IPO Liaison Meeting

Minutes of Fourth Meeting

1. Date and Time: October 8, 2025 (Wednesday), from 5:00 p.m. to 7:00 p.m.

2. Venue: Conference Room, 9th Floor, TSE

3. Attendees: see list of members

4. Meeting Minutes

Hayase, Senior Manager, Listing Examination Department, JPX-R:

Today, we are holding this meeting to exchange views with stakeholders in light of recent cases where scandals have emerged after companies go public. We understand that, in some cases, investigations by authorities are still ongoing and the full picture is not yet clear. However, from the perspective of meeting investor expectations, we believe it is important for stakeholders to collaborate and take action where possible.

Recently, when scandals occur at listed companies, independent investigation committees are formed, and detailed reports are published. This facilitates an environment where we can gain insights for improving our operations. With that in mind, we've organized this meeting to share awareness of these issues.

Please turn to page 1 of Document 1. As introduced at the outset, the matters for which we seek your input today are outlined on page 1. We believe that the nature of IPOs lends to an increase in the risk of misconduct. This is because they undoubtedly provide the motive element of the three key factors for misconduct—such as the realization of founder gains or the exercise of stock options—and can also lend legitimacy to misconduct stemming from the mistaken belief that some wrongdoing is permissible when the entire company is united in pursuing a listing. In such an environment, particularly from the perspective of preventing misconduct before it occurs and detecting it early, collaboration among stakeholders becomes a crucial element alongside the efforts of each gatekeeper. We would appreciate your opinions from this perspective as well. Furthermore, based on recent cases of misconduct and the contents of investigation reports, we would like to share key points we have identified.

The first point concerns cases of changing auditing firms while in the process of preparing for an IPO. While such changes have become less uncommon recently—partly due to the auditing firm shortage stemming from the increase in companies preparing for IPOs—it is important to reiterate

that changing auditing firms requires careful consideration. Furthermore, although the materials only mention changing auditing firms, the same principles apply to changing the lead underwriter during IPO preparation.

Meanwhile, regarding the replacement of such auditing firms or lead underwriters, particularly in cases where the predecessor had identified certain issues, cooperation with the successor may prove difficult in situations where conflicts with the issuer are anticipated.

It is only natural that when a company wishes to terminate a contract, regardless of the industry, it would prefer to avoid conflict and settle matters amicably whenever possible. Consequently, it is rare for the company to convey its true thoughts in communications with other parties. In fact, when we contact the representatives of the previous lead underwriter or auditing firm in cases where they have been replaced, we often sense an atmosphere where they find it difficult to respond due to their position.

On the other hand, and I apologize if this sounds harsh, the continued “passing of the buck” in the IPO industry is undesirable. For example, if an exchange clearly states something like, “If an auditing firm or lead underwriter has changed within the past three years, we will also interview the predecessor,” and this leads to smoother communication because parties can say, “Well, the Exchange said so,” then such an approach might be worth considering. I would appreciate hearing your thoughts on this.

Next, I would like to discuss the second point: measures to prevent and detect at an early stage accounting fraud such as round-tripping. As noted in the materials, many of the cases of accounting fraud introduced in the reference documents involve external collaborators and may appear as legitimate transactions on the surface. Consequently, many are difficult to detect independently, even during the process of preparing for listing.

However, while I cannot delve into the specifics of each case, the fact that such misconduct has been uncovered—even after a company goes public—indicates that someone provided information in some form to the authorities or other relevant parties. We believe that if we could obtain such information earlier and in a more concrete manner, it would significantly contribute to preventing misconduct before it occurs and detecting it at an early stage.

In this matter, the Exchange receives over 100 whistleblower reports annually, and several cases each year involve the discovery of misconduct triggered by such submissions that prevent companies from achieving listing. Furthermore, last month we revised the information submission format on the Tokyo Stock Exchange website to enable the provision of more detailed information. Since then, we have observed a significant improvement in the accuracy of the information received.

