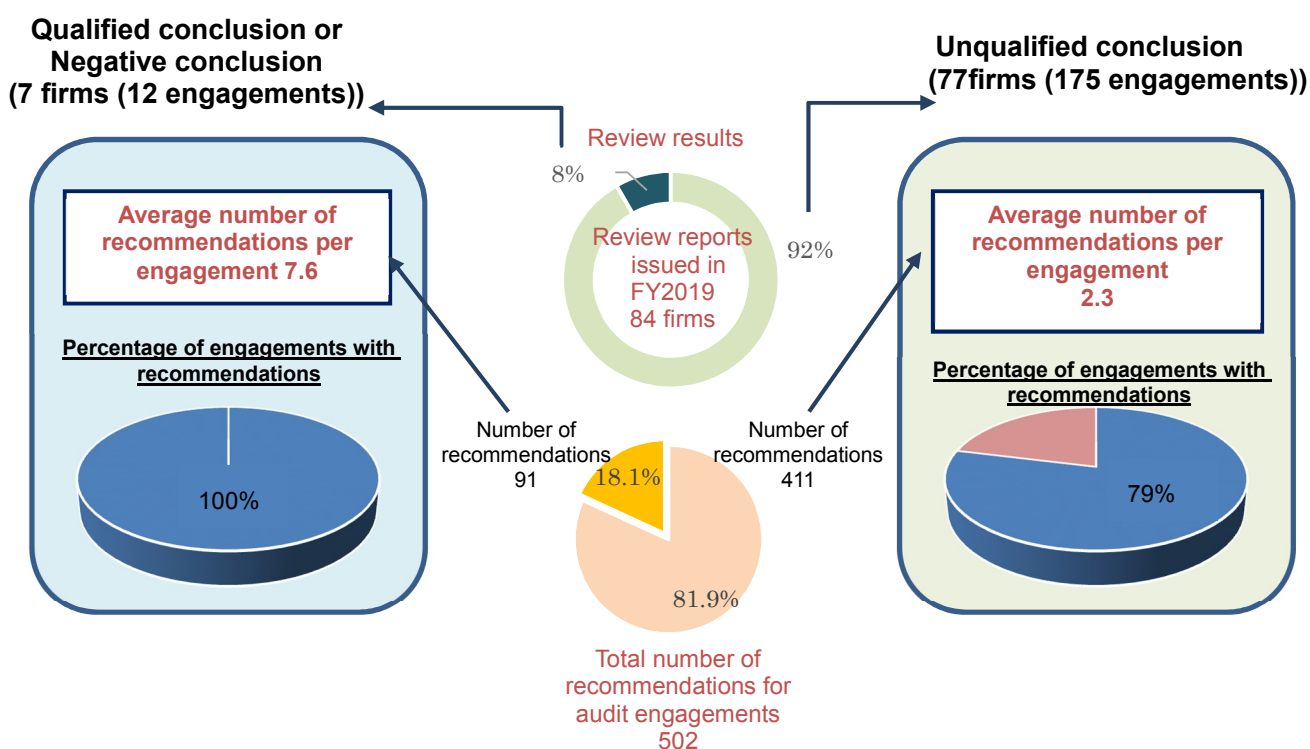
5.2 Recommendations for improvement related to “Quality control of individual audit engagements”

The following table shows the number of recommendations for improvement related to “Quality control of individual audit engagements” that were provided to 84 audit firms to which quality control reports were issued in FY2019.

Result of reviews	Number of audit firms	Number of selected engagements (A)	Number of recommendations for improvement (B)	Average per audit engagement (B/A)	Number and percentage of engagements provided with recommendations for improvement
Qualified conclusion or Negative conclusion	7	12	91 ^{*1}	7.6	12 (100%)
Unqualified conclusion	77	175	411	2.3	138 (79%)
Total	84 ^{*2}	187	502	2.7	150 (80%)

*1 Out of the 91 recommendations, 20 led to qualified conclusions or negative conclusions.

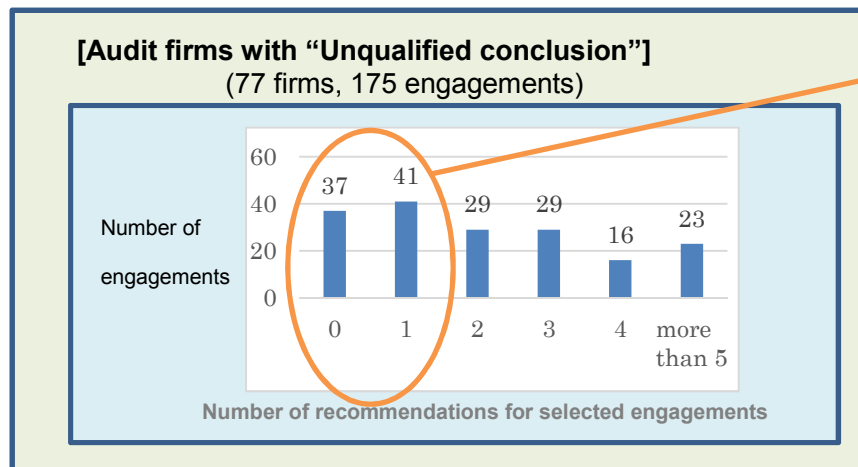
*2 The number includes two audit firms whose review reports were carried over to FY2019, but excludes two audit firms whose review reports were carried over to FY2020.



