

The Japanese Institute of Certified Public Accountants  
**Overview of the Quality Control Review 2022**

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## 【Part 1 Overview of the Quality Control Review】

# 1. The Japanese Institute of Certified Public Accountants

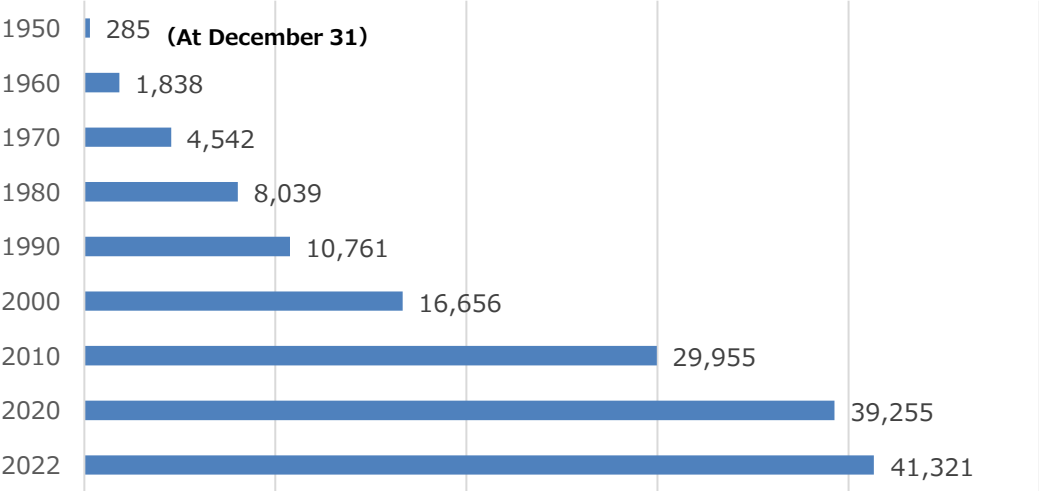
**The Japanese Institute of Certified Public Accountants (“JICPA”) is dedicated to provide instruction and oversight of certified public accountants (“CPAs”) to improve their qualifications to fulfill their mission as a CPA.**

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. Also, JICPA 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, 2022, the total number of members, including associate members, stood at 41,321 which consisted of the following: the number of members totaled 33,490, including 33,217 of CPAs of Japan and of other countries in Japan as well as 273 audit firms; and the number of associate members, including junior accountants and successful candidates of the CPA examination, stood at 7,831.

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

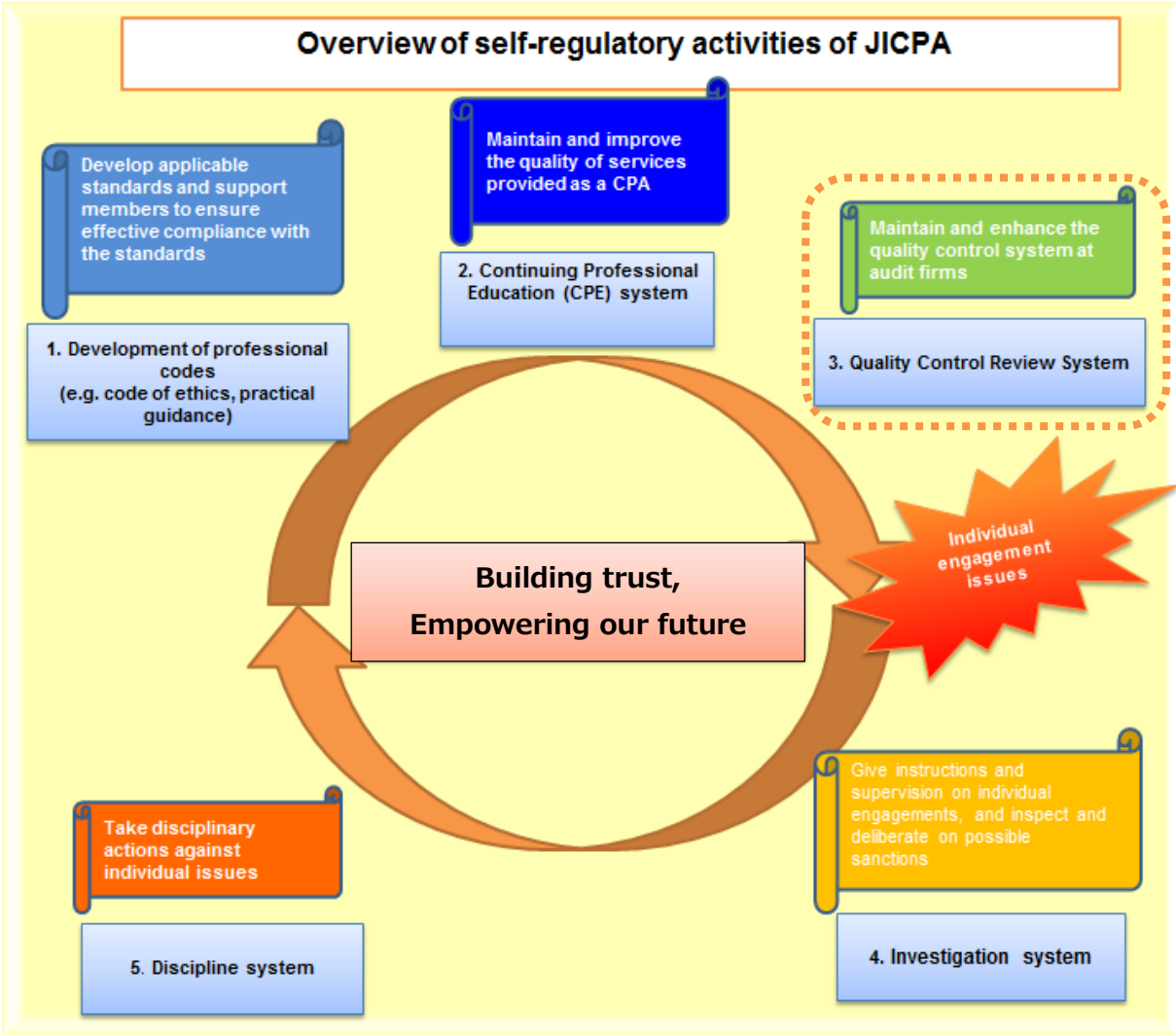
**[Number of members (At March 31)]**



## 2. Activities of JICPA as a Self-Regulatory Body

JICPA is a self-regulatory body dedicated to continuously retain the high professional abilities of our members, with an aim 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 Systems

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### (1) Overview of the Quality Control Review System and a Summary of the Registration System for Audit Firms that Engage in Audits of Listed Companies

#### ① Quality Control Review System

In the light of public nature in services prescribed in Article 2-1 of the CPA Act for audit engagements, JICPA has implemented a system for quality control reviews, namely the "Quality Control Review System," as part of its self-regulatory activities since FY1999 with an aim to maintain and enhance an appropriate quality level of audit engagements, and to ensure social confidence in those services. The Certified Public Accountants and Auditing Oversight Board (the "CPA AOB") has monitored the Quality Control Review System of JICPA since FY2004.

Based on the JICPA Constitution, the Quality Control Committee established in JICPA conducts quality control reviews in accordance with the quality control review standards and procedures to assess the design and operation status of the quality control system of audit firms and CPAs (collectively as "audit firms") and, as needed, issue recommendations for improvement and impose appropriate measures. Quality control reviews are focused on instructing and supervising audit firms. They are not intended to badger and penalize audit firms or to interfere audit opinions issued by audit firms.

#### ② Registration System for Audit Firms that Engage in Audits of Listed Companies

JICPA has introduced the Registration System for Audit Firms that Engage in Audits of Listed Companies in 2007 to further enhance the quality control system of audit firms that engage in audits of listed companies ("listed company audit firms"). Under the system, the Listed Company Audit Firms Subcommittee, established within the Quality Control Committee, is responsible for maintaining official rosters of audit firms that engage in audits of listed companies (the "official roster of registered firms") and associate registered audit firms, reflecting registration decisions made and measures taken by the Quality Control Committee in the rosters, and making them available to the public.

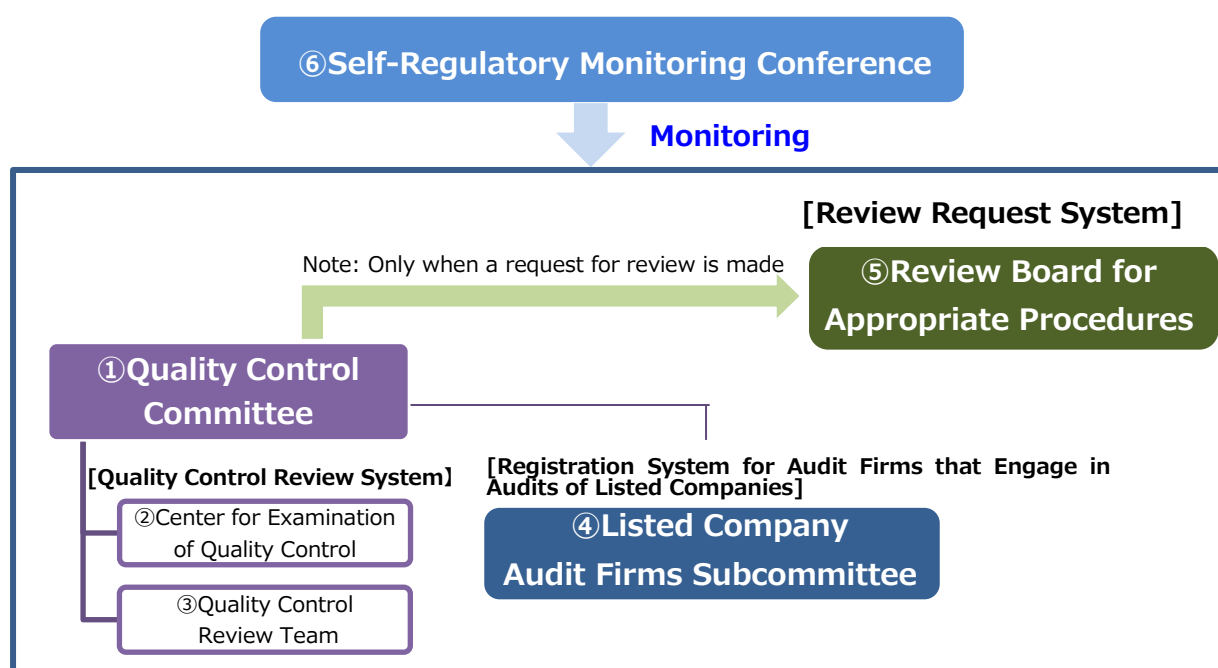
The Securities Listing Regulations of stock exchanges require that listed companies should engage audit firms that are registered either on the official roster of registered firms or the official roster of associate registered audit firms (collectively as the

“Official Rosters”).

For more details, please refer to “4. Registration System for Audit Firms that Engage in Audits of Listed Companies.”

## (2) Organization Structure of the Quality Control Review Systems

The Quality Control Review System and the Registration System for Audit Firms that Engage in Audits of Listed Companies, collectively represented as the Quality Control Review Systems, are operated mainly by the Quality Control Committee as shown in the figure below. For more details, please refer to a brochure titled “Explanatory Material for the Quality Control Review Systems (Japanese only)” in chapters “II 3. Operation of the quality control review,” “IV 2. The Registration System for Audit Firms that Engage in Audits of Listed Companies” and “V 1. Organizational structure related to self-regulation of JICPA.”



### ① Quality Control Committee

The committee is mainly responsible for the deliberation and decision-making on quality control review results as well as the registration status of listed company audit firms.

### ② Center for Examination of Quality Control

The center is responsible for examining the progress and results of quality control reviews as well as the registration status of listed company audit firms.

**③ Quality Control Review Team**

The team is responsible for conducting quality control reviews and investigating whether the quality control system of audit firms is appropriate for a listed company audit firm.

**④ Listed Company Audit Firms Subcommittee**

The subcommittee is mainly responsible for gathering information related to listed companies and listed company audit firms, and also maintaining the Official Rosters.

**⑤ Review Board for Appropriate Procedures**

The board examines requests from members to review the registration status on the Official Rosters or measures undertaken for the registration.

**⑥ Self-Regulatory Monitoring Conference**

The conference provides opinions and advice on the operations based on a broader perspective encompassing capital markets and social impact.

### **(3) Quality Control System of Audit Firms**

Quality control reviews are conducted to assess whether or not audit firms have appropriately designed and operated a quality control system for the following matters.

- ① Audit firms as well as all partners and professional staff belonging to audit firms (collectively as “professional personnel”) comply with professional standards as well as applicable laws and regulations.
- ② Audit firms or engagement partners issue audit reports appropriately.