At the same time, regarding investigations initiated by whistleblower reports, I understand that balancing this with whistleblower protection often places a burden on all of you. At the second

meeting, issues were also raised concerning the confidentiality obligations of auditing firms. If there are any challenges related to coordinating and utilizing such reports, I would appreciate your input.

Furthermore, as indicated under the second point, companies that concealed misconduct at the time of listing are often criticized for having a management system that has become largely symbolic. While it is true that in many cases, management was involved in or concealed the misconduct, making such cases difficult to uncover, the fact that they were eventually discovered in some form after listing suggests that the company's internal self-cleansing mechanisms should have been functioning properly.

In the investigation report, typical issues mentioned include the malfunction of internal whistleblower systems and weaknesses in internal audits. I would welcome your thoughts on these matters as well.

Furthermore, the points I have raised thus far stem from concerns regarding exchange listing examinations. Given that many of the cases cited this time involve accounting fraud, I would greatly appreciate it if the auditing firms, as accounting experts, could share your perspectives on recent cases of misconduct to the extent possible.

Japanese Institute of Certified Public Accountants:

I would like to provide an overview regarding Document 2. As a self-regulatory body, the Japanese Institute of Certified Public Accountants (JICPA) implements various initiatives aimed at quality management and improvement. Today, I will give an explanation on what these efforts entail. While the document is titled “Early Detection of Accounting Fraud, Including Round-Tripping” the document as a whole does not solely focus on early detection of accounting fraud. Its primary purpose is to introduce JICPA's self-regulatory initiatives. While auditing firms are likely already familiar with this content, we hope to further strengthen our collaboration through this forum.

Please turn to page 2. Here, we introduce three systems currently established by our self-regulatory body: the “Continuing Professional Development System,” the “Quality Control Review System,” and the “Individual Case Review System.” Details will be explained in the following slides.

Please turn to page 3. Regarding “Initiatives under the Continuing Professional Development (CPD) System,” our response to misconduct includes requiring the completion of six units of quality management training since 2006. Starting in 2016, at least two of these units must be training corresponding to case studies of misconduct. We are implementing measures to ensure adequacy in both knowledge and experience.

Please turn to page 4. This section covers “Initiatives under the Quality Control Review System.” This system was established by our association to review the status of audit quality control, aiming to maintain and enhance the quality standards of certified public accountant audits and to maintain

and secure public trust in audits. The Quality Control Review System sets key focus areas for implementation each fiscal year. For fiscal year 2025, “Identification, Evaluation, and Response to Risks of Material Misstatement, Including Fraud” is listed as one of the focus areas for audits. Furthermore, improvement recommendations and other findings observed during each year's review are compiled into a collection of case studies. Given the involvement of diverse stakeholders, this collection of case studies is also publicly available. It is published on our association's website, accessible to anyone.

Please turn to page 5. This section covers “Initiatives under the Individual Case Review System.” When there is concern about misconduct in the work performed by a certified public accountant, the Individual Case Review System examines whether disciplinary action is warranted. During the review process, matters deemed beneficial for improving auditing services are compiled into the “Audit Recommendations Collection.” Similarly, items from cases where disciplinary action was taken that are considered useful for enhancing future services are compiled into the “Disciplinary Case Studies Collection.” These are intended for members and associate members and are not publicly available. We also conduct training using these materials.

Please turn to page 6. For your reference, our association issued a notice titled “Our Association's Initiatives Regarding Round-Tripping (Notice)” on September 15, 2022. One initiative involves listing the URLs of whistleblower hotlines established by auditing firms on our association's website, serving as a directory of these hotlines. Another initiative involves creating and publishing a leaflet raising awareness about round-tripping.

Please turn to page 7. This page introduces, for your reference, the initiatives of the Public Accountants and Auditors Review Board and the Securities and Exchange Surveillance Commission. This concludes our association’s brief explanation.

Ernst & Young ShinNihon LLC:

I will provide an explanation based on the materials we have distributed*. EY's website features a page for startups, and this material was posted in August 2025.