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:

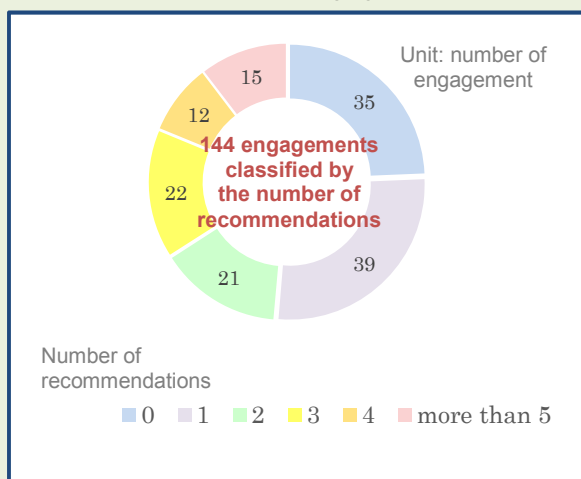
[Number of recommendations for improvement for selected engagements]



This indicates that there were 37 engagements with no recommendation and 41 engagements with only one recommendation.

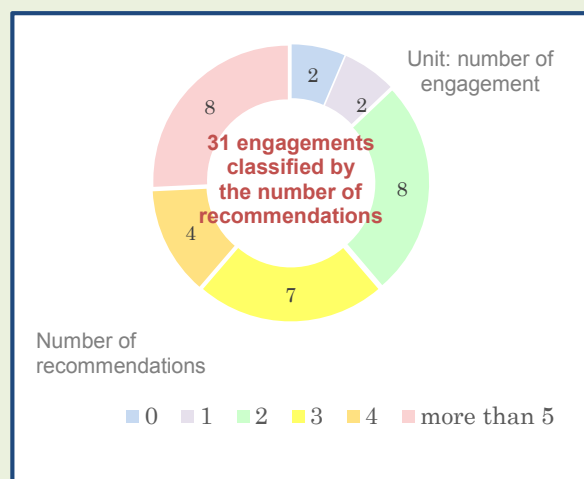
Classification by registration status

[Listed Company Audit Firms] (51 firms, 144 engagements)



Average number of recommendations per engagement
2.0 / engagement

[Other audit firms] (26 firms, 31 engagements)

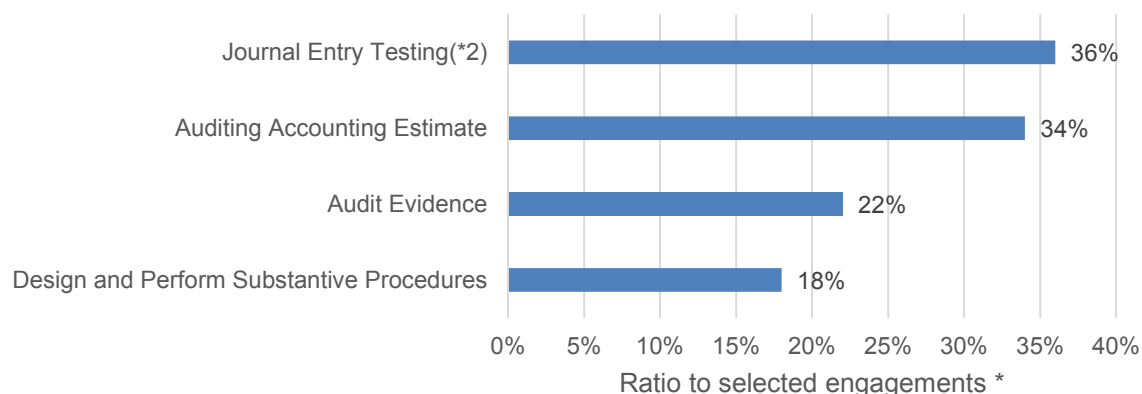


Average number of recommendations per engagement
3.7 / engagement

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

Recommendations for quality control of individual audit engagements are mainly related to “Journal entry testing,” “Auditing accounting estimates,” and “Audit evidence.”

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



*1

Number of engagements provided with
recommendations for each item

$$\text{* Ratio to selected engagements (\%)} = \frac{\text{Number of engagements provided with recommendations for each item}}{\text{Number of selected engagements}}$$

*2 “Journal Entry Testing” was originally included in the “Identifying, assessing and addressing the risk of material misstatements including fraud” in previous years. However, it is presented as a separate item in FY2019 given the increasing importance in reviews.

Example of recommendations for improvement

Example 1: Journal entry testing

In performing journal entry testing, which is one of the audit procedures to address the risk of management’s override of internal controls, the auditor automatically selects a number of journal entries over a certain amount. In other words, the auditor fails to extract journal entries by taking various possible fraud scenarios into account. Further, the auditor examines the selected journal entries by reviewing account names and their descriptions without performing substantive procedures, such as vouching.

Example 2: Auditing accounting estimates

No impairment is recognized by the audit client for the investment in its affiliated company in capital deficit, based on an assumption that the value of investment will recover to the acquisition cost within 5 years. However, the auditor does not seem to have critically reviewed the feasibility of the affiliate’s aggressive business plan.

Example 3: Audit evidence

In assessing the indication of impairment on fixed assets, the auditor uses the document prepared by the audit client. However, the auditor does not seem to check the accuracy of information provided in the document, including operating income.