The quality control system of an audit firm mainly consists of the following policies and procedures. Audit firms are responsible for designing and operating these policies and procedures under their quality control system. Engagement partners are responsible for conducting audits in accordance with the quality control system of the audit firm.



## [Quality control system of audit firms]

### **Responsibility for quality control**

- Cultivate a culture under which quality of audit engagements 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 the audit firm (including resource management of professional personnel), and determine whether the audit firm has the ability to conduct an audit appropriately

### **Hiring, training and evaluating professional personnel**

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

### **Engagement performance**

- Build up information and techniques required for audits (e.g. audit manuals and guidance, audit practice tools)
- Instruct, supervise and review by engagement partners
- Prepare audit work papers 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 are maintained
- Conduct a thorough engagement quality control review

### **Monitoring the quality control system**

- Evaluate impacts of deficiencies identified through the process of ongoing monitoring and periodic inspections, and communicate and remediate the identified deficiencies

### **Documentation of the quality control system**

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

## (4) Types of Quality Control Reviews and Audit Firms Subject to the Review

Quality control reviews consist of regular reviews and special reviews.

The Quality Control Committee gathers the latest information relating to audit firms mainly through off-site monitoring. The committee selects audit firms subject to regular and special reviews based on the information and develops an annual quality control review plan, which is revised as needed through ongoing information gathering.

**[Type of quality control reviews]**

	Regular review	Special review
Purpose	To assess the design and operation of an audit firm’s quality control system	To assess the design and operation of an audit firm’s quality control system <b><u>in certain audit areas or certain audit engagements</u></b>
Frequency	In principle, the review is conducted every three years (every two years for large-sized audit firms <sup>(*1)</sup> ). Based on the judgment of the Quality Control Committee, the frequency may be shortened or extended (however, the review is conducted at least once in every five years)	When the Quality Control Committee deems it necessary, the review is conducted in a timely manner in order to mainly assess the following matters: - Quality control system of an audit firm - Status of audit engagements - Specific matters
Audit firms subject to review	Audit firms subject to regular reviews <sup>(*2)</sup>	All audit firms that provide audit engagements
Procedures	Site visit	Site visit, inquiry or in writing

(\*1) 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, namely Ernst & Young ShinNihon LLC, PricewaterhouseCoopers Aarata LLC, KPMG AZSA LLC, and Deloitte Touche Tohmatsu LLC.

(\*2) Audit firm subject to regular reviews is defined as an audit firm that audits Public Interest Entities defined under the CPA Act as well as large-sized Credit Associations (“Shinkin Banks”) and other financial institutions.

## [Audit firms subject to regular reviews]

(As of March 31, 2022)

	Audit Firms	CPAs <sup>(*1)</sup>	Total
Audit firms subject to regular reviews	152	64	216
Of the above, the listed company audit firms <sup>(*2)</sup>	131	11	142

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

(\*2) For detail, please refer to "4. Registration System for Audit Firms that Engage in Audits of Listed Companies."

## (5) Process of Quality Control Reviews

### ① Regular review

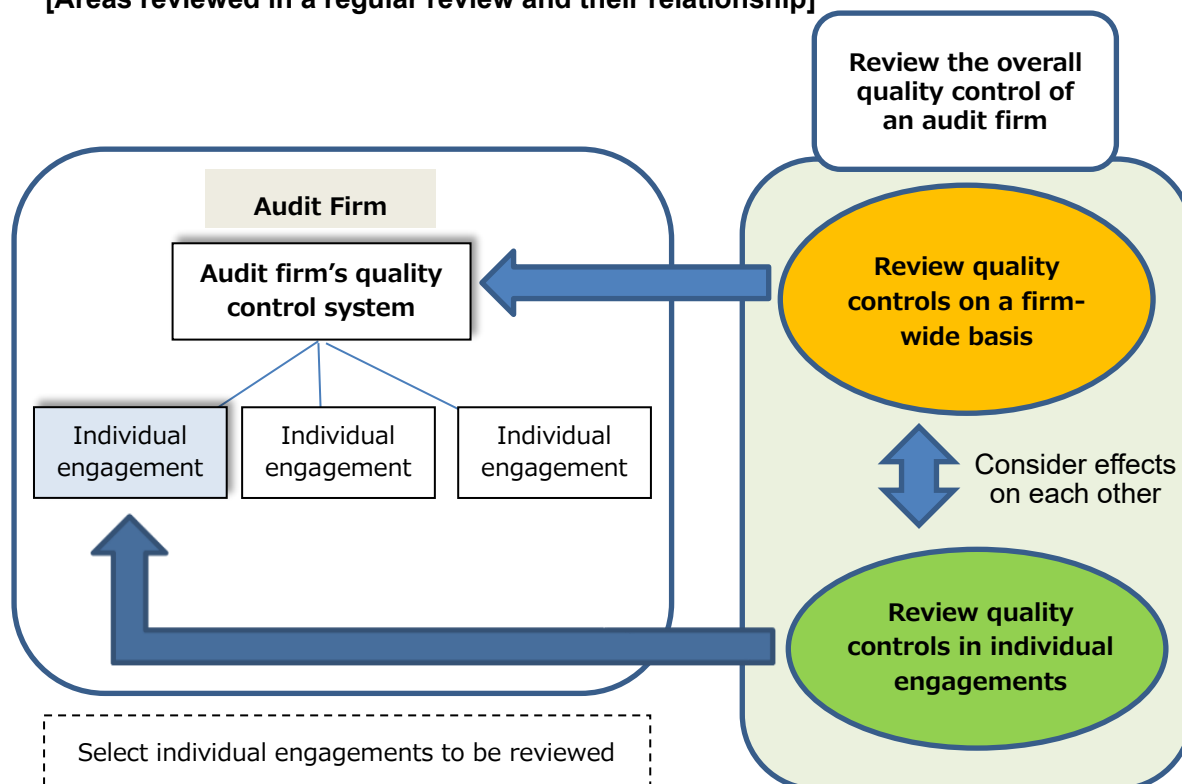
In order to assess the status of audit quality controls on a firm-wide basis, regular reviews are conducted mainly through the following procedures. As illustrated below, quality control on a firm-wide basis and quality control in audit engagements are interrelated.

- Review quality control on a firm-wide basis  
Review whether an audit firm designs and operates the system of audit quality control appropriately.
- Review quality control in audit engagements  
Review whether the quality control system of an audit firm is appropriately applied to individual audit engagements ("individual engagements").

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

Also, when significant findings or a large number of findings are identified in the review of individual engagements, the impact on the quality control system on a firm-wide basis is assessed.

**[Areas reviewed in a regular review and their relationship]**



**② Special review**

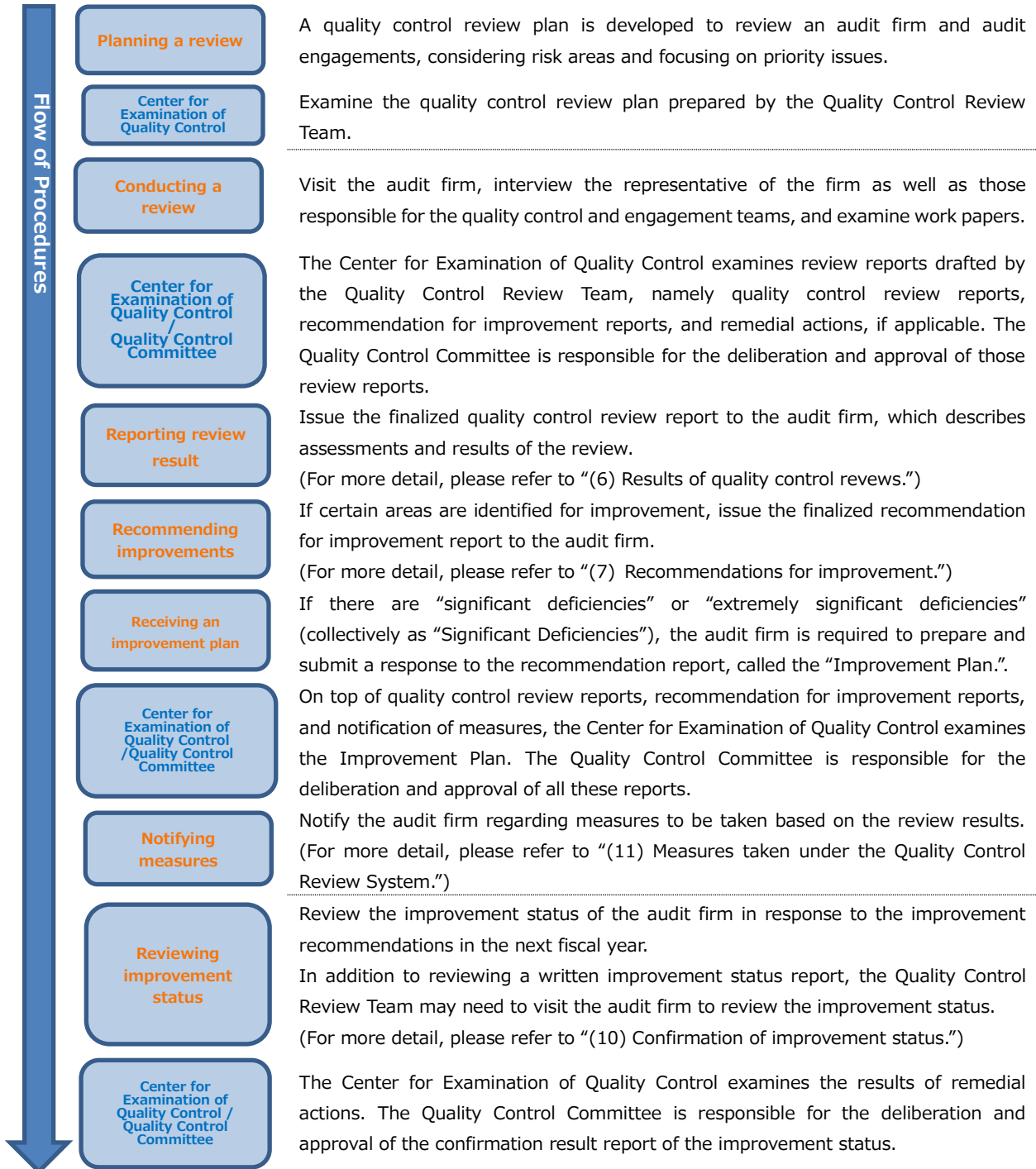
Audit firms subject to a special review are selected when an annual quality control review plan is developed. Also, whenever it is deemed necessary to conduct a special review immediately, audit firms are selected for such review even during the middle of the fiscal year.

A special review is conducted for selected firms after determining the scope based on the purpose of the special review, considering certain areas of concern or specific audit engagements.

[Detailed procedure for quality control reviews]

In principle, the procedure for quality control reviews is as follows:

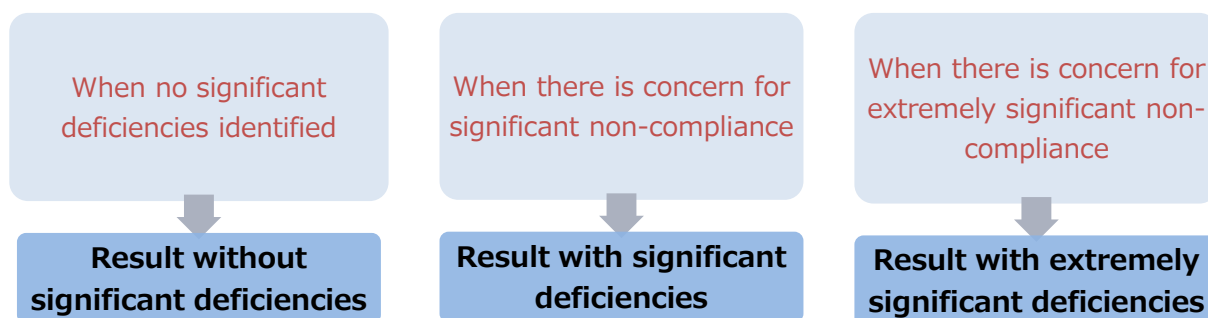
(Orange: Procedures performed by the Quality Control Review Team; Blue: Procedures performed by the Quality Control Committee or the Center for Examination of Quality Control)



## (6) Results of Quality Control Reviews

JICPA issues a quality control review report to audit firms, which contains a result of quality control review for the design and operation of a quality control system of the audit firm.

Results of quality control reviews are classified into the following three types based on whether or not Significant Deficiencies are identified for non-compliance with professional standards or applicable laws and regulations in the design and operation of a quality control system of audit firms.