* Materials provided by Ernst & Young ShinNihon LLC
“Practical Internal Control for Sound Revenue Recognition in Startups - Three Practical Approaches Startup Stakeholders Should Implement Immediately”
https://www.ey.com/content/dam/ey-unified-site/ey-com/ja-jp/insights/start-ups/documents/ey-internal-control-practices-to-improve-revenue-recognition-for-startup-v4.pdf

We are aware that this material has been published amid criticism that auditing firms and securities companies failed to detect fraud in recent cases of misconduct that have come to light.

However, we fundamentally believe that it is crucial for startups and their management to thoroughly understand accounting and internal control and to respond appropriately. Therefore, we have created this content with the aim of communicating to startups what points they should pay attention to and how they should specifically respond.

Section 1 describes internal control for identifying barter transactions that do not meet revenue recognition criteria. Recognizing that transactions lacking genuine demand and economic rationale cannot be recognized as revenue, it outlines internal control and approaches to prevent such transactions within the company.

Section 2 describes internal control related to revenue recognition. Particularly in startups, where intangible services such as IT operations are often handled, it becomes difficult for internal audits or auditors to verify revenue if the company lacks a system to confirm the existence of sales internally. Therefore, this section details specific methods for establishing internal control.

Item 3 addresses internal control related to advertising and promotional expenses. We present the described internal control as an effective means to verify that advertising and promotional activities are conducted appropriately.

The final “concluding” section contains the most critical information. For entrepreneurs and CFOs aiming to launch startups or pursue IPOs, improving accounting literacy is of paramount importance. From this perspective, we conduct awareness campaigns through the distribution of this material and the hosting of seminars. Accounting literacy, in other words, should be established as common sense. We feel a sense of urgency that unless we continuously disseminate this content, fraudulent transactions will recur. Therefore, we consider improving accounting literacy to be the most critical challenge.

From this perspective, regarding “today’s discussion points,” I believe we should focus our efforts on prevention. It is crucial that the management of startups fully recognize examples of misconduct and similar cases. Even if on a future occasion, we would appreciate it if this information were conveyed to them.

Hayase, Senior Manager, Listing Examination Department, JPX-R:

As you pointed out, enhancing management's awareness and accounting literacy is indeed a crucial factor. Investigation reports on cases of accounting fraud also note that when employees lack necessary accounting literacy, they may be involved in misconduct yet unable to determine whether it warrants reporting, rendering whistleblowing systems ineffective.

From a compliance perspective, we tend to focus on legal compliance and preventing insider trading. However, we recognize that accounting literacy is equally important. We will consider incorporating efforts to raise awareness among those in management about this issue as part of our preventive measures.

Auditing firm:

We feel it is deeply regrettable that such incidents continue to occur. We are committed to ensuring the reliability of capital markets and providing high-quality audits, and we understand that every other auditing firm is also working hard to do the same.

I have on hand a document compiled in 2020 by the Audit Promotion Liaison Council regarding responding to the “audit refugee” problem (Report of the Liaison Council on the Appointment of Auditing Firms for Initial Public Offerings (IPOs), March 2020). It includes the following statement:

“The audits and underwriting reviews conducted during the IPO preparation period are not merely checks of numbers or formalities. They are critical processes that independently verify the soundness of corporate management—including the caliber of management, corporate culture, and business operations—from a third-party perspective. This lays the foundation for the company to become one that can meet investor expectations over the long term.”

In this case as well, I believe the audit contract was signed at a relatively early stage. This also applies to us, but the withdrawal of an auditing firm is a highly sensitive matter. It is essential to calmly assess the situation, considering factors such as the character of the company’s management, whether there are particular industry characteristics that make audits challenging, and the existence of overseas subsidiaries. The intentions of the management are also extremely important; since a company tends to reflect its management's views, there are often instances where audits become impossible due to the management's stance. The same goes for the internal control environment—if the decision is made to prioritize sales and postpone improvements to internal control, no matter how much we point out issues, those improvements do not materialize. I have personally experienced such situations.