6. Causes of recommendations for improvement and action plans (Corrective action)

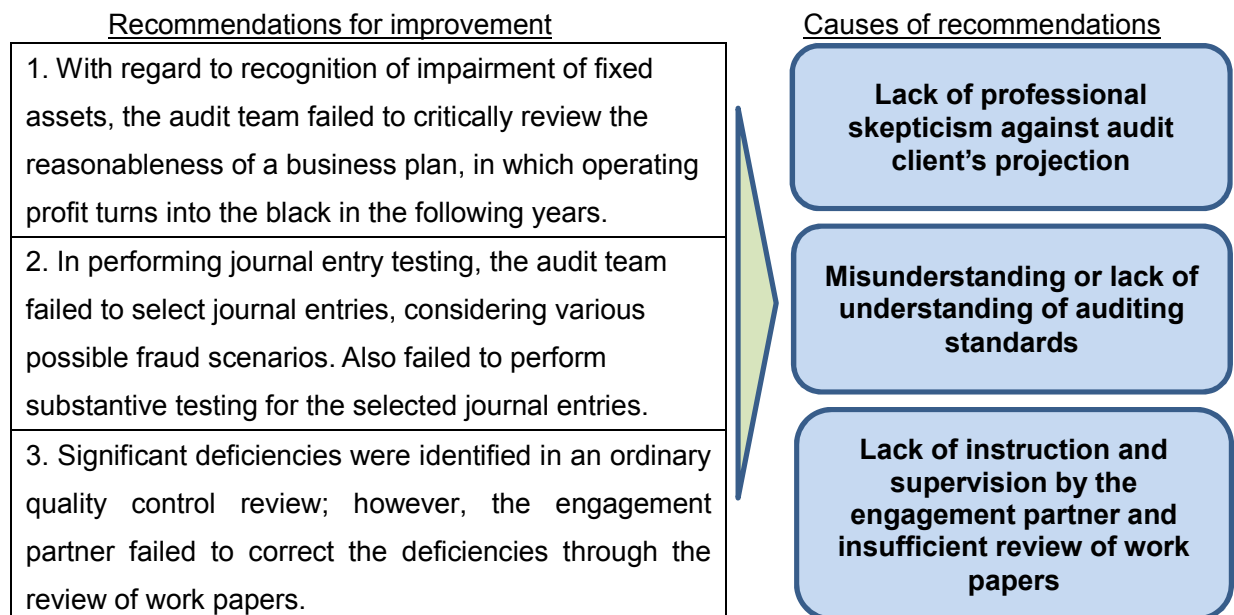
In order to plan and implement appropriate and effective corrective actions, it is important for audit firms to clarify causes of recommendations for improvement. Accordingly, audit firms are required to include their analysis for “Causes of recommendations for improvement” for each recommendation in an Improvement Plan, which is developed based on a Recommendation Report.

In some cases, “Causes of recommendations for improvement” may have arose from a more deeply rooted cause. Further, if such root cause is commonly found in multiple cases, it may indicate a significant issue resides in the culture of audit firms or management's behavior. Thus, audit firms are required to document “Root causes of recommendations for improvement” in the Improvement Plan whenever qualified conclusions are issued as a result of quality control reviews.

To enhance the quality of audits, reviewers work closely with audit firms and provide instructions as necessary in tackling causes of recommendations and preparing Improvement Plans.

6.1 Causes of recommendations for improvement and action plans

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



In response to the above recommendations, audit firms are responsible for having their professional personnel understand issues mainly through training and also following up on corrective actions taken. The following illustrates specific corrective actions that could be applied by audit firms:

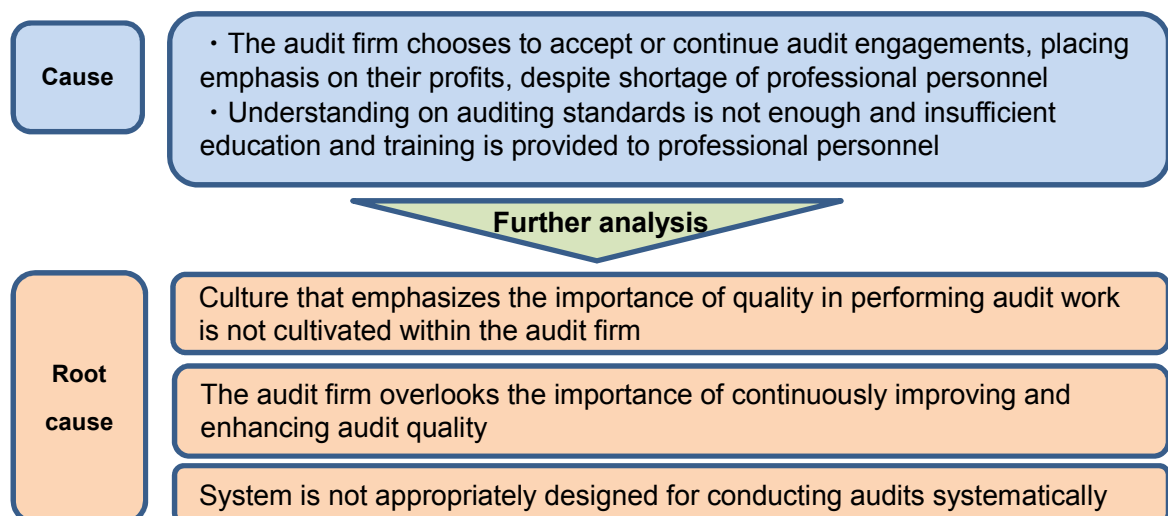
1. Exercise professional skepticism and evaluate the reasonableness of business plans, including the rationale of significant assumptions used by management, for the purpose of evaluating impairment of fixed assets that have a significant impact on the financial statements.
2. Have a thorough understanding on auditing standards and select journal entries based on various possible fraud scenarios. Perform substantive procedures, such as vouching, for the journal entries selected.
3. Plan an audit properly and budget enough time for engagement partners so they can appropriately provide instruction and supervision to staff in a timely manner and properly reviews work papers.