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

Result with Significant Deficiencies is expressed under certain circumstances, including the following: when the design or operation of the quality control system is significantly inappropriate or insufficient; when there is concern that material misstatements may be overlooked in key accounting areas (e.g. accounting estimates, revenue recognition); and when an audit firm is not obtaining appropriate and sufficient evidence to reduce audit risks to an acceptable low level for those key areas.

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

**!** Detailed results of quality control reviews, including specific examples, are disclosed in the "Explanatory Material for the Quality Control Review Systems" (Japanese only) for reference purposes.

## **(7) Recommendations for Improvement**

Regardless of the result of a quality control review, if deficiencies are identified for non-compliance with professional standards or applicable laws and regulations (i.e. recommendations for improvement), a “Recommendation Report,” describing such recommendations for improvement, will be prepared and issued to an audit firm together with the quality control review report.

Also, in the event of result with Significant Deficiencies, the audit firm is required to prepare and submit a response to the recommendation report, called the “Improvement Plan.”

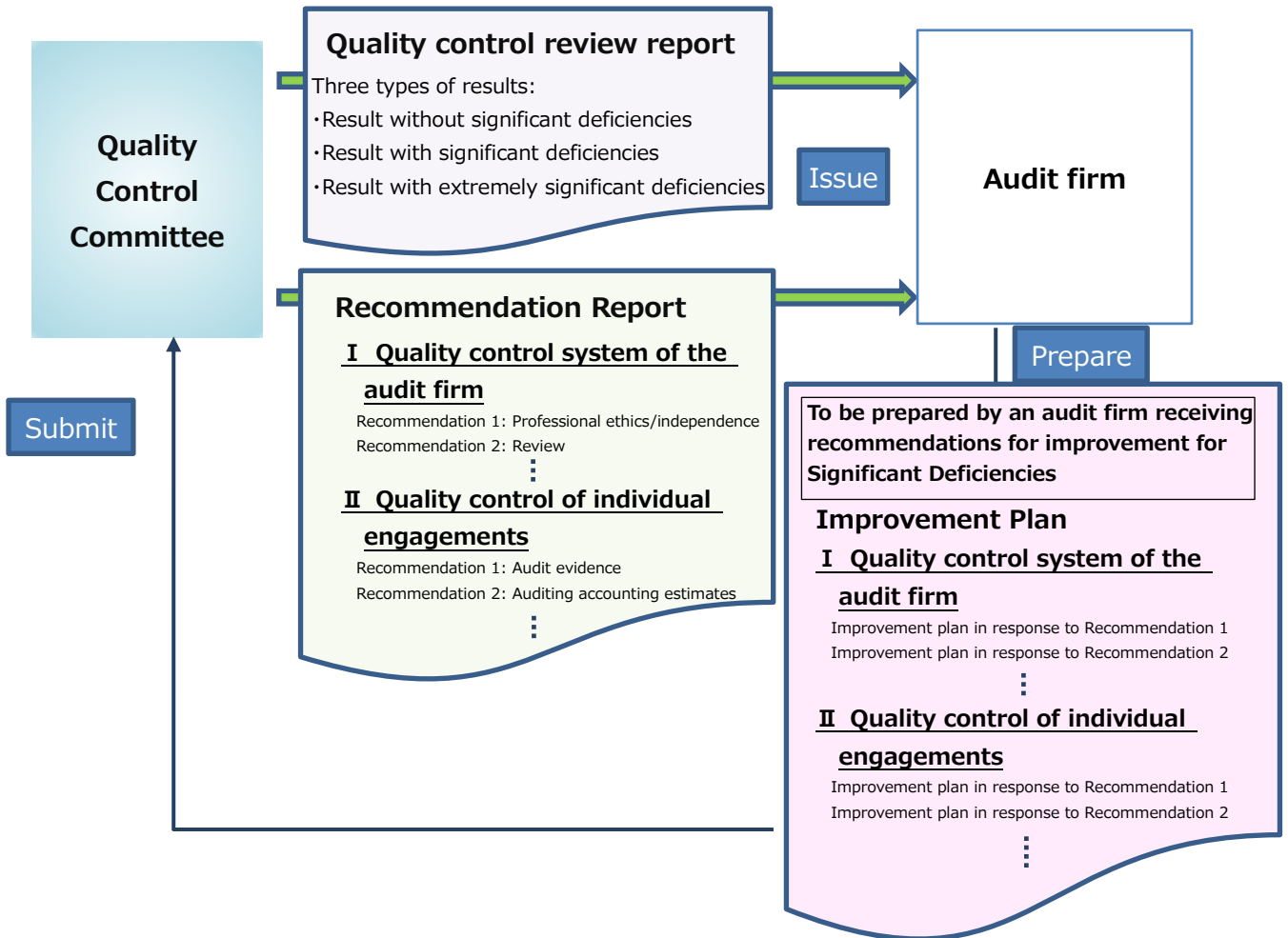
### **① Recommendation Report**

Recommendations for improvement are put into two sections under the recommendation report, namely recommendations for the quality control on a firm-wide basis and recommendations for the quality control in audit engagements.

### **② Improvement Plan**

Of the recommendations for improvement received, an audit firm shall prepare and submit to the Quality Control Committee an Improvement Plan describing remedial actions related to Significant Deficiencies. (Although the audit firm is not required to describe remedial actions for other deficiencies, it is necessary for the audit firm to voluntarily improve all items for which improvement recommendations were made.) The Quality Control Review Team will provide necessary instructions to the audit firm to encourage improvement regardless of whether or not the audit firm is required to prepare an Improvement Plan.

## [Recommendation Report and Improvement Plan]



## (8) Cause of Recommendations for Improvement (Root Cause Analysis)

In order to develop and implement more effective and appropriate remedial actions, it is essential for audit firms to identify the reason where deficiencies are coming from. Therefore, in the event of a result with Significant Deficiencies, audit firms shall describe causes that led to recommendations for improvement in their Improvement Plans.

In some cases, there could be root causes behind recommendations for improvement. Such root causes commonly found in several causes are generally related to poor audit culture and weak management of an audit firm. Therefore, when an audit firm receives result with Significant Deficiencies, it is required to describe in the Improvement plan both causes and root causes that led to recommendations for improvement after having a careful deliberation between the chief executive officer of the audit firm and the Quality Control Review Team.



## **(9) Practical Operation for Quality Control Reviews (the Objection System)**

The Quality Control Committee has a system in which an audit firm can file an objection with the Center for Examination of Quality Control when it has reasonable grounds to believe that their assertions related to Significant Deficiencies pointed out in the quality control review report (draft) are not sufficiently examined. When filing an objection, an audit firm is required to submit a written objection accompanied by supporting documents of the claim. In FY2021, one audit firm filed an objection.

## **(10) Confirmation of Improvement Status**

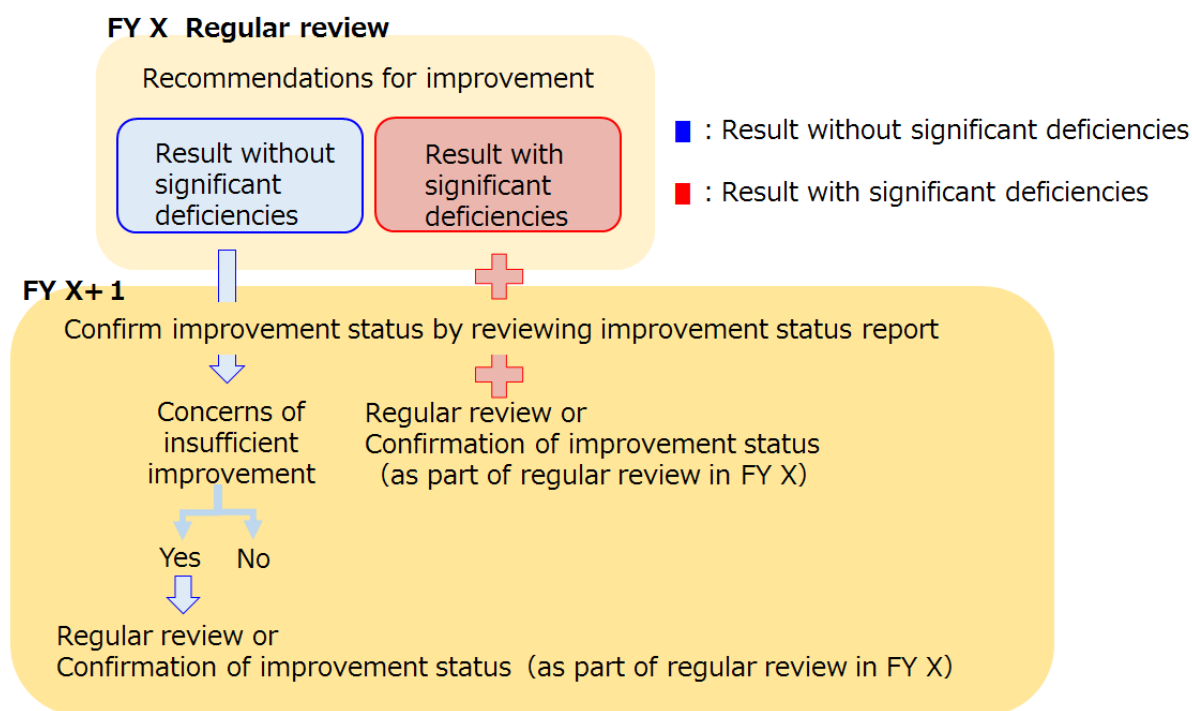
In the following fiscal year after a quality control review, all audit firms that received recommendations for improvement as a result of the quality control review are required to submit their improvement status report to the Quality Control Committee, which can review the report to check the status of implementation of each audit firm's remedial actions. After checking the status, the Quality Control Committee issues a confirmation result report of the improvement status describing the status of improvement to each audit firm.

- Audit firms with result with Significant Deficiencies

Once confirming the status of remedial actions through the improvement status report in the following fiscal year, such audit firms will be subject to another regular review or will be examined for the actual improvement.

- Audit firms with result without significant deficiencies

If improvements seem to be insufficient for an audit firm as a result of reviewing the improvement status report, such audit firm will be subject to regular review or will be examined for the actual improvement and remedial actions will be confirmed by visiting the firm.



\* Since special reviews are conducted when the Quality Control Committee determines it is necessary to confirm the quality control system of an audit firm in a timely manner, the improvement status will be confirmed in the following fiscal year, in principle, even if only deficiencies are identified without any Significant Deficiencies.

## (11) Measures Taken under the Quality Control Review System

Measures to be taken against audit firms are determined based on the result of quality control reviews to encourage audit firms with insufficient level of quality controls to voluntarily improve their quality control system and to continuously monitor their improvement status. In principle, the Quality Control Committee determines measures as presented in the following table based on the nature and frequency of findings identified in quality control reviews, including the confirmation of improvement status. In addition, when findings identified in previous quality control reviews are not improved, coming up as findings again, the committee considers whether stricter measures under the Quality Control Review System need to be imposed.

If an audit firm unreasonably refuses or does not cooperate with quality control reviews, the Quality Control Committee determines to recommend the audit firm to withdraw from audit engagements regardless of the frequency of quality control reviews.

Furthermore, when a recommendation to withdraw from audit engagements is issued

to a listed company audit firm, the registration on the Official Rosters may be canceled on top of the withdrawal measures (For more detail, please refer to “4. Registration System for Audit Firms that Engage in Audits of Listed Companies (3) Measures taken for the registration on the Official Rosters”).

**【Measures taken under the Quality Control Review System】**

Findings	Quality control review 1st time	Quality control review 2nd time	Quality control review 3rd and beyond
Extremely significant deficiencies	Recommendation to withdraw <sup>(*1)</sup>	Recommendation to withdraw <sup>(*2)</sup>	Recommendation to withdraw <sup>(*2)</sup>
Significant deficiencies	Severe warning <sup>(*1)</sup>	Recommendation to withdraw <sup>(*1)</sup>	Recommendation to withdraw <sup>(*2)</sup>
Deficiencies	None	Warning	Severe warning

(\*1) Mitigated measures can be taken based on individual circumstances, such as the size of the audit firm, history of audit engagements with listed companies, frequency of quality control reviews, and results of previous reviews.

(\*2) A recommendation to withdraw from audit engagements is the strictest measure among the measures under the Quality Control Review System. If an audit firm receives “Result with extremely significant deficiencies” twice or more in a row, the strictest measure will be applied to the firm. Likewise, if an audit firm receives “Result with significant deficiencies” three times or more in a row, the firm will be recommended to withdraw from audit engagements.

**(12) Collaboration with the System for Individual Case Review**

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

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

In principle, audit firms are not allowed to disclose quality control review reports, Recommendation Reports, Improvement Plans, and the confirmation result report of the improvement status (collectively as “Quality Control Review Reports”) to third parties. However, audit firms are allowed to disclose the outline of the latest quality control review results to third parties in their own reports, such as the “Audit Quality Report.”