Back in the discussions we had in 2020, the idea was to broaden the scope of audits and steadily move forward so we could properly support good companies. However, looking back at this case, it is disappointing that this approach did not function as intended. With regard to handovers in particular, this is stated in the audit standard report, so it is crucial that these are carried out properly. While the party providing the handover will, of course, share information within reasonable limits, I believe it is also essential for the recipient to have the right mindset and actively accept the handover appropriately. At major auditing firms, handovers are almost always conducted, but in smaller firms, there are at times cases where they refuse to participate in the handover process. In such situations, I sometimes need to insist, saying “No, please listen.” Nevertheless, I feel that it is necessary to maintain an even higher level of skepticism in these cases.

A change in auditors or the lead underwriter securities company represents a significant turning point. It is important to carefully consider the background and approach the situation with a

mindset that goes beyond ordinary skepticism—almost stepping into the “red zone.” I believe this is something we need to reflect on.

The 2020 materials also emphasized the importance of proceeding steadily rather than rushing into audit agreements. This reaffirms the need to thoroughly communicate this mindset rather than hastening an IPO. Examining past IPO-related incidents reveals many similar patterns. Furthermore, as noted in those materials, I believe education on what management should strive to be is also necessary. Through my own incubation activities, I strongly feel the importance of not just pushing companies to go global via an IPO but also communicating what management's responsibilities truly entail. Rereading the materials, while some content may be dated, the underlying spirit remains unchanged. It clearly outlines skepticism and points for caution, making it worth revisiting. Many aspire to become accounting auditors. Rather than narrowing the field and reverting to past practices, it is crucial to use this incident as an opportunity to recommit to thorough efforts.

Finally, regarding round-tripping, I've also encountered several other cases aside from this particular issue where we have received external reports. While confidentiality obligations sometimes prevent us from learning details, we can generally discern the vital points. It is possible to delve deeper into them, and obtaining such information is important in audits. While confidentiality obligations are a factor, sharing information in some form is crucial. Ultimately, we can generally identify where the issues lie. Therefore, I believe that advancing such information sharing would enable us to proactively address various problems.

Hayase, Senior Manager, Listing Examination Department, JPX-R:

Regarding the sharing of information related to whistleblower reports, we received comments in the previous meeting pointing out that auditing firms often find it difficult to respond due to confidentiality obligations. Since then, we have also spoken directly with members of the auditing firms and gained a deeper understanding of these concerns. As for us, we will strive to create an environment where information obtained from whistleblower reports and similar sources can be shared with auditing firms as much as possible, and we would like to actively provide such information. Furthermore, we believe it is important for each firm to check the information provided, and for us to understand situations where providing feedback might be difficult. We recognize the importance of maintaining ongoing communication in these cases.

Auditing firm:

It's difficult to determine how best to categorize these points, but for the time being, I would like to proceed with my remarks in line with the materials.

Earlier, the Senior Manager, Mr. Hayase, mentioned that it might be worthwhile to conduct interviews with the predecessor auditing firm when there is a change of auditors. Personally, I

strongly agree with this approach and believe it should definitely be done. The reason is that, in the case of listed companies, there is still a sense of reassurance because an audit certificate has been issued by said predecessor auditing firm. However, in the case of pre-IPO companies, except in the rare situations where a Companies Act audit has been conducted, there is generally no audit certificate. In other words, the handover occurs while the audit is still in progress, and I believe extra caution is required.

While changing auditing firms is not uncommon, in most cases it is due to communication errors at the working level or mismatches between the company and the auditing firm. However, this recent case with alt Inc. is a rare instance involving suspicions of round-tripping, so I feel it was an issue where the incoming auditing firm should have been particularly vigilant.

Moreover, as I have said, because the audit is still in progress at that stage, there is a possibility that the incoming firm may unintentionally lack important information. Therefore, I believe it is appropriate to consider conducting interviews with the predecessor auditing firm.