6.2 Root causes of recommendations for improvement and action plans

The following illustrates root causes behind recommendations identified in an Improvement Plan as well as action plans in response to the recommendations:

Recommendations for improvement

1. The audit firm accepted or continued audit engagements without carefully considering fraud risks or work volume associated with the engagements. As a result, a large number of recommendations for improvement for quality control were identified at the level of individual engagements.
2. Since the quality control system of the audit firm was not properly operated, in many cases, audit procedures were not performed sufficiently at the level of individual engagements. It appears that engagement partners failed to fulfill the responsibility for the quality control.



Action plans implemented by audit firms in response to the above recommendations for improvement are as follows:

- | |
|---|
| 1. Raise awareness of audit quality by repeatedly emphasizing the importance of quality control. Also, design the system under which fraud risks and audit working hours are taken into account when newly accepting or continuing audit engagements. |
| 2. Enhance the understanding of auditing standards, improve audit quality through continuous education and training for professional personnel, and conduct audits systematically. |

6.3 Measures taken by JICPA

JICPA's role is to provide instructions to audit firms tackling on corrective actions mainly through effective communication with audit firms, implementation of trainings that are useful for audit work, and provision of audit tools. Moreover, when a number of significant recommendations are identified for an audit firm, such as the case in 6.2 above, 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 such audit firms. In addition to the above roles, JICPA supervises Listed Company Audit Firms by assessing their registration status.

7. Registration System for Listed Company Audit Firms

7.1 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.

This registration system is incorporated into the Quality Control Review System. Within the Quality Control Committee, a center called the “Center for Listed Company Audit Firms” is established, which is responsible for preparing lists of registered firms and publishing the lists on JICPA’s website.

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

* Website only available in Japanese.

The list of registered firms contains information not only about the profile of registered firms, but also the status of quality control reviews, summary of qualified matters and disciplinary actions.

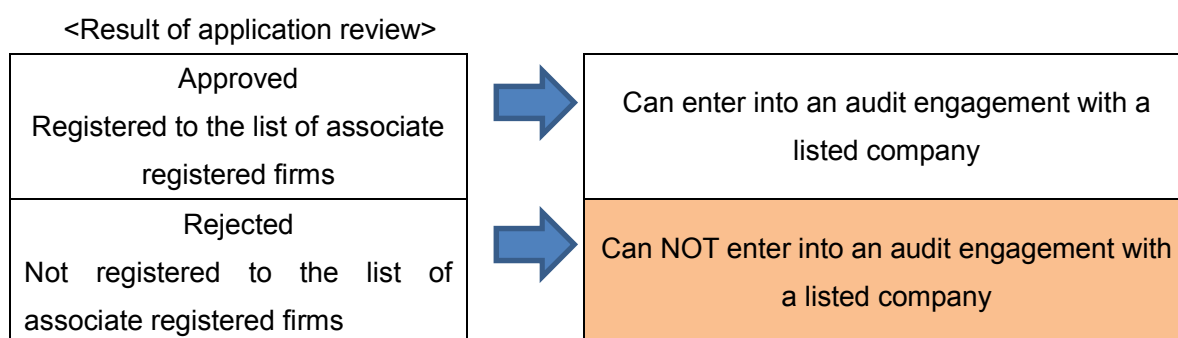
For the overview of Listed Company Audit Firms, such as the number of listed company audits, please refer to Appendix1. “Overview of audit firms in the list of registered firms.”

! According to the Securities Listing Regulations of stock exchanges, an accounting firm engaged in an audit of a listed company must be an audit firm registered either in the list of registered firms or associated registered firms. In addition, an accounting firm engaged in IPOs must be an audit firm registered either in the list of registered firms or associated registered firms which has passed quality control reviews. (For Tokyo Stock Exchange, refer to Article 205, Item 7-2, Article 441-3, etc. of Securities Listing Regulations)

7.2 Application review process for the registration to the list of registered firms

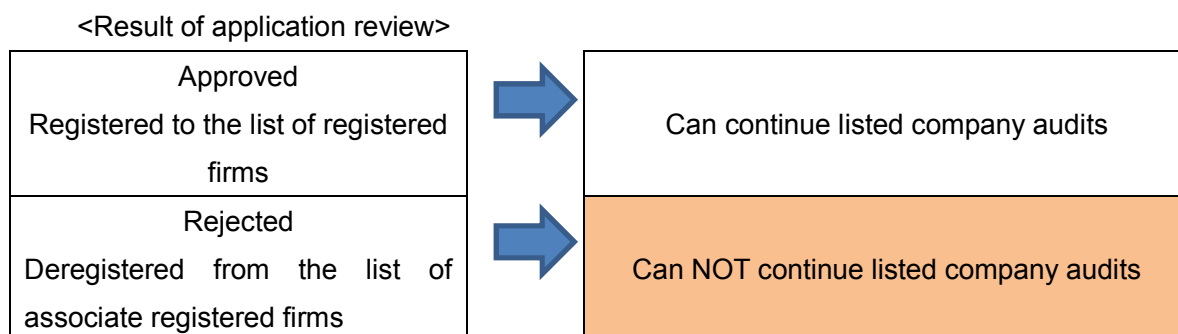
Application review process for associate registered firms

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



Application review process for registered firms

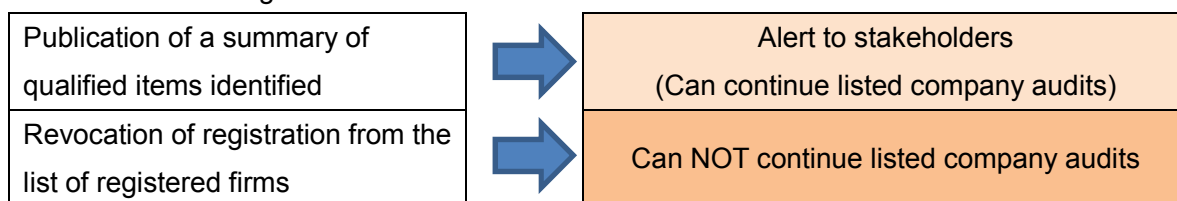
Once approved as an associate registered firm, the firm can sign an audit engagement with a listed company, under which audit service is provided and audit report is issued. The associate registered firm should go through JICPA's ordinary quality control review before the firm can submit an application to be added to the list of registered firms. Based on the result of the quality control review, JICPA will review the application and assess whether the firm can be registered to the list of registered firms.