### **(14) 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 (collectively as “Company’s Auditors”) of listed companies 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 as the outcomes.

That said, when auditing listed companies, audit firms are required to communicate to the Company’s Auditors in writing or in the form of electromagnetic records about quality control review results and associated measures taken in response to the results. Such information may include whether or not recommendations for improvement were issued for quality controls of individual engagements and also their issue areas as well as the general trend. However, audit firms are not allowed to disclose the Quality Control Review Reports. Audit firms should communicate such information on or after receiving the Quality Control Review Reports.

### **(15) Monitoring the Operation of the Quality Control Review System**

In order to ensure the objectivity and fairness of JICPA's self-regulatory activities and to contribute to social confidence in the CPA system, the operation of the Quality Control Committee is monitored by the Self-Regulatory Monitoring Conference, which mainly consists of academic experts who are not members of JICPA. The Self-Regulatory Monitoring Conference is dedicated to express opinions and provide advice from a broad perspective.

<https://jicpa.or.jp/about/activity/self-regulatory/quality/monitoring.html>

## 4. Registration System for Audit Firms that Engage in Audits of Listed Companies

### (1) Overview of the Registration System for Audit Firms that Engage in Audits of Listed Companies

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

Within the Quality Control Committee, the Listed Company Audit Firms Subcommittee is established, which is responsible for preparing the Official Rosters and the list of deregistered firms from the Official Rosters and publishing the information on JICPA's website.

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

\* Website only available in Japanese.

【Examples of the Official Rosters published on JICPA's website (Japanese only)】

Name	Organization	Representative	Address	Disclosed documents	Quality control review implementation status (*1)	Measures; Disciplinary sanctions; Administrative punishment; Recommendations (*2)	Other Information (*3)	Last updated date
<a href="#">IROHA Audit &amp; Co.</a>	Company	Kansa Taro	Tokyo Pref.	<a href="#">Pledge</a> <a href="#">Quality control system overview</a> <a href="#">Explanatory document</a>	FY2021 Regular: Dec.2021 Review: Mar.2019 Follow: Feb. 2017	<a href="#">Yes</a>		Jan. 10, 2022
<a href="#">ABC Audit &amp; Co.</a>	Company	Kaikei Hanako	Osaka Pref.	<a href="#">Pledge</a> <a href="#">Quality control system overview</a> <a href="#">Explanatory document</a>	FY2021 Confirmation: Jan. 2022 <a href="#">Special</a> : Oct. 2020 Review: Dec. 2018			Jan. 31, 2022

(\*1) The terms described in the "Quality control review implementation status" column are defined as follows:

Regular: Regular review (Regular reviews conducted under the system up to June 2020 were described as "Review")

Special: Special review (detail is posted on the linked site)

Confirmation: Confirmation of improvement status

Follow: "Follow-up review" under the system up to June 2020

2<sup>nd</sup> Follow: "Second follow-up review" under the system up to June 2020

(\*2) If "Yes" in the "Measures; Disciplinary sanctions; Administrative punishment; Recommendations" column, the detail is posted on the linked site.

(\*3) If "Yes" is displayed in the "Other information" column, the contents are posted to the link destination.

The Official Rosters contain information not only about the profile of listed company audit firms, but also the status of quality control reviews, summary of Significant Deficiencies, disciplinary sanctions and others. The type of the listed company audit firms and the list of deregistered firms are as follows:

**[Type of listed company audit firms]**

Type		Name of Roster	Application Conditions for Registration	Application Review Process
Registered firms		Official roster of registered firms	Associate registered audit firms that engage in audits of listed companies	Determine the appropriateness of registration based on the result of regular reviews
Associate registered audit firms	Audit firms before quality control reviews	Official roster of associate registered audit firms	Audit firms that have specific plans to engage in audits of listed companies	Determine the appropriateness of registration based on the result of on-site reviews conducted by the Quality Control Review Team
	Audit firms that passed quality control reviews		Audit firms that satisfy both of the following: <ul style="list-style-type: none"> <li>•Have an intention to enter into audit engagements with listed companies in the future</li> <li>•Already engaged in audits of companies that are recognized to be equivalent to listed companies</li> </ul>	Determine the appropriateness of registration based on the result of regular reviews

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

**[List of deregistered firms]**

Name of Roster	Audit firms which are to be put on the list of deregistered firms
List of deregistered firms from the Official Rosters	<ul style="list-style-type: none"> <li>• Audit firms that do not apply for registration on the official roster even though it signed an audit engagement with listed companies</li> <li>• Audit firms that received orders to withdraw from audit engagements based on the result of quality control reviews, and thus is determined to be removed from the official roster</li> <li>• Audit firms that are NOT allowed for registration as a result of an application review</li> <li>• Audit firms removed from the Official Rosters due to disciplinary sanctions, etc.</li> </ul>

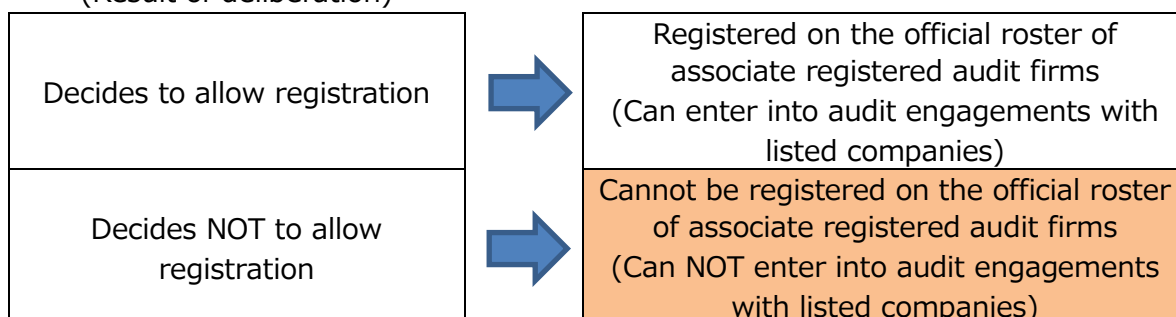
(Note) "Disciplinary sanctions, etc." represent administrative sanctions imposed by the Financial Services Agency as well as sanctions imposed by JICPA which are stipulated in its bylaws.

## (2) Application Review Process for the Registration on the Official Rosters

### ① Application review process for the registration on the official roster of associate registered audit firms

If an audit firm that has currently not entered into any audit engagements with listed companies plans to enter into a new one, the audit firm must apply for registration on the official roster of associate registered audit firms. When the audit firm has not gone through any quality control reviews, it must apply for registration every time it plans to engage with listed companies. The Center for Examination of Quality Control and the Quality Control Committee review and deliberate whether or not to register the audit firm based on the result of investigations or regular reviews conducted by the Quality Control Review Team.

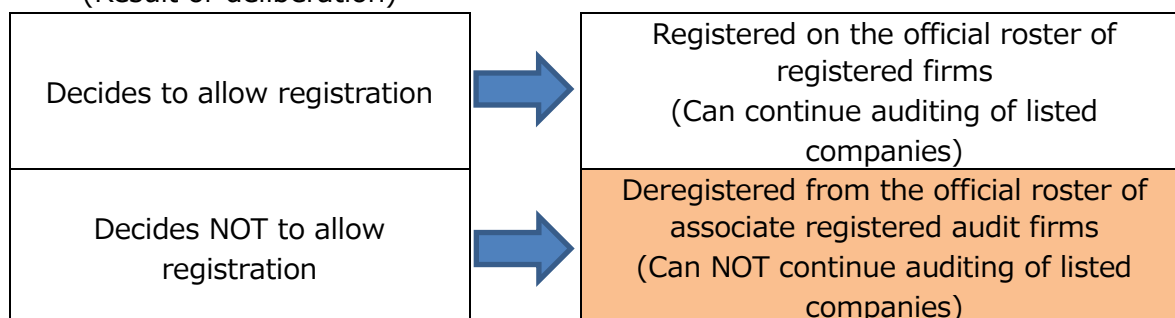
(Result of deliberation)



## ② Application review process for the registration on the official roster of registered firms

If an associate registered audit firm enters into audit engagements with listed companies, it must apply for registration on the official roster of registered firms. Based on the result of regular reviews, the Center for Examination of Quality Control and the Quality Control Committee review whether or not to register the firm.

(Result or deliberation)



## (3) Measures Taken against the Registration on the Official Rosters

When extremely significant deficiencies are identified for a registered firm as a result of quality control reviews and a recommendation for withdrawal is determined as a measure taken against the firm, a decision is made at the same time to remove the firm from the Official Rosters.

When Significant Deficiencies are identified as a result of quality control reviews, consideration is given whether or not a removal is required based on the impact and frequency of deficiencies identified.

Audit firms subject to removal are put on the list of deregistered firms and designated as auditors restricted from re-registration on the Official Rosters. Those designated auditors are no longer allowed to apply for registration on the Official Rosters, unless the designation is cancelled.

## (4) Disclosures on the Official Rosters

As part of JICPA's effort to disclose information to stakeholders in the capital market, when Significant Deficiencies are identified for a registered firm as a result of quality control reviews, the outline of deficiencies is disclosed in the Official Rosters. When registered firms are cancelled for registration, the outline of deficiencies is disclosed in the list of deregistered firms from the Official Rosters.

Also, when disciplinary sanctions are imposed on listed company audit firms by the Commissioner of the Financial Services Agency or JICPA, such fact may be disclosed



according to the nature of disciplinary sanctions.

**(5) Review Request System**

Audit firms can file an application to the Review Board for Appropriate Procedures for a review when procedures are inappropriate, facts are significantly misinterpreted, or new facts arise regarding the registration status on the Official Rosters or measures undertaken for registration.

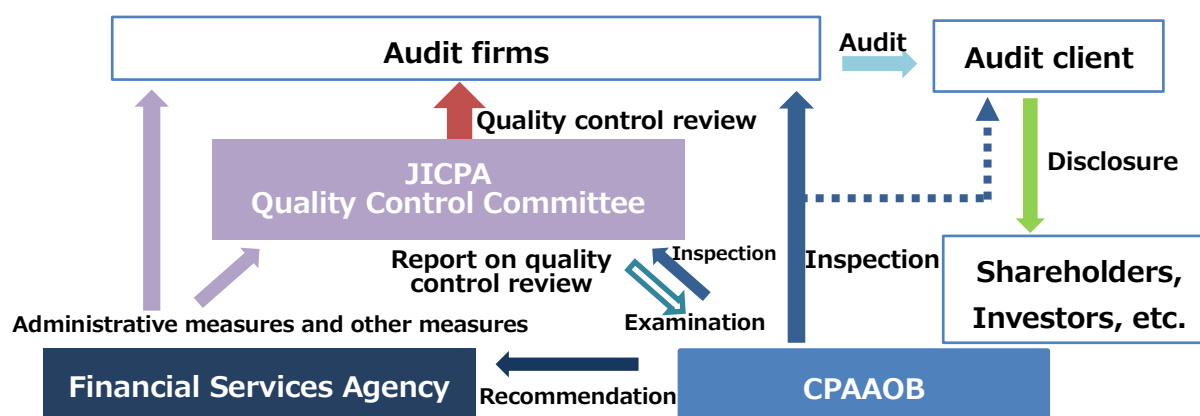
**!** To ensure that audit firms are capable enough and have an appropriate system to audit listed companies, application reviews are strictly conducted to assess the appropriateness of registration status on the Official Rosters and to determine necessary measures to be taken against registered firms (For status in FY2021, please refer to “Part 2 Implementation Status and Results, 3. Overview of the Official Rosters”).

## 5. Relationship with the CPAAOB

### (1) Monitoring by the CPAAOB

In accordance with the CPA Act, JICPA reports the status of quality control reviews on a monthly and annual basis to the CPAAOB, which is a consultative administrative body established in the Financial Services Agency.

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



### (2) Cooperation with the CPAAOB

In order to further enhance the effectiveness of the Quality Control Review System, JICPA regularly holds staff meetings with the CPAAOB. Through analyses of specific cases, issues and associated measures for quality control reviews are summarized so that JICPA can more effectively conduct quality control reviews in the following fiscal years.

In FY2021, both CPAAOB inspectors and JICPA reviewers looked into individual cases to analyze and identify issues, which were further subject to discussions and deliberations between the inspectors and reviewers. Since FY2020, quality control reviews have been conducted under a new system based on the quality control review policy called the "Developing/conducting review plans and providing instructions based on a thorough understanding of the operation management system of the audit firms," which is established through continuous case analyses with the CPAAOB. In FY2022, JICPA continues to adhere to the policy and associated measures to improve operations and enhance the effectiveness of quality control reviews. Individual improvements and issues identified through the analyses are communicated to reviewers through trainings and other means for the purpose of enhancing quality control reviews.