However, as mentioned earlier, confidentiality obligations may pose challenges. I imagine other auditing firms present also find it difficult to provide written responses to exchange inquiries due to their audit agreements. Of course, there are confidentiality release clauses, so I believe they can answer to a certain extent if asked. However, once the audit agreement expires, the confidentiality release also becomes invalid, and I understand they can no longer discuss matters without the company's consent. In this context, having the predecessor auditing firm seek the company's consent could be a source of trouble. There is also the risk of halting the IPO before the misconduct is fully investigated. That said, (if these challenges can be overcome), I am in favor of consulting the predecessor auditing firm in such cases and believe we should definitely proceed in this manner.

Regarding the second point about preventing misconduct before it occurs, fundamentally, as accounting auditors, I believe we should conduct thorough audits and issue our opinions even in the absence of information sharing. If we are unable to do so, it raises the question of what role the auditing firm is fulfilling in the first place. On the other hand, I also feel that, as a partner, signing the audit report carries an extremely significant responsibility, and before signing, I want to obtain as much information as possible. There are always situations where, if we had known certain facts, we could have taken additional measures, so I would very much appreciate information sharing wherever possible. There may also be cases in which the lead underwriter or the staff in charge of examination at the stock exchange are unsure of the seriousness or level of certain issues. In such circumstances, sharing the latest fraud methodologies or perspectives from audit practice—using channels such as staff seconded from auditing firms to securities companies or the stock exchange—could help facilitate more thorough evaluation from the perspective of listing examination.

Hayase, Senior Manager, Listing Examination Department, JPX-R:

As you mentioned, regarding the replacement of an auditing firm while in the process of preparing for an IPO, it is common practice to replace the firm without issuing an audit opinion, making responsible communication difficult. Furthermore, the structure of the company preparing for listing often undergoes significant changes as the listing approaches, so even if an issue existed at the time, the situation may have changed a year later. Additionally, concerning information sharing, aligning the understanding between the party providing the information and the receiving party is also important. Taking these points into consideration, I hope we can continue to discuss these matters moving forward.

Auditing firm:

Thank you for your initial remarks on accounting literacy — I found them very much to the point. When we talk about accounting literacy, people often think of accounting standards or financial reporting practices. However, in the context of fraud prevention, what's truly critical is whether the CFO and the administrative departments can effectively serve as the second line of defense in the three lines of defense model — and whether they are fully aware of that role. Without this awareness, the governance framework risks becoming a mere formality. As an auditing firm supporting the listing process, we believe it is essential to closely examine this aspect. Equally important is the management's commitment and integrity in building a robust second line of defense. If this is neglected, the system may fail to function properly, potentially creating opportunities for misconduct at the executive level. Although accounting literacy can be somewhat abstract, we, as auditors, must assess how it is actually reflected in day-to-day operations.

Regarding investigations triggered by whistleblower reports, while information sharing among relevant parties is certainly important, we must also consider confidentiality obligations. Moreover, the short window between listing approval and the actual listing imposes significant time constraints. Given these limitations, thorough investigation may not always be feasible within the available timeframe. If concerns remain unresolved, it is important to adopt a flexible stance — including the possibility of delaying the listing — rather than adhering rigidly to the original schedule.

Hayase, Senior Manager, Listing Examination Department, JPX-R:

Regarding the final point you raised, whistleblower reports are often received after listing approval, leaving only a limited window before the actual listing. I understand this can place a considerable burden on all parties involved. One possible way to encourage earlier reporting might be to disclose the company name at the time of the listing application. However, I recognize that this approach presents significant challenges.

It is also essential that whistleblowers provide sufficient and relevant information to support our sound decision-making. To facilitate this, we recently updated our submission form to prompt more specific and detailed input. While it may still be too early to identify clear trends, I feel that the reports we've received recently have become noticeably more concrete and specific.

Auditing firm:

My comments may echo what others have already mentioned. When it comes to auditor changes, there can be a range of reasons, including differences in compatibility. That said, I believe it is essential to ensure that such background information is properly and thoroughly communicated to the incoming auditor. The Japanese Institute of Certified Public Accountants (JICPA) has issued guidance encouraging communication with the successor auditor, even in cases where the predecessor auditor has not issued an audit opinion. In light of this, I believe we should proceed with appropriate and orderly coordination.