7.3 Registration status in the list of registered firms

Based on the result of ordinary quality control reviews for Listed Company Audit Firms, JICPA determines necessary measures to be taken within the framework of the Quality Control Review System as well as the registration status in the list of registered firms. If JICPA determines that a revocation of registration is required as a measure against a Listed Company Audit Firm, the audit firm will no longer be able to continue the audit of listed companies.

<Measures taken against the firm>



! To ensure that audit firms are capable enough and have an appropriate system to audit listed companies, JICPA strictly conducts application reviews, assesses the appropriateness of registration status in the list of registered firms, and determines necessary measures to be taken against registered firms.

8. Overview of the list of registered firms

During the period between April 1, 2019, and March 31, 2020, 13 audit firms were newly added to the list of registered firms after application reviews, and eight audit firms were deregistered due to termination of audit engagements with listed companies or for other reasons.

As a result, there were 136 Listed Company Audit Firms as of March 31, 2020.

There was one audit firm whose registration status in the list of registered firms changed based on the results of the quality control review in FY2019.

See further detail at “Appendix 1. Overview of audit firms in the list of registered firms.”

[Breakdown of Listed Company Audit Firms]

As of March 31, 2020

	Audit Firms	CPAs	Total
Audit firms registered in the list of registered firms	111	7	118
Audit firms registered in the list of associate registered firms	17	1	18
Total	128	8	136

9. Response to recommendations from the Quality Control Oversight Board

The Quality Control Oversight Board, a monitoring body of the Quality Control Committee, is responsible for reviewing and assessing whether or not quality control reviews and activities of the Center for Listed Company Audit Firms are properly conducted, and providing recommendations to the Quality Control Committee accordingly. The Quality Control Committee received a report titled “2018 Recommendation for Quality Control Committee Activities” dated June 3, 2019, from the Quality Control Oversight Board. The Quality Control Committee responded to the recommendations, which is summarized below.

The JICPA Constitution was amended in July 2019, under which the Quality Control Oversight Board is now replaced with the Self-Regulatory Monitoring Committee for monitoring purposes. For details, please refer to “10. Changes in organization structure to improve self-regulatory functions.”

9.1 Recommendations No.1: Further enhance quality control reviews

(1) Action plan to enhance reviewer’s capability (on-going recommendation)

To enhance reviewer’s capability, the Quality Control Committee successfully has held regular meetings for reviewers throughout the year, where reviewers can exchange views and share information on the review process and typical recommendations for improvement. Furthermore, the Quality Control Committee has continued to hold trainings for reviewers, clearly focusing on improving reviewers’ technical skills (i.e. skills to identify issues, to write concisely, and to provide instruction) as well as their capabilities (i.e. to be insightful, make good judgement, and explain clearly).

(2) Preparation for a change in the Quality Control Review System (new recommendation)

In March 2019, a report titled “Outline of amendments to the JICPA Constitution regarding Quality Control Review System” was published by the Quality Control Committee. Based on the report, the committee has set up a project team responsible for the design and operation of the new Quality Control Review System and also carefully considered comments received from stakeholders in order to prepare for the new system to be implemented in FY2020. Further, the Quality Control Committee plans to implement an appropriate and sufficient review system under which audit firms seeking approvals for the auditing of listed companies for the first time are reviewed more carefully.

In order to reinforce information gathering and analysis capabilities through off-site monitoring, the Quality Control Committee is sharing information with the Audit and Discipline

Review Council and also reviewing methods used to gather and analyze information on listed companies and audit firms, so that the committee can collect more useful information in an efficient manner.

For major amendments to the Quality Control Review System, please refer to “10. Changes in organization structure to improve self-regulatory functions.”

9.2 Recommendations No.2: Raise awareness of the Quality Control Review System and the Registration System for Listed Company Audit Firms

- (1) Proactively work on raising public awareness about the Quality Control Review System and the Registration System for Listed Company Audit Firms (on-going recommendation)

The Quality Control Committee has conducted the following to raise public awareness about the Quality Control Review System and the Registration System for Listed Company Audit Firms:

- Distributed and published on JICPA's website the following booklets: “Overview of the Quality Control Review 2019,” which summarizes the Quality Control Review System and JICPA's related activities; and “Illustrative Examples and Guidance on Quality Control Reviews 2019,” which provides guidance on actual recommendations made in quality control reviews.
- Contributed to “Monthly Journal for Audit & Supervisory Board Members” (September 2019) about the Quality Control Review System (titled “Implementation status of the quality control reviews of JICPA (FY2019)”).
- Provided lecture on the theme of “Illustrative Examples and Guidance on Quality Control Reviews” hosted by the Public Interest Incorporated Association Japan Audit & Supervisory Board Members Association (February 2020).

10. Changes in organization structure to improve self-regulatory functions

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. JICPA is dedicated to take measures as necessary, keeping in mind that it is critically important to maintain its members' discipline via self-regulation and to further enhance the audit system and environment. JICPA Constitution was amended in July 2019 to reinforce its important self-regulatory activities, namely the Quality Control Review System and the System for Individual Case Review (i.e. a system that reviews audit results and reasonableness of audit opinions related to individual audit issues as well as professional ethics of CPAs). The following describes major changes made to the Quality Control Review System and also to the Registration System for Listed Company Audit Firms, which is a system incorporated under the Quality Control Review System.