Also, through continuous discussions with the CPAAOB regarding the frequency of regular reviews conducted for large-sized audit firms and the improvement of instructions

and monitoring provided to small- and medium-sized audit firms, JICPA has concluded that regular reviews will be conducted every three years for large-sized audit firms, instead of every two years, from now on. In addition, JICPA exchanged views with the CPAAOB about paperwork submission and JICPA's information gathering practice to enhance work efficiency in the Quality Control Review System for the purpose of reducing administrative workload and improving efficiency of audit firms throughout the review process.

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

## 【Part 2 Implementation Status and Results】

# 1. Implementation Status and Results of Quality Control Reviews

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## (1) Quality Control Review Plan

### Focus area in FY2021

Reviewers were required to check the following focus areas in conducting regular reviews in FY2021, based on previous recommendations for improvement and recent trend in quality control reviews. Additional items for the FY2021 quality control review are highlighted in red.

- 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 and team members)
  - Wrap-up of audit files and management and retention of audit records

- Auditing individual engagements
  - Key Audit Matters
  - Auditing accounting estimates
  - Identifying, assessing and addressing the risk of material misstatements due to fraud
  - Procedures for group audits
  - Evaluation of internal control in financial statement audit and internal control audit
  - Audit procedures over other information included in entities' disclosures

### Major consideration points in developing regular review plans in FY2021

Major consideration points in developing quality control review plans based on the understanding of operation management system of audit firms are as follows:

- 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 for quality control reviews, focus on audit engagements for large-sized listed companies.
  - Determine the number of individual engagements subject to review based on the risk assessment of individual engagements as well as the evaluation result of monitoring effectiveness conducted by audit firms.

② Reinforce risk approach in conducting regular reviews

- Focus on audit areas with higher risk of material misstatements.
- Determine the number of reviewers in charge of individual engagements depending on the size or risk of the audit 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 remedial actions.
- Provide instruction to improve the quality of audits by requiring audit firms to document the root cause of recommendations for improvement when they prepare the Improvement Plan.

④ Enhance post-review instructions

- After the completion of on-site reviews, including regular reviews, visit audit firms and make calls as necessary to continuously provide instructions for developing effective improvement plans and implementing remedial actions appropriately based on an understanding of root causes that led to recommendations for improvement.

**COVID-19 pandemic impact on the FY2021 quality control review**

Following FY2020, quality control reviews in FY2021 were conducted under unusual circumstances due to the spread of COVID-19 pandemic. A series of announcements were made by JICPA regarding audit considerations related to COVID-19 and remote work-related issues. Under such circumstances, quality control reviews in FY2021 focused on whether sufficient and appropriate audit evidences could be obtained by auditors at a time when preventive measures were taken against the COVID-19 pandemic. Other measures were also implemented to conduct reviews amid the spread of pandemic, such as adjusting visit schedules and checking situations of audit firms in advance to avoid the “three Cs (Crowded places, Close contact settings and Closed spaces). Depending on the situation, JICPA conducted virtual reviews, used large conference rooms, and ensured fresh air thorough ventilation as needed.

## (2) Quality Control Reviews in FY2021

The following table shows the result of quality control reviews in FY2021:

	Number of audit firms reviewed		Number of audit firms receiving review reports		Number of carried-over audit firms	
Regular reviews	76	(56)	75 <sup>(Note4)</sup>	(57) <sup>(Note5)</sup>	2	(1)
Confirmation of improvement status	11 <sup>(Note6)</sup>	(13)	9	(13)	2	(-)
Total	87	(69)	84	(70)	4	(1)
Number of audit firms subject to regular review <sup>(Note7)</sup>	209	(206)				
Percentage of audit firms reviewed under regular review	36%	(27%)				
Percentage of audit firms reviewed	42%	(33%)				

(Note 1) FY2020 numbers are shown in parentheses.

(Note 2) The number of audit firms subject to special reviews is excluded from the above table.

(Note 3) The audit firms were subject to a regular review in FY2021; however, the deliberation and approval of quality control review reports were carried over to the next year (hereinafter referred as to the "carried-over audit firms").

(Note 4) The number includes one audit firm carried over from FY2020 and excludes two audit firms carried over to FY2022.

(Note 5) The number includes two audit firms carried over from FY2019 and excludes one audit firm carried over to FY2021.

(Note 6) Confirmation was cancelled for one audit firm due to refusal of a review, which is excluded from the table.

(Note 7) The number represents audit firms subject to regular review as of April 1, 2021 (the number in parentheses is as of April 1, 2020).

The number of audit firms that went through a regular review in FY2021 at an interval shorter than three years from the previous review as well as the number of audit firms whose interval is more than three years but whose regular review schedule is extended to FY2022 or after are presented below. The number of audit firms with an extended review interval increased in FY2020, the previous fiscal year, amid the spread of pandemic. Regular reviews were conducted in FY2021 for those firms, unless specific reasons were provided.

	FY2020	FY2021
Number of audit firms with shorter review interval	5	10
Number of audit firms with extended review interval	29	12

Breakdown of audit firms by size for those subject to regular reviews and those that went through regular reviews or confirmation of improvement status is as follows:

**[Breakdown of audit firms by size]**

		Number of audit firms subject to regular review	Number of audit firms that underwent:			
			Regular review		Confirmation of improvement status	
Listed company audit firms	Large-sized/ second-tier <sup>(Note2)</sup>	9 (9)	4 (3)	- (-)		
	Other	Over 10 companies	20 (17)	8 (5)	3 (5)	
		5~9 companies	26 (32)	9 (8)	3 (5)	
		2~4 companies	50 (40)	21 (8)	2 (2)	
		Less than 2 companies	32 (38)	10 (14)	1 (1)	
	Sub-total <sup>(Note3)</sup>	137 (136)	52 (38)	9 (13)		
Other audit firms <sup>(Note4)</sup>		72 (70)	24 (18)	2 (-)		
Total		209 (206)	76 (56)	11 <sup>(Note5)</sup> (13)		

(Note 1) Number of audit firms in FY2020 are shown in parentheses.

(Note 2) Large-sized audit firms: Ernst & Young ShinNihon LLC / PricewaterhouseCoopers Aarata LLC / KPMG AZSA LLC / Deloitte Touche Tohmatsu LLC  
 Second-tier audit firms: GYOSEI & CO. / BDO Sanyu & Co. / Grant Thornton Taiyo LLC / Crowe Toyo & Co. / PricewaterhouseCoopers Kyoto

(Note 3) Includes the number of audit firms deregistered from the official roster of registered firms in FY2021.

(Note 4) "Other audit firms" represent audit firms other than the listed company audit firms.

(Note 5) The number excludes one audit firm whose confirmation process was cancelled due to the refusal of a review.



### **(3) Initiatives for Improving the Effectiveness of Quality Control Reviews**

Quality control reviews have been conducted under the new system since July 2020 to improve transparency and effectiveness. Major initiatives in FY2021 are as follows:

#### **① Providing instruction and oversight in response to root causes**

The review team provides instructions to audit firms to improve the quality of audit, such as having a good communication with them in identifying the cause of recommendations for improvement and developing improvement plans. It is also important for the review team to encourage audit firms with result with Significant Deficiencies to enhance quality control of audits and to oversee the progress of improvement, which could be achieved by determining measures based on quality control review results. For registered firms, it is also necessary for the review team to reconsider their registration status in the Official Rosters.

When audit firms with result without significant deficiencies appear to have difficulties in voluntary improvement, the review team provides instructions for improvement, such as providing advice to describe the root cause at the beginning of the recommendation report.

#### **② Understanding the operation management system thoroughly**

The review team develops and executes review plans based on a thorough understanding of operation management system of audit firms on top of their quality control system and the business environment surrounding selected individual engagements.

If there are recommendations for improvement as a result of review procedures, the review team provides instructions to audit firms to appropriately identify causes of findings, including whether or not there are problems in their operation management system, so that audit firms can develop remedial actions to align with the root cause analysis.

When confirming the progress of remedial actions in the following year, the review team ensures that the implementation of remedial actions by audit firms is not merely a tentative treatment, but a fundamental solution for them, including a change in operation management system.

#### **③ Using a consultation system for subject matters**

Subject matter experts (e.g. ethics, accounting, IT) are assigned to the Center for Examination of Quality Control in the Quality Control Committee as members of specialized working groups, which are capable of providing technical insights as

necessary throughout the quality control review process. In FY2021, the consultation system was used in eight cases, compared to three in FY2020.

④ **Enhancing post-review instructions**

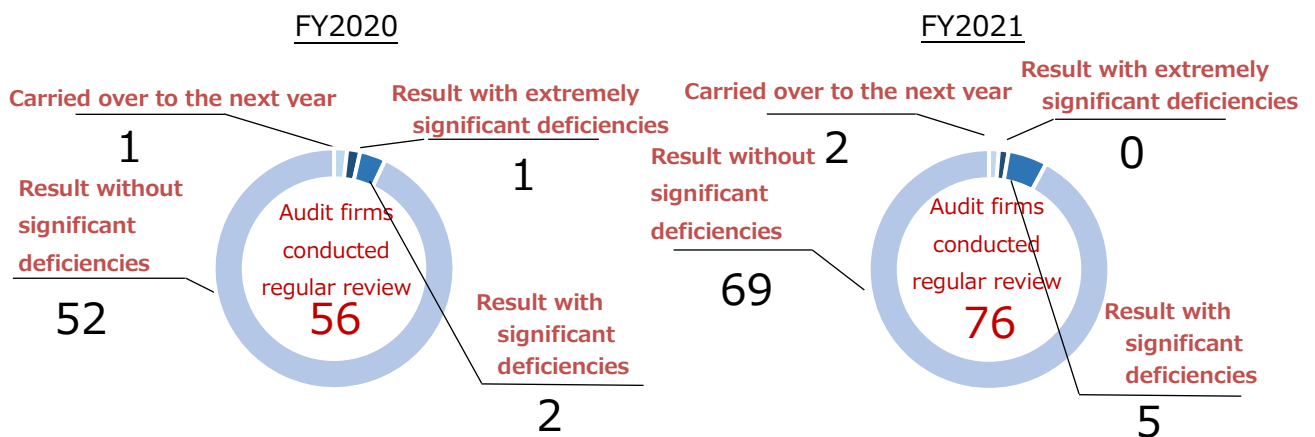
At the end of or after on-site reviews, the review team confirms whether improvement plans developed by audit firms are feasible and effective enough, considering issues identified through quality control reviews and underlying root causes, including operation management system of audit firms. Also, the review team instructs audit firms to review improvement plans as necessary. The approach and frequency of such post-review instructions are determined based on the importance of issues audit firms are facing and the capability of audit firms to improve issues on their own.

**(4) Results of Regular Reviews**

FY2021 results of quality control reviews and associated measures represent those deliberated and approved by the Quality Control Committee during the period from May 2021 to April 2022.

① **Results of regular reviews**

Regular reviews were conducted for 76 audit firms in FY2021, which resulted in “Result without significant deficiencies” of 69 audit firms, and “Result with significant deficiencies” of five audit firms. “Result with extremely significant deficiencies” was nil. Two audit firms were carried over to the next year and no audit firm received “Disclaimer of conclusion.”



As the number of audit firms that underwent regular reviews increased from FY2020, the number of audit firms with result with Significant Deficiencies also increased from three in FY2020 to five in FY2021. One of the three audit firms with

result with Significant Deficiencies in FY2020 was originally subject to improvement status confirmation in FY2021 but rejected a review. The other two audit firms were excluded from audit firms subject to regular reviews due to a change in auditors.

There was one audit firm that underwent regular review in FY2020, whose quality control review report issuance was carried over to FY2021 ending up with a result of extremely significant deficiencies. The audit firm underwent another regular review in FY2021, whose quality control review report issuance will be carried over to the next fiscal year.

The five firms identified for their Significant Deficiencies seem to have the following common root causes: little appreciation on culture that emphasizes the importance of audit quality; chief executive officer's lack of understanding relating to the necessity of organizing the firm to conduct systemic audits; and the firm being unable to conduct systemic audits due to resignations and time constraint. These root causes typically result in deficiencies in the quality control system of an audit firm, such as engagement partners failing to give proper instructions and supervision, insufficient review of working papers, and poor engagement quality control reviews and periodical inspections.

As a result of the above, all of the five firms also end up receiving a number of recommendations for improvement in focus areas for individual engagements, including auditing accounting estimates and identifying, assessing and testing fraud risks and other risks of material misstatements.