From the perspective of preventing accounting fraud—such as round-tripping—before it occurs, we continue to see such cases emerge year after year. Even if stock exchanges tighten regulations and securities firms and auditing firms enhance their enforcement efforts, such measures alone may not be sufficient. It could ultimately become a game of whack-a-mole. Ultimately, I believe that the mindset and awareness of management are the most critical factors. In past cases, including the recent issue involving alt Inc., there seemed to be a disconnect between the company's stated future vision and the strategies intended to achieve it. In some instances, the CEO was unable to clearly articulate the rationale behind those strategies, which raised concerns. As auditors, I believe we should use such signs as a starting point to conduct in-depth interviews to understand how management is thinking. Enhancing training and education for management is also essential. Without such efforts, simply strengthening regulations may not be effective — it would just be another game of whack-a-mole. I believe that systemic reforms should come only after these foundational measures have been implemented.

Hayase, Senior Manager, Listing Examination Department, JPX-R:

We are also working to enhance awareness through initiatives such as requiring executives who have applied for listing to complete e-learning courses designed to prepare them for the responsibilities of leading a listed company. One idea we are considering is incorporating content on ethical and responsible management — including accounting literacy — into these courses. Additionally, I understand the concern that overly strict regulations could place an undue burden on sincere and responsible executives. This reinforces the importance of prioritizing educational efforts as a first step.

Securities company:

The preparation period for a listing typically spans two to three years, during which time potential irregularities may surface. Such issues can often be identified through the behavior of executives, the balance sheet (BS) and profit and loss statement (PL), as well as evaluations from external stakeholders. In terms of executive behavior, we should be particularly cautious when we observe remarks suggesting that the IPO itself is the ultimate goal, an excessive focus on boosting valuation, or signs of pressure being placed on teams to meet budget targets for the listing application period. It is also clearly unnatural when revenue and costs increase by nearly the same amount—especially when the increases are not in personnel expenses, but in areas such as R&D or advertising. These cases require closer scrutiny. When preparing for a listing and conducting reviews—as we do with deep-tech companies, for example—it is important not only to listen to the company itself, but also to seek evaluations from external parties. This helps ensure a more objective and well-rounded assessment. We should also be vigilant in cases where there is a high dependency on a particular business partner in terms of transaction volume, or when there are transactions involving shareholders or related parties.

Regarding whistleblower reports, it may be helpful to clearly state in the submission form that the information may be shared with securities firms, auditing firms, and issuers. I believe many whistleblowers submit reports with the intention of preventing a problematic listing, and they may actually expect their information to be used in that way. If someone still chooses to report despite knowing that the information will be shared, the credibility of that information is likely to be high. Such reports could serve as a valuable resource in uncovering potential misconduct.

Hayase, Senior Manager, Listing Examination Department, JPX-R:

While rare, we do occasionally work with securities companies to gather insights directly from a listing applicant's business partners. However, given the limited timeframe of the listing examination process, it can be challenging for the Exchange to approach these partners close to the listing date—particularly from an information management standpoint. For this reason, we largely rely on the interviews conducted by securities companies during the listing preparation period, and we hope to continue close collaboration in this area.

Regarding whistleblower reports, we have clearly stated in the submission portal that, as a general rule, the information will be shared with both the securities firm and the auditing firm. At the same time, it is important to ensure that such information is not conveyed to the company in a way that would directly reveal the nature of the report. We recognize the need to handle each case carefully and flexibly, with whistleblower protection as a top priority.

Securities company:

I agree that accounting literacy is essential, as the mindset of executives—particularly the CEO—can significantly influence accounting practices. On the other hand, it is expected that executives seeking a public listing will be highly focused on business expansion and financial performance. Especially in the period just before or after listing, many CEOs—particularly those of companies on the Growth Market—tend to step on the accelerator to scale their businesses. From the perspective of whether there is an effective "brake" on that acceleration, the key lies in whether outside auditors and independent directors are able to step in and offer candid advice when necessary. For example, if board meeting minutes suggest that important matters requiring careful scrutiny were not sufficiently discussed, we make a point of asking stakeholders in more detail about what was actually deliberated at the time. We are not only concerned with formal structures, but also with whether there is a functioning mechanism that serves as a real check on management. Although our time interacting with the CEO is limited during the securities review process, we remain attentive to whether the CEO is open to listening to external officers and whether the corporate culture allows for candid advice or feedback to be expressed without hesitation.