10.1 Quality Control Review System

The Quality Control Review System was amended to improve effectiveness and enhance transparency. Quality control reviews will be conducted based on the new system effective July 1, 2020.

1. Quality Control Review System

- (1) Changed ordinary quality control reviews and responses to recommendations for improvement
 - Ordinary quality control reviews

Types of conclusion issued for ordinary quality control reviews in a “Quality control review report” have changed. The current types of conclusion (i.e. “Unqualified conclusion,” “Qualified conclusion” and “Negative conclusion”) are abolished. Instead, under the new system, it should be described in the report whether or not “extremely significant deficiencies” or “significant deficiencies” in the design and operation of quality control system of audit firms are identified as a result of a quality control review.

[Change in the results of ordinary quality control reviews]

Before amendment		After amendment
Negative conclusion		
Qualified conclusion(with a great concern for significant non-compliance issues)	→	Result with extremely significant deficiencies
Qualified conclusion		Result with significant deficiencies
Unqualified conclusion		Result without significant deficiencies

- Response to recommendations for improvement (preparing Improvement Plans)
Under the new system, in case of “Result with extremely significant deficiencies” or “Result with significant deficiencies,” audit firms are required to prepare Improvement Plans. On the other hand, in case of “Result without significant deficiencies,” audit firms are not required to prepare Improvement Plans to encourage their work on self-improvements.

(2) Changed follow-up reviews

Follow-up reviews under the current system are abolished. Under the new system, as a general rule, when an ordinary quality control review comes out with “Result with extremely significant deficiencies” or “Result with significant deficiencies,” another ordinary quality control review will be conducted in the following year, or JICPA will look into the improvement status and provide instructions as necessary. On the other hand, when a review comes out with “Result without significant deficiencies,” improvement status should be reported to JICPA in writing as a general rule. When improvements seem to be insufficient, another ordinary quality control review or confirmation of improvement status will be conducted by JICPA.

(3) Relaxed rules to conduct extraordinary quality control reviews

JICPA has relaxed rules and made it easier to conduct extraordinary quality control reviews. Under the new rule, JICPA can conduct a extraordinary quality control review whenever the Quality Control Committee deems it necessary, regardless of whether or not an audit opinion has been expressed, in order to review quality control systems and audit status of an audit firm or look into specific issues as needed.

(4) Added flexibility to the frequency of ordinary quality control reviews

JICPA continues to keep the rule of conducting ordinary quality control reviews once in every

three years. That said, under the new system, more flexibility is given to ordinary quality control reviews depending on the judgement of the Quality Control Committee: they can be conducted in the following year successively; or they can be extended to once in every five years at most.

(5) Enhanced the feedback system for the Quality Control Committee

Under the new system, the Quality Control Committee is allowed to provide its observations directly to the Chairman and President of JICPA regarding issues related to audit firms and auditing standards that are identified through quality control reviews.

2. Registration System for Listed Company Audit Firms

(1) Clarified the role of the Center for Listed Company Audit Firms and enhanced off-site monitoring

Staff are newly assigned to the Center for Listed Company Audit Firms, which is responsible for updating the list of registered firms. Also, by adding a new role to become an information center for audits of listed companies, the Center for Listed Company Audit Firms is now expected to actively gather and analyze information about listed companies and listed company audit firms.

(2) Improved disclosures on deficiencies identified in Listed Company Audit Firms

Currently, when “Qualified conclusion (with a great concern for significant non-compliance issues)” is issued, the outline of qualified issues is disclosed in the list of registered firms as measures against audit firms (Please refer to “3.9 Measures taken as a result of ordinary quality control reviews”). Under the new system, when either “Result with extremely significant deficiencies” or “Result with significant deficiencies” is identified, the outline will be disclosed in the list of registered firms.

(3) Audit firms seeking to audit listed companies for the first time

In determining whether or not an audit firm seeking approval to audit listed companies for the first time can be registered to the list of associate registered firms, the current system requires that the Center for Examination of Application for Associate Registered Firm should be responsible for the review by examining application documents and interviewing applicants as necessary. Under the new system, though, reviewers should first investigate whether or not an applicant’s quality control system is capable enough to audit listed companies and should provide instructions as necessary. Based on those results, the Center for Examination of Quality Control will examine the application.

10.2 JICPA's organization structure for self-regulation

Not only the Quality Control Review System and the System for Individual Case Review are improved, but also JICPA's organization structure regarding the overall self-regulation, including monitoring bodies of both review systems, has been amended to improve transparency. The new self-regulatory organization structure is in place effective October 1, 2019.

1. Established Self-Regulatory Monitoring Conference

Under the current system, the Quality Control Review System and the System for Individual Case Review have their own monitoring bodies, namely the Quality Control Oversight Board and the Auditing Monitoring Conference, respectively. In order to reinforce JICPA's self-regulatory system and obtain further understanding from society, the monitoring bodies are replaced by establishing a single monitoring body called "Self-Regulatory Monitoring Conference" under the new system. The new monitoring body is responsible for monitoring the operation of JICPA's overall self-regulatory activities and providing insights and advice from a higher level.