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

**[Breakdown by size of audit firms]**

(Unit: Number of audit firms)

		Breakdown of review report type					
		Result without significant deficiencies	Result with significant deficiencies	Result with extremely significant deficiencies	Carried-over audit firms	Total	
Listed company audit firms	Large-sized/second-tier	4 (3)	- (-)	- (-)	- (-)	4 (3)	
	Other than large-sized/second tier	Over 10 companies	8 (5)	- (-)	- (-)	- (-)	8 (5)
		5~9 companies	9 (8)	- (-)	- (-)	- (-)	9 (8)
		2~4 companies	16 <sup>(Note3)</sup> (9)	4 <sup>(Note3)</sup> (1)	- (-)	1 (-)	21 (10)
		Less than 2 companies	10 (14)	- (-)	- (-)	- (-)	10 (14)
	Sub-total		47 (39)	4 (1)	- (-)	1 (-)	52 (40)
Other audit firms		22 (14)	1 (2)	<sup>(Note4)</sup> 1 (1)	1 (1)	25 (18)	
Total		69 (53)	5 (3)	1 (1)	2 (1)	77 (58)	

(Note 1) FY2020 numbers are shown in parentheses.

(Note 2) Audit firms other than large-sized audit firms and second-tier audit firms are categorized by the number of listed companies they audit.

(Note 3) The two audit firms that underwent regular review in FY2019 and were carried over to FY2020 are included.

(Note 4) The audit firm that underwent regular review in FY2020 and was carried over to FY2021 is included.

**!** "Result with Significant Deficiencies" is expressed when it is concluded based on regular reviews that there is a concern for significant non-compliance with professional standards or applicable laws and regulations in the design and operation of a quality control system of audit firms. It does not automatically mean there is a significant compliance violation in auditing engagements or a doubt in the reasonableness of audit opinions. For examples of significant deficiencies, please refer to Section I and II of "Explanation of Quality Control Review Cases in FY2021" (Japanese only).

② **Focus areas and review results**

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

a. Design and operation of the quality control system of audit firms

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

(Unit: Number of audit firms)

Focus areas	FY2019	FY2020	FY2021
1. Culture that emphasizes the quality of audit engagement	3	2	3
2. Governance and management of audit firms	3	2	1
3. Hiring, education/training, evaluation and assignment of professional personnel	1	4	5
4. Professional ethics and independence (Rotation of engagement partners and team members)	3	-	1
5. Addressing Key Audit Matters	_(Note 2)	-	-
6. Wrap-up of audit files and management and retention of audit records	_(Note 2)	4	11

(Note 1) Some audit firms received multiple recommendations for improvement.

(Note 2) Not applicable as these items were not identified as focus areas in FY2019.

In FY2021, six audit firms identified for their Significant Deficiencies (including one carried-over audit firm from FY2020) received recommendations for improvement on “1. Culture that emphasizes the quality of audit engagement” and “2. Governance and management of audit firms.” These recommendations were mainly due to the following: lack of awareness among representatives of the audit firms about the necessity of conducting systemic audits; and resignation of many partners, leading to a weak operation management system and a lack of the firm’s capability in addressing fraud risks.

Also, recommendations for improvement related to “3. Hiring, education/training, evaluation and assignment of professional personnel” include comments about inconsistent evaluation standards for professional personnel with inadequate evaluation process in place.

The number of recommendations for improvement related to “6. Wrap-up of audit files and management and retention of audit records” increased in FY2021, many of which were about inappropriate archiving practice within audit firms. For example, it was unclear whether an audit firm completed archiving within a designated time frame in accordance with its archiving policy simply because the actual date of the completion of archiving was never recorded.

b. Individual engagements

The following items were identified as focus areas in FY2021 for individual engagements. The number of audit firms that received recommendations for improvement by each focus area is presented below.

(Unit: Number of audit firms)

Focus areas	FY2019	FY2020	FY2021
1. Key Audit Matters	_(Note2)	_(Note2)	-
2. Auditing accounting estimates	32	17	47
3. Identifying, assessing and addressing the risk of material misstatements due to fraud	3	2	5
•Professional skepticism	19	16	32
•Revenue recognition	46	15	27
•Risk of management’s override of internal controls			
4. Procedures for group audits	3	2	-
5. Evaluation of internal control in financial statement audit and internal control audit	_(Note2)	3	2
6. Audit procedures over other information included in entities’ annual report	_(Note2)	1	-

(Note 1) Some audit firms received multiple recommendations for improvement.

(Note 2) Not applicable as these items were not identified as focus areas prior to FY2021.

The number of audit firms that underwent regular reviews increased by 20 audit firms, from 56 audit firms in FY2020 to 76 audit firms in FY2021. The number of audit firms that received recommendations for improvement related to focus areas increased as well. Many of the recommendations for improvement were related to the following areas as they were in FY2020.

Regarding “2. Auditing accounting estimates,” recommendations were mainly related to impairment accounting of fixed assets, including goodwill, as well as

accounting estimates, including valuation of loans receivable, valuation of inventories, and allowance for doubtful accounts. For example, comments included lack of capability to critically assess assumptions used by management and insufficient consideration given on the methods used by management in developing accounting estimates and their underlying data.

In "3. Identifying, assessing, and addressing the risk of material misstatement due to fraud," many of the recommendations were related to "Revenue recognition." Particularly, comments were given on insufficient audit procedures to address fraud risks, failure to conduct audit procedures designed to test fraud risks, and lack of audit evidence with stronger corroboration. Also, recommendations related to "Risk of management's override of internal controls," which saw a declining trend in FY2020, increased in FY2021. Many were related to journal entry testing, such as inadequate assessment of fraud risk scenarios and failure to perform detail testing on extracted journal entries.

The Quality Control Review Team provides instructions to audit firms to improve these recommendations and follow up on remedial actions taken by the firms.

## (5) Results of Special Reviews

In FY2021, a special review was conducted for one audit firm, which signed an agreement to audit restated financial statements included in amended annual securities reports and issued an audit opinion in a short time frame. Original financial statements for the same period were audited by a predecessor auditor.

The purpose of the special review was to confirm whether quality control of the audit firm (such as procedures of engagement acceptance, resource management of professional personnel, and engagement performance) were properly operated.

Results of the special reviews, including the number of audit firms, are as follows:

	FY2020		FY2021
Themes	Merger of audit firms	Auditor change	Audit of amended annual securities report for previous years
Number of audit firms	1	6	1
Result	Result without significant deficiencies	Result without significant deficiencies	Result without significant deficiencies

## (6) Confirmation of Improvement Status

### ① Confirmation of improvement status

The following represents a breakdown of 11 audit firms by the size of audit firms whose improvement status was confirmed.

In addition to the table below, there was one audit firm that rejected a quality control review in FY2021 and therefore was unable to confirm its improvement status.

(Unit : Number of audit firms)

		Confirmation results								
		Result without insufficient improvement		Result with insufficient improvement		Carried-over audit firms		Total		
Listed Company Audit Firms	Large-sized/second-tier	-	(-)	-	(-)	-	(-)	-	(-)	
	Other	Over 10 companies	2	(4)	1	(1)	-	(-)	3	(5)
		5~9 companies	3	(4)	-	(1)	-	(-)	3	(5)
		2~4 companies	1	(1)	1	(1)	-	(-)	2	(2)
		Less than 2 companies	-	(1)	1	(-)	-	(-)	1	(1)
Sub-total		6	(10)	3	(3)	-	(-)	9	(13)	
Other audit firms		-	(-)	-	(-)	2	(-)	2	(-)	
Total		6	(10)	3	(3)	2	(-)	11	(13)	

(Note 1) FY2020 numbers are shown in parentheses.

Like in FY2020, there were three audit firms with "Result with insufficient improvement" in FY2021. Of the three audit firms with "Result with insufficient improvement" in FY2020, one was subject to a regular review in FY2021 with a shorter review interval while another firm was confirmed for its improvement status for two consecutive years. The remaining one audit firm was dissolved in FY2020.

### ② Confirmation of remedial actions in writing

Improvement status reports submitted by audit firms are reviewed as follows. The audit firm with insufficient improvement in FY2021 underwent confirmation of improvement status in the same fiscal year and was carried over to FY2022.



(Unit : Number of audit firms)

		FY2020	FY2021
Number of audit firms that are subject to the review of improvement status reports		60	46 <sup>(Note1)</sup>
Number of audit firms with concerns of insufficient improvement	With concern	1 <sup>(Note2)</sup>	1
	No concern	59	44

(Note 1) Includes one audit firm that could not be confirmed for its status of whether or not remedial actions were appropriately implemented based on a review of its improvement status report. Thus, no conclusion could be made in FY2021 whether it had concerns of insufficient improvement. The audit firm is subject to a regular review in FY2022.

(Note 2) As a result of reviewing a improvement status report submitted by the audit firm in FY2020, the audit firm still had concerns of insufficient improvement. Therefore, the audit firm was subject to a regular review in FY2021 with a shorter review interval and ended up with result without significant deficiencies.

## (7) Measures taken as a Result of Quality Control Reviews

### ① Determination of measures

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

(Unit: Number of audit firms)

Result of quality control reviews and related measures				
Result of quality control reviews	Measures <sup>(Note2)</sup>	FY2019	FY2020	FY2021
Results with extremely significant deficiencies	Recommendation to withdraw from audit engagements	-	-	1
	Recommendation to withdraw from audit engagements (Insufficient improvement)	1	1	-
	Severe warning	2	-	-
	Sub-Total	3	1	1
Results with significant deficiencies	Recommendation to withdraw from audit engagements	-	-	-
	Recommendation to withdraw from audit engagements (Insufficient improvement)	-	1	-
	Severe warning	-	-	3
	Severe warning (Insufficient improvement)	-	1	1
	Warning	3	1	1
	Sub-Total	3	3	5
Results without significant deficiencies with recommendation for improvement	Warning (Insufficient improvement)	1	1	3
Total		7	5	9

(Note 1) More than one measure could be taken against an audit firm as a result of quality control reviews. With that in mind, audit firms are classified in the above table based on the most severe 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.

(Note 2) "Recommendation to withdraw from audit engagements (Insufficient improvement)," "Severe warning (Insufficient improvement)," and "Warning (Insufficient improvement)" in the "Measures" column were determined based on the confirmation of improvement status as a result of insufficient improvement in their remedial actions.

(Note 3) There was one audit firm in FY2019, two in FY2020, and one in FY2021, which were carried over from previous years and whose measures were determined in FY2019, FY2020 and FY2021, respectively. The result of quality control reviews and measures taken against those audit firms

were “Qualified conclusion with warning” in FY2019, and “Unqualified conclusion with warning (Insufficient improvement)” and “Qualified conclusion with warning” in FY2020 and “Results with extremely significant deficiencies and Recommendation to withdraw from audit engagements” in FY2021.

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

(Unit: Number of audit firms)

<b>Result of quality control reviews and related measures</b>				
<b>Result of quality control reviews</b>	<b>Measures</b>	<b>FY2019</b>	<b>FY2020</b>	<b>FY2021</b>
Refusal of review	Recommendation to withdraw from audit engagements	-	-	1 <sup>(Note 2)</sup>
Confirmation results with insufficient improvement	Recommendation to withdraw from audit engagements (Insufficient improvement)	-	1	-
	Warning (Insufficient improvement)	4	2	3
Total		4	3	4

(Note 1) More than one measure could be taken against an audit firm as a result of quality control reviews. With that in mind, audit firms are classified in the above table based on the most severe 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.

(Note 2) Review was refused and the confirmation of improvement status was canceled accordingly.

## ② Reporting to the Chairman of the Audit Practice Review and Investigatory Committee

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

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

(Unit: Number of audit firms)

	<b>FY2019</b>	<b>FY2020</b>	<b>FY2021</b>
Refusal of review	-	-	1 <sup>(Note1)</sup>
Results with extremely significant deficiencies	3 <sup>(Note2)</sup>	-	1
Results with significant deficiencies	-	1	-

(Note1 ) One audit firm refused a review and thus the confirmation of improvement status was canceled accordingly, which was reported to the Chairman of the Audit Practice Review and Investigatory Committee.

(Note 2) FY2019 column represents the number of audit firms reported to the Chairman when “Negative conclusion” or “Qualified conclusion with concerns of extremely significant non-compliance” were expressed in FY2019 or before.

## 2. Recommendations for Improvement Related to Regular Reviews in FY2021

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

### **[Breakdown of recommendations for improvement]**

Fiscal year	Number of recommendations for improvement			Total	Number of audit firms that received quality control review report	Individual engagements selected for quality control review
	Quality control system of the audit firm	Quality control of individual engagements			Of which, number of audit firms with recommendations for improvement	
FY2020	39	299	338	57	56	148
FY2021	69	453	522	75	73	182

(Note) Two carried-over audit firms from FY2019 are included in the FY2020 column, both of which received recommendations for improvement. The number of those related to "Quality control system of the audit firm" and "Quality control of individual engagements" were one and 14, respectively. Three individual engagements were selected for quality control review. Likewise, one carried-over audit firm from FY2020 is included in the FY2021 column, which received recommendations for improvement. The number of those related to "Quality control system of the audit firm" and "Quality control of individual engagements" were eight and 42, respectively. One individual engagement was selected for quality control review.