In addition, while information may come from various sources, it is important to build a system that gives whistleblowers confidence that their reports will be properly investigated and not ignored. Specifically, rather than simply setting up one or two contact points, it is necessary to establish multiple reporting channels so that whistleblowers can choose the most appropriate one based on the nature of the information they hold.

Hayase, Senior Manager, Listing Examination Department, JPX-R:

When a scandal is uncovered after a company has gone public, it is typically the external directors who are expected to take the lead. I believe their ability to function effectively in such situations is a critical factor.

In addition, from the perspective of ensuring the credibility of the internal whistleblowing system, we believe it is important to consider whether multiple reporting channels are available and whether a structure is in place that allows whistleblowers to report concerns with confidence and peace of mind.

Securities company:

Rather than focusing on individual cases, I would like to raise broader points regarding the prevention of corporate misconduct.

First, it is about the system for registered auditors of listed companies. I understand that this system was introduced to ensure the reliability of financial audits particularly as the scope of auditing firms involved in IPOs has expanded to include smaller firms. However, in practice, many of the firms registered under the previous system remain registered under the current one. Given this,

I believe it may be time for the industry to reassess whether the current framework is truly adequate.

As for the quality of corporate management, we have observed that some startup executives—especially those under pressure to deliver results—tend to cross lines that, while not necessarily illegal, are not always appropriate. There appears to be a mindset among some that "as long as it's not against the law, it's acceptable." We view this as a serious concern and will continue to monitor such behavior closely while providing appropriate guidance to promote sound governance.

One area of concern is the system involving multiple recommending securities companies, where more than one firm jointly sponsors a company for listing. We are concerned that some executives may mistakenly believe that by adding an additional recommending securities company, they can proceed without addressing issues previously raised by the original sponsor. Moreover, involving a second recommending securities company can sometimes create the impression that one firm may offset the other's concerns, leading to the mistaken belief that weaker internal controls are acceptable. We find this kind of misunderstanding concerning. It is essential that securities companies—regardless of which one is more actively involved—are able to provide consistent and appropriate guidance.

Similarly, from the perspective of accounting audits, it may be time to reconsider whether it is truly appropriate for a single auditing firm to remain continuously involved throughout the listing process. For example, a system could be introduced that requires a change of auditors between the fiscal year before last and the most recent fiscal year. While this may present certain challenges, it could offer meaningful benefits in terms of fraud detection.

From the standpoint of financial reporting, if we follow the textbook principle that financial figures reflect management's intentions, then the role of internal control reporting and internal control audits is to verify and challenge these intentions. Currently, Part I of the "annual securities report for initial listing application" (hereinafter referred to as "Part I") is not subject to internal control reporting. Furthermore, even when a securities registration statement is filed, companies may opt out of internal control audits for up to three years after listing. If the Exchange were to require internal control reporting for Part I and subject it to audit by accounting firms, it could significantly enhance fraud prevention.

In terms of early detection of misconduct, or fraud, we note that some overseas exchanges—such as those in Hong Kong—publicly disclose listing applications on their websites as soon as they are submitted. It may be worth considering a similar approach at TSE, including early disclosure at the time of listing application as well. In addition, by clearly disclosing external reporting channels, the Exchange could establish a more robust system for receiving credible information from outside parties.

Lastly, I understand that, in order to provide greater flexibility in listing timing, audit reports and summary audit reports are currently submitted at the time of listing approval rather than at the application stage. However, I believe there is merit in reconsidering the previous practice of submitting audit certifications at the time of application. Reinstating this requirement could allow the Exchange to engage more deeply with accounting auditors during the review process and gain a clearer understanding of the audit's implementation and findings.