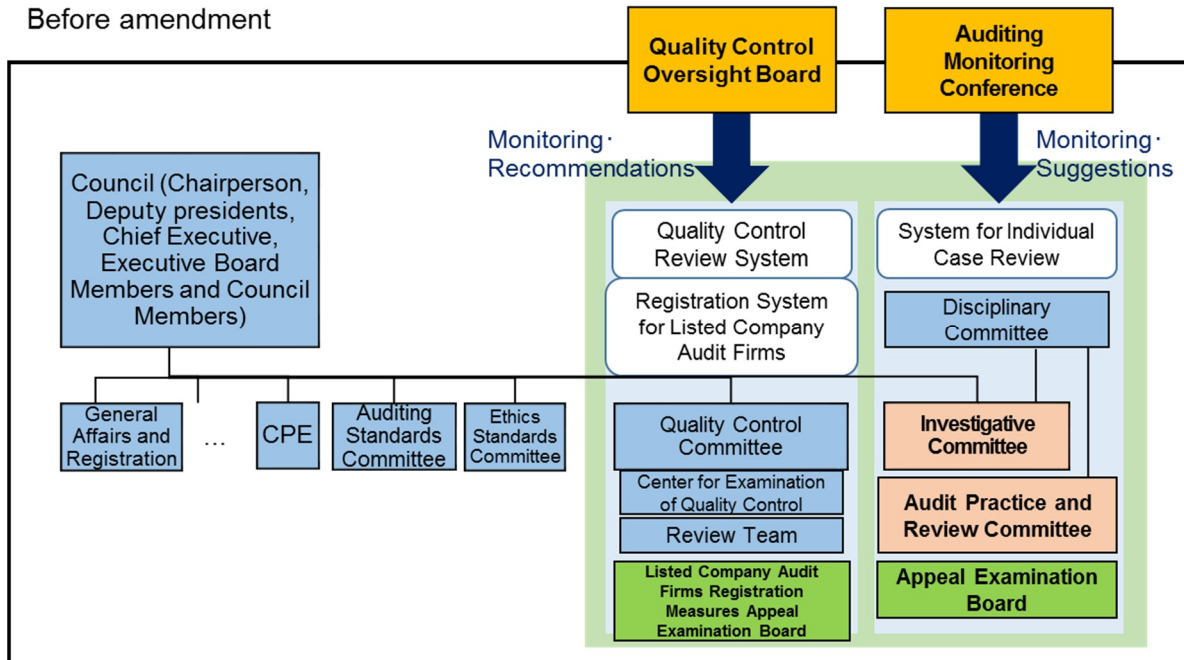
See further detail on the "Self-Regulatory Monitoring Conference" on JICPA's website in Japanese (<https://jicpa.or.jp/about/activity/self-regulatory/quality/monitoring.html>).

2. Established Review Board for Appropriate Procedures

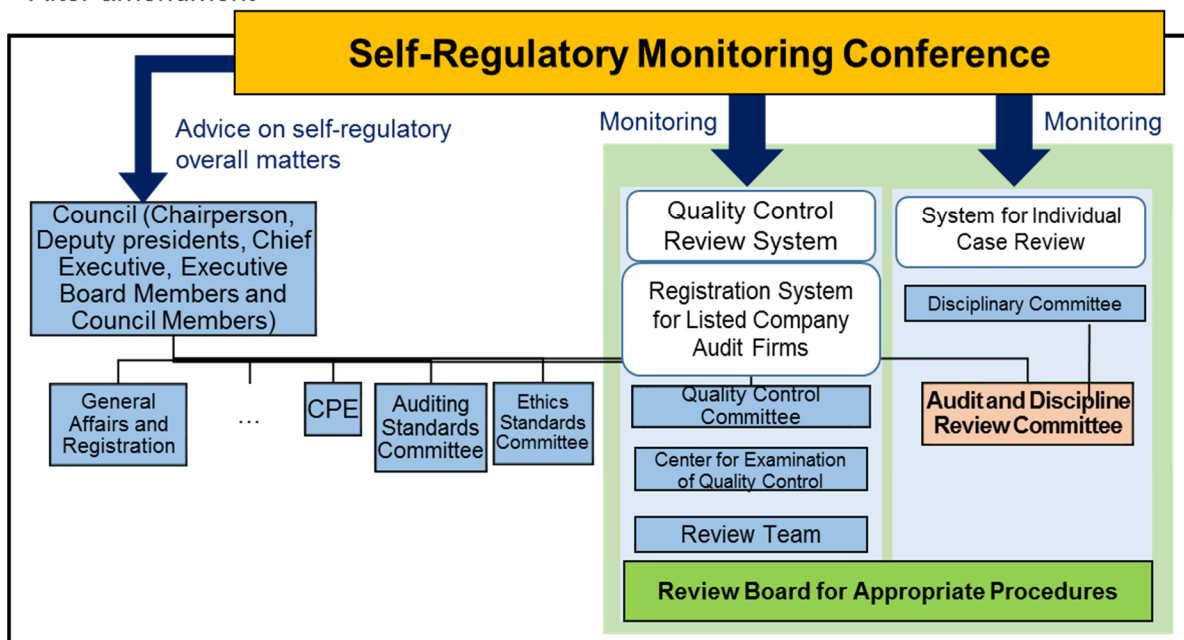
Under the current system, the Quality Control Review System and the System for Individual Case Review have their own appeal examination bodies, namely the Listed Company Audit Firms Registration Measures Appeal Examination Board and the Appeal Examination Board, respectively. Under the new system, the examination bodies have been integrated and become the "Review Board for Appropriate Procedures" to improve expertise in examining disciplinary actions against members and to ensure fairness in making judgement.

[Self-regulatory system of JICPA]

Before amendment



After amendment



11. Future action plan

JICPA amended part of JICPA Constitution at its Annual General Assembly in July 2019 and changed its organization structure to promote a smooth rollout of the new system, aiming to improve the Quality Control Review System.