### **(1) Recommendations for Improvement Related to "Quality Control System of the Audit Firm"**

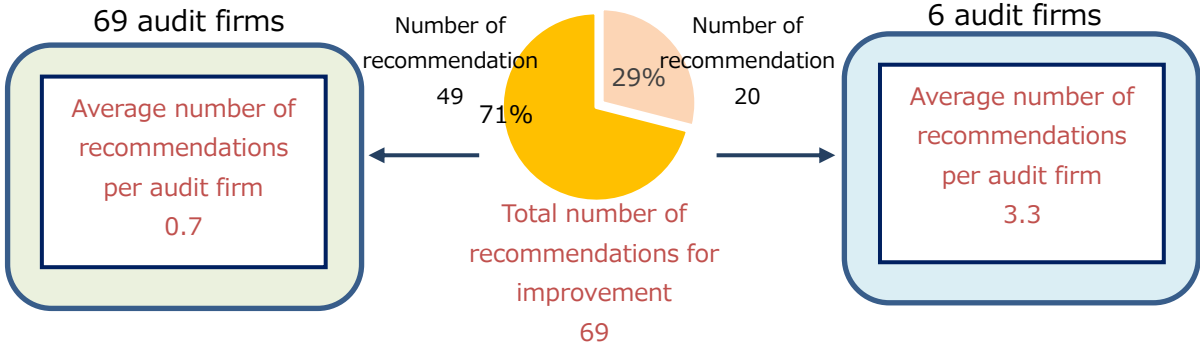
The following table shows the number of recommendations for improvement related to "Quality control system of the audit firm."

**【Number of recommendations for improvement related to “Quality control system of the audit firm”】**

Result of reviews	Number of recommendations for improvement		Number of audit firms that received quality control review report		
	(A)	Average per audit firm (A/B)	(B)	Of which, number of audit firms with recommendations for improvement	
Result without significant deficiencies	49(25)	0.7(0.5)	69(53)	23(21)	33%(40%)
Result with Significant Deficiencies	20(14) <sup>(Note 2)</sup>	3.3(3.5)	6(4)	6(4)	100%(100%)
<b>Total</b>	<b>69(39)</b>	<b>0.9(0.7)</b>	<b>75(57)</b>	<b>29(25)</b>	<b>39%(44%)</b>

(Note 1) FY2020 figures are in parentheses.  
 (Note 2) Out of the total recommendations, 14 (7) led to Significant Deficiencies.  
 (Note 3) Two carried-over audit firms from FY2019 are included in the FY2020 column. One audit firm received Qualified conclusion with one recommendation for improvement, and the other audit firm received Unqualified conclusion without any recommendations. Likewise, one carried-over audit firm from FY2020 is included in the FY2021 column, which received results with Significant Deficiencies with eight recommendations for improvement.

**【Audit firms that received quality control review report in FY2021】 75 audit firms**  
**【Result without significant deficiencies】**                      **【Result with Significant Deficiencies】**



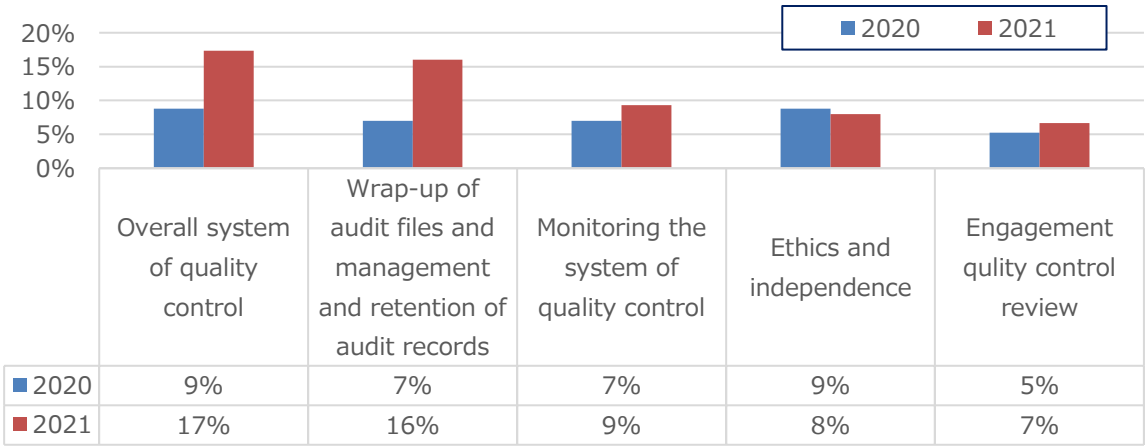
! Recommendations for improvement represent matters with a certain degree of concern for significant non-compliance against professional standards as well as applicable laws and regulations. They are recommendations described in the recommendation for improvement reports, representing matters requiring improvement for the purpose of enhancing audit quality control.

! Since the number of audit firms that underwent regular reviews varies from year to year, the number of recommendations for improvement cannot simply be compared year-on-year. Still, they should be able to provide some useful information about the trend in recommendations made. Hence, recommendations for information are broken down into “Quality control system of the audit firm” and “Quality control of individual engagements.”

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

Among the recommendations related to quality control system of the audit firm, the occurrence rate of “Overall system of quality control,” “Wrap-up of audit files and management and retention of audit records,” “Monitoring the system of quality control” and “Engagement quality control review” increased in FY2021 compared to FY2020.

**[Occurrence rate of recommendations for improvement (Quality control system of the audit firm)]**



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

❗ For more details on recommendations for improvement, please refer to “Explanation of Quality Control Review Cases in FY2021” (Japanese only).

**(2) Recommendations for Improvement Related to “Quality Control of Individual Engagements”**

The following table shows the number of recommendations for improvement related to “Quality control of individual engagements.”

**【Number of recommendations for improvement related to “Quality control of individual engagements”】**

Result of reviews	Number of recommendations for improvement (A)		Number of audit firms that received quality control review report	Individual engagements selected for quality control review (B)		
		Average per audit engagement (A/B)			Of which, number of engagements provided with recommendations for improvement	
Result without significant deficiencies	352(268)	2.1(1.9)	69(53)	170(143)	118(93)	69%(65%)
Result with Significant Deficiencies	101(31) <sup>(Note2)</sup>	8.4(6.2)	6( 4)	12(5)	12(5)	100%(100%)
Total	453(299)	2.5(2.0)	75(57)	182(148)	130(98)	71%(66%)

(Note 1) FY2020 figures are in parentheses.

(Note 2) Out of the total recommendations, 14 (7) led to Significant Deficiencies.

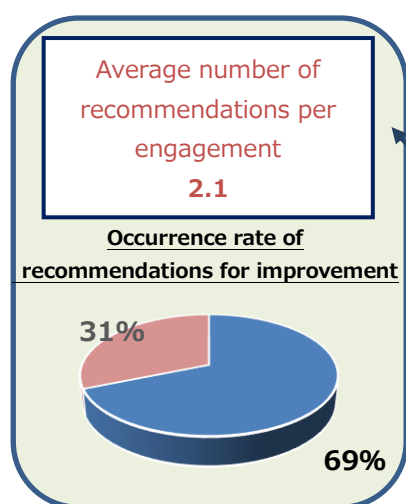
(Note 3) Two carried-over audit firms from FY2019 are included in the FY2020 column. One audit firm received Unqualified conclusion with one recommendation for improvement, and the other audit firm received Qualified conclusion with 13 recommendations for two selected engagements. Likewise, one carried-over audit firm from FY2020 is included in the FY2021 column, which received results with Significant Deficiencies with 42 recommendations for improvement for one selected engagement.

**【Audit firms that received quality control review report in FY2021】**

75 audit firms (182 engagements)

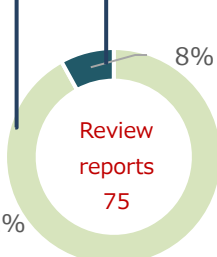
**【Result without significant deficiencies】**

69 audit firms 170 engagements



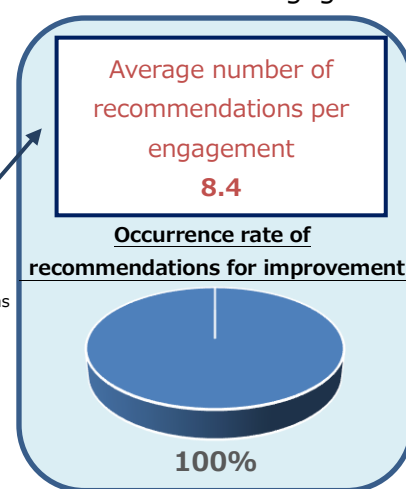
**Result of review**

←

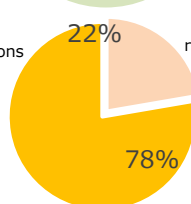


**【Result with Significant Deficiencies】**

6 audit firms 12 engagements



Number of recommendations: 352



Number of recommendations: 101

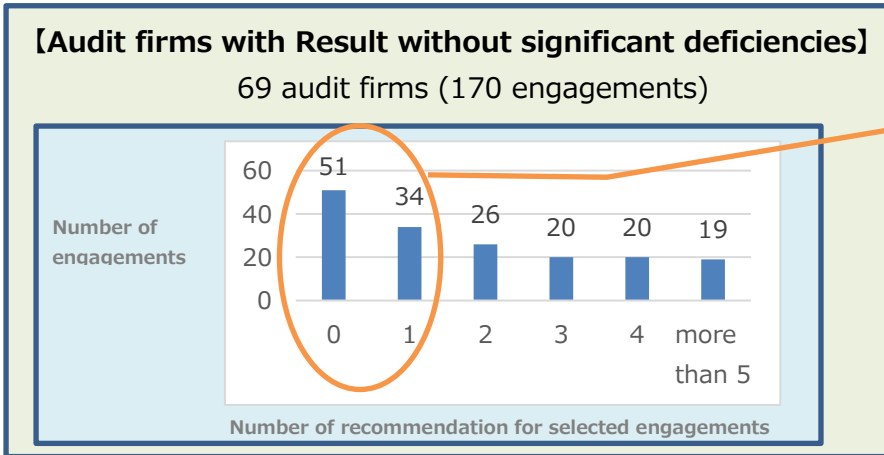
Total number of recommendations for audit engagements: **453**



**Recommendations for improvement for audit firms with “Result without significant deficiencies”**

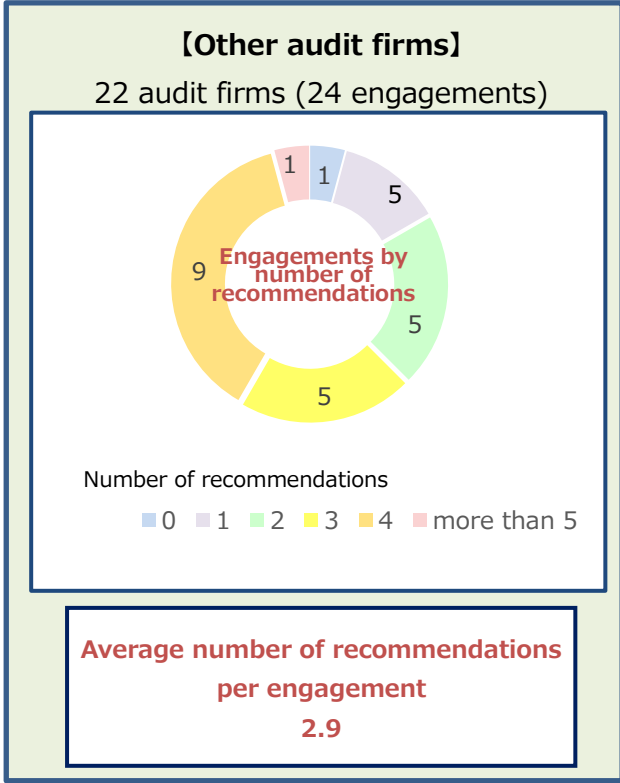
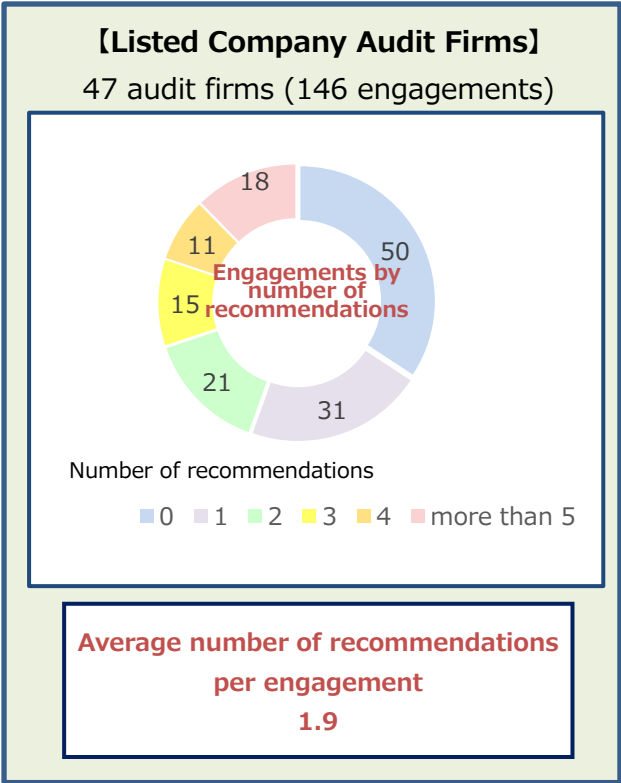
Regarding audit firms with “Result without significant deficiencies,” the number of recommendations for selected individual engagements is represented as follows:

**[Number of recommendations for improvement for selected engagements]**



(Information) This indicates that there were 51 engagements with no recommendation and 34 engagements with only one recommendation.

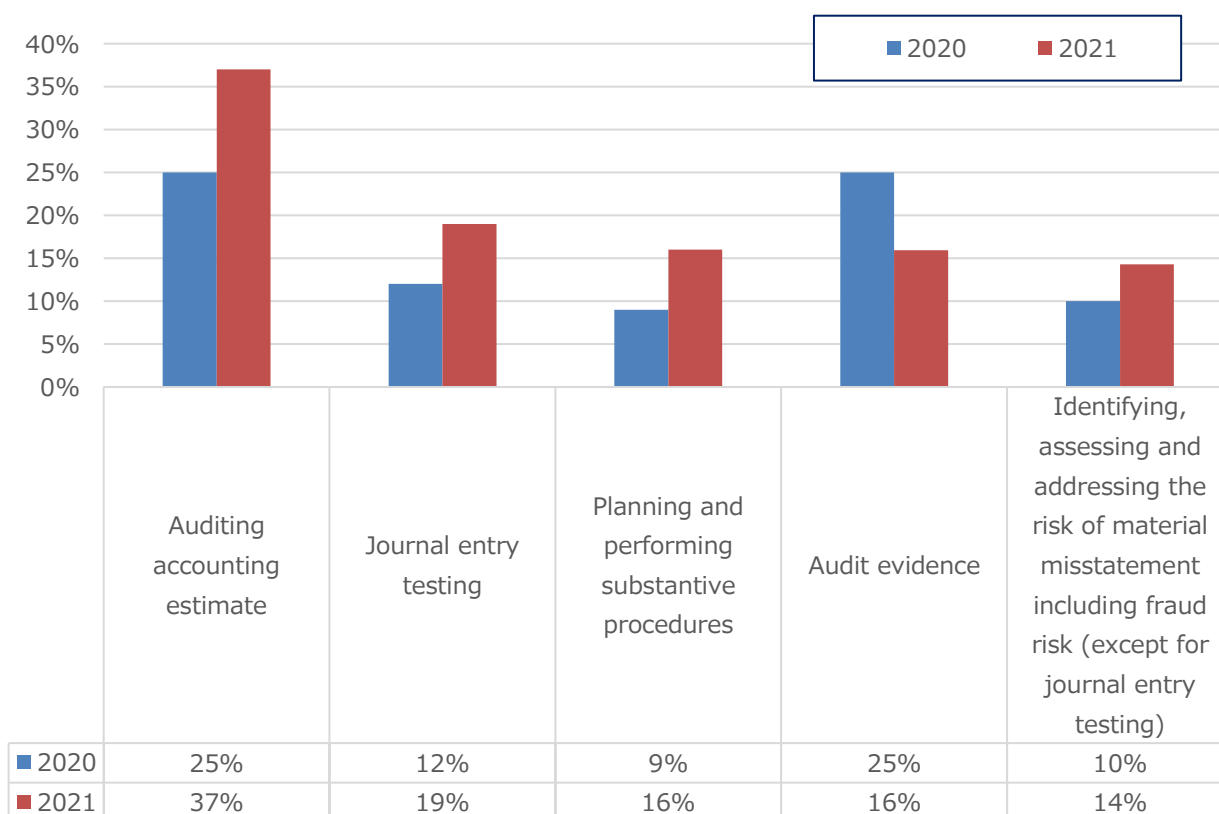
**Classification by registration status**



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

Among the recommendations related to quality control of individual engagements, “Auditing accounting estimates,” “Journal entry testing,” “Planning and performing substantive procedures,” “Identifying, assessing and addressing the risk of material misstatement, including fraud risk (except for journal entry testing)” increased in FY2021 compared to FY2020.

**[Occurrence rate of recommendations for improvement (Quality control of individual engagements)]**



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

### 3. Overview of the Official Rosters

#### (1) Registration on the Official Rosters

For the fiscal year from April 1, 2021, to March 31, 2022, seven audit firms were newly registered through application reviews and five audit firms were deregistered due to termination of audit engagements with listed companies or for other reasons. Also, there were no audit firms that were put on the list of deregistered firms during the relevant period. As a result, there were 142 listed company audit firms as of March 31, 2022.

**[Breakdown of the listed company audit firms]**

(As of March 31, 2022)

	Audit Firm	CPAs (*)	Total
Registered firms	118	8	126
Associate registered audit firms	13	3	16
Total	131	11	142

(\*) Joint Offices are subject to quality control reviews on a joint office basis. One Joint Office is counted as one CPA and is included in the number of CPAs in this table.

If an audit firm newly plans to enter into audit engagements with listed companies, the Quality Control Review Team reviews whether or not to register the audit firm on the official roster of associate registered audit firms. The Quality Control Review Team investigates whether a quality control system is appropriately implemented and provides instructions as needed mainly around the following areas. The Center for Examination of Quality Control and the Quality Control Committee review and deliberate whether or not to register the audit firm based on the result of investigations or regular reviews conducted by the Quality Control Review Team.

- Developing policies and manuals related to quality controls
- Securing sufficient human resources to audit listed companies
- Preparing engagement partners’ rotation plans
- Considering fee dependence on specific clients (i.e. listed company expected to sign an audit contract)
- Assessing audit risks around audit work expected to be performed

The following table shows the number of newly registered firms approved by the Quality Control Committee during the period from April 1 to March 31 of each fiscal year after receiving applications to become registered firms or associate registered audit firms.

	FY2019	FY2020	FY2021
Audit firms registered on the official roster of registered firms	5	11	3
Audit firms registered on the official roster of associate registered audit firms	8	7	7
Number of application reviews to be registered as associate registered audit firms	13	13	20

(Note 1) The number of audit firms registered on the official roster of associate registered audit firms differs from the number of application reviews because audit firms are required to file an application to be registered as an associate registered firm each time they plan to enter into an audit engagement with listed companies.

(Note 2) As a result of the quality control review in FY2021, there are two audit firms whose approval process of becoming registered firms or associate registered audit firms are in progress as of March 31, 2022.

## **(2) Measures taken for the Registration on the Official Rosters**

During the period from April 1, 2021 to March 31, 2022, the Quality Control Committee did not decide to take any measures against audit firms regarding the registration status on the Official Rosters.

## **(3) Disclosures and Review Requests Related to Listed Company Audit Firms**

During the period from April 1, 2021 to March 31, 2022, disclosures of disciplinary sanctions against listed company audit firms and review requests in the fiscal year are as follows:

### **① Disclosure as a result of quality control reviews for listed company audit firms**

No audit firms were disclosed in the Official Rosters for their significant deficiencies identified as a result of quality control reviews.

### **② Disclosures of disciplinary sanctions against listed company audit firms**

Two audit firms were disclosed in the Official Rosters for their disciplinary sanctions, which are described below:

Audit firms on which the CPAAOB recommended the Commissioner of the Financial Services Agency to impose administrative sanctions or other measures	1
Audit firms that received an order to improve business by the Financial Services Agency	—
Audit firms that received disciplinary sanctions by JICPA	1

③ **Designation of auditors restricted from re-registration on the Official Rosters**

In FY2021, no members were newly designated as auditors restricted from re-registration on the Official Rosters and two accountants were taken off from the designation list. As of March 31, 2022, 12 accountants remain to be designated as auditors restricted from re-registration on the Official Rosters.

④ **Review requests made to the Review Board for Appropriate Procedures**

In FY2021, no audit firms made new review requests to the Review Board for Appropriate Procedures with respect to registration status on the Official Rosters or measures undertaken for the registration. Although the Listed Company Audit Firm Registration and Complaint Review Committee (\*), the previous review board, had been reviewing two audit firms since FY2018, no conclusions were reached because disputes were ongoing. The two cases are subject to review by the Review Board for Appropriate Procedures from October 1, 2019; however, no conclusions are yet made as of the end of FY2021.

(\*) The committee was originally set under the Quality Control Review System as a complaint review body. As of October 1, 2019, it was unified into the Review Board for Appropriate Procedures based on the July 2019 JICPA Constitution amendment.

## 4. Future Action Plan

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With an aim to improve the Quality Control Review Systems, JICPA started offering quality control reviews based on the new system effective July 1, 2020. FY2022 will be the third fiscal year under the new system.

As a series of amendments are made for international standards on quality management and ethical requirements as well as “Quality Management Standards for Audit” in Japan for the purpose of pursuing an even more stringent audit, the Quality Control Committee is determined to take the following actions in order to promote the Quality Control Review System in Japan.

### **1. Enhancing instruction capability**

The Quality Control Committee has been enhancing off-site instructions in addition to regular on-site reviews. Specifically, review teams are making effort in enhancing communication through additional visits or calls after regular reviews are completed to provide instructions to audit firms on developing effective improvement plans and implementing remedial actions appropriately. More off-site instructions will be given going forward even during the interval period of regular reviews.

### **2. Dealing with revisions to the International Standards of Quality Management and Code of Ethics**

The IAASB finalized “International Standards on Quality Management 1–Quality Management of Audit Firms (ISQM 1),” “International Standards on Quality Management 2–Engagement Quality Reviews (ISQM 2),” and “International Standards on Auditing 220 (revised)–Quality Management for an Audit of Financial Statements” in September 2020. Also, the IESBA finalized the revision of the Code of Ethics in December 2020. In Japan, the “Quality Management Standards for Audit” was revised by the Business Accounting Council in November 2021. Also, three exposure drafts, i.e. the Quality Control Standards Committee Report No. 1 (Revised) “Quality Control at Audit Firms,” the Audit Standards Committee 220 (Revised) “Quality Control in Audit Engagement,” and the Quality Control Standards Committee Report No. 2 “Engagement Quality Reviews”, were released in March 2022.

### **3. Considering an approach for quality control reviews that aligns with the nature of audit firms**

An appropriate quality control system varies depending on the nature of audit firms, such as the complexity of the organizational structure, characteristic in business

operations, relationship with network firms, and the nature of audit engagements. Given the circumstances audit firms are facing as mentioned in the previous paragraph, JICPA will continue exploring a suitable approach that aligns with the nature of audit firms in order to provide more effective and efficient quality control reviews.

Specifically, the review team aims to identify risks corresponding to characteristics of an audit firm and areas to be reviewed to address such risks for each component of the Quality Control Review System. Also, the review team will develop a review plan at an early stage of quality control reviews based on the characteristics of the audit firm through an understanding of its operation management system.

#### **4. Enhancing off-site monitoring**

In principle, regular reviews are conducted every three years for an audit firm, while both external and internal environment surrounding the audit firm will change during the three-year interval period. That said, in order to conduct the next regular review more effectively and efficiently, it is essential to enhance JICPA's off-site monitoring during this interval period and identify major events and other significant changes.

#### **5. Addressing the Discussion Summary of the Advisory Council on the Systems of Accounting and Auditing**

According to the "Discussion Summary of the Advisory Council on the System of Accounting and Auditing (2021)" issued in November 2021, several issues were put on the table for discussion purposes in the areas of "Ensuring confidence in audit," "Improving the capacity and capabilities of the CPAs," and "Improving the environment for high quality audit." The Quality Control Committee is committed to secure and enhance confidence in accounting and auditing in response to "Improving the capacity and capabilities of the CPAs" by taking the following measures: strengthening risk approach in quality control reviews; fulfilling the responsibility as a self-regulatory body of accounting profession; and pursuing an aim to conduct better quality control reviews.