Going forward, JICPA is committed to strengthen its self-regulatory function by taking the following approaches: conduct quality control reviews based on risk approach; provide feedback on the quality control review results to other committees or bodies; and promote collaboration and information sharing among organizations belonging to the Quality Control Committee and the System for Individual Case Review.

With that in mind, the Quality Control Committee is dedicated to take the following actions under the new system, which are applicable to quality control reviews starting from FY2020, and is ready to properly address new issues identified, if any, through the process of implementing the new system:

1. Enhance instruction capability

To enhance instructions to audit firms whose audit quality does not meet a certain level, the Quality Control Committee will conduct risk-focused quality control reviews based on a thorough understanding of an audit firm's operation. Also, the Quality Control Committee will make sure that adequate instructions are provided through sufficient communication between audit firms and reviewers.

2 Review audit firms seeking approval to audit listed companies for the first time

In determining whether or not an audit firm seeking approval to audit listed companies for the first time can be registered to the list of associate registered firms, reviewers will visit the audit firm and examine whether or not an applicant's quality control system is capable enough to audit listed companies. Reviewers will continue to provide instructions as necessary. Based on those results, final decisions will be strictly made for the application.

3. Enhance capability of reviewers

The Quality Control Committee will continuously provide trainings to enhance reviewers' capability by clarifying the skills required for reviewers depending on their job titles and years of experience. In particular, the Quality Control Committee will emphasize the importance of having a thorough understanding of an audit firm's operation and also focusing on root causes of recommendations when providing instructions to audit firms so as to enhance technical skills of reviewers. The effectiveness of reviewer trainings will be reassessed on a going forward basis.

4. Coordinate with the CPAAOB

The Quality Control Committee will continue to hold meetings with the CPAAOB to exchange opinions on practical issues and tasks of quality control reviews with an aim of enhancing the effectiveness of quality control reviews from an operational perspective.

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

The overview of 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, 2020

Number of listed company audits	Number of audit firms	Composition (%)	Total number of listed company audits	Composition (%)
More than 100	5	3.7%	2,896	75.8%
20 to 99	8	5.9%	389	10.2%
10 to 19	13	9.5%	181	4.7%
Less than 10	110	80.9%	353	9.3%
Total	136	100.0%	3,819	100.0%

2. Breakdown based on the number of CPAs (including audit practitioners 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, 2020

Number of CPAs, etc.	Number of audit firms	Composition (%)	Number of CPAs	Composition (%)
More than 1,000	4	2.9%	19,872	78.2%
100 to 999	7	5.2%	2,393	9.4%
20 to 99	67	49.3%	2,526	9.9%
Less than 20	58	42.6%	632	2.5%
Total	136	100.0%	25,423	100.0%

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

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

1. Overview of the change in auditors

There were 143 cases of change in auditors during the period from April 1, 2019, to March 31, 2020. The information is obtained by JICPA based on timely disclosures made by listed companies during the period pursuant to the Securities Listing Regulations of stock exchanges. This number does not include three cases of change in auditors due to merger of audit firms and one due to cancellation of joint audit. 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	24	10	34
	Other than Big 4 audit firms	60	49	109
	Total	84	59	143

Out of the 143 changes in auditors, 84 predecessor auditors were from Big 4, accounting for more than half of the changes. On the other hand, only 34 successor auditors were from Big 4.

2. Reasons for the change in auditors

Reporting entities are required to disclose reasons for 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 extremely important as an 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). JICPA is also working to enhance disclosure information on reasons for the change in auditors and monitor those reasons in a timely manner by requiring Listed Company Audit Firms to report specific reasons for the change in a document titled “Notification form for change in the current status of registered firms”

(hereinafter referred to as the “Notification Form”) that is submitted to JICPA.

The table below summarizes reasons for change in auditors for 106 cases that occurred between April 1, 2019, and March 31, 2020, whose change was reported by both predecessor and successor auditors by April 30, 2020, through the submission of 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) Changed to the same auditor within the consolidated group	14	14
(2) Changed to an international firm due to overseas expansion	2	6
(3) Not satisfied with responsiveness and quality of auditors	1	30
(4) Audit fees	52	35
(5) Number of years serving as an auditor	32	28
(6) Difficult situations encountered during the audit period	2	1
(7) Disagreement on accounting and auditing issues	-	1
(8) Accounting scandals	10	9
(9) Increase in audit risk due to changes in business environment or social/political landscape	10	2
(10) Other	13	17
Total	136	143

* Since multiple selection is possible, the total number reported above does not match with the 106 cases of change in auditors.

According to the summary, both predecessor and successor auditors reported “Audit fees” as the number one reason for the change in auditors. As for the second major reason, predecessor auditors reported “Number of years serving as an auditor,” whereas successor auditors reported “Not satisfied with responsiveness and quality of auditors.” Note that predecessor and successor auditors reacted quite differently to the response “Not satisfied with responsiveness and quality of auditors.”

Timely disclosure shows that 98 out of the 106 cases were due to “Expiration of the audit term,” the most selected response; however, there was only one case that gave “Expiration of the audit term” as the sole reason for the change in auditors. In other words, in most cases, it turns out that other reasons in addition to the “Expiration of the audit term” were provided for the change in auditors. This is probably due to the fact that the Financial Services Agency started requiring reporting entities to disclose actual reasons for the change in auditors other than the expiration of

the audit term, according to a report issued in January 2019 by “Advisory Council on Enhancement of Information Provided by Audits,” a council established within the Financial Services Agency. Other major reasons given by reporting entities included “prolonged number of years serving as an auditor” and “an increase in audit fees,” which align with responses provided by predecessor and successor auditors.