Hayase, Senior Manager, Listing Examination Department, JPX-R:

In the context of joint recommendations, companies frequently choose this approach when they are mindful and conscious of stock prices. However, it is essential to recognize that appointing joint lead managers introduces a stringent constraint: the company cannot proceed with its public listing without receiving approval from both securities firms. To clarify, if one of the firms decides to withdraw, please understand that the company cannot move forward with the listing until TSE conducts a thorough investigation and is satisfied with the rationale behind the withdrawal.

To enhance flexibility in the IPO process, companies are now exempt from submitting internal control reports at the time of listing. In addition, the timing for submitting audit reports has been consolidated. We actively engage with auditing firms through interviews and other channels, and I am confident that there are no operational issues at present. Nonetheless, we are keen to gather feedback from stakeholders to ascertain that no negative impacts are arising. Regarding disclosure at the time of the listing application, I believe there are no systemic issues; however, the matter ultimately depends on practical conventions. Recently, some companies have voluntarily disclosed their applications, indicating that the current framework supports either approach effectively.

Regarding the system for registered auditors of listed companies, there seems to be an increasing involvement of auditing firms with limited IPO experience. This trend is linked to the expansion of the auditor base, partly driven by the "audit refugee" problem—where companies aiming for an IPO struggle to find auditing firms capable of providing the necessary audit services for their IPO applications. However, we acknowledge the limitations of these efforts and recognize the necessity to explore more effective strategies in response to this growing trend of the expanding auditor base.

Auditing firm:

In our firm, we have not changed the audit process just because the timing for submitting audit reports has changed. Our approach to handling reviews and interviews with TSE is still the same as before. Therefore, we believe that the content and standard of our audits stay consistent, regardless of whether it is the application stage or the approval stage.

Hayase, Senior Manager, Listing Examination Department, JPX-R:

For administrative reasons, we have consolidated the timing for submitting audit reports. However, we announced at the time of the regulatory revision that audit procedures themselves should still be completed by the application stage, as was previously the case. We believe this arrangement has been accepted by the auditing firms. While the audit report itself may not be available at the time of application, as pointed out, I don't believe there are any practical issues with communication.

Securities company:

When it comes to fraud, I believe we should do everything we can. However, excessive measures could potentially shrink the IPO market, so it is important to carefully consider the extent of our actions.

One key point is assessing the quality of management, where the role of external stakeholders becomes crucial. When signs of fraud emerge through internal reporting or audits, it is desirable for the company to activate a self-cleansing mechanism. Nonetheless, we would like external parties to verify the effectiveness of the company's response. As a securities company, we plan to involve external parties in the verification process during underwriting. For example, if the Exchange's guidelines clearly define key discussion points for interviews with external directors, it could help enhance their awareness.

As mentioned earlier, increasing the workload could potentially lead to a contraction of the IPO market. Since the majority of executives are sincerely preparing for IPOs, we should concentrate on curbing the actions of the few who engage in fraudulent activities. The current penalties, which consist mainly of minor fines, may not be adequate compared to the benefits gained from going public. We should consider enhancing deterrents by holding fraudulent executives more accountable, potentially including measures such as confiscating the proceeds from public offerings.

Even when examining individual cases of past fraud, the methods can be so sophisticated that it becomes unrealistic to catch everything during the review process. Of course, it is crucial to steadily work on what can be done now, but we should aim to strengthen deterrents without going overboard in our measures.

Hayase, Senior Manager, Listing Examination Department, JPX-R:

As you mentioned, it is not our intention to increase the burden on IPOs by adding more workload. Instead, it is more important to determine the scope of what can be effectively managed. We are open to considering the idea of the Exchange specifying key topics for interviews with external directors in advance to facilitate their preparation. Strengthening penalties presents a

challenge because the options available to the Exchange, such as delisting, primarily affect investors rather than directly penalizing the responsible executives.

Securities company:

Regarding the change of auditors, securities companies have systems in place to take appropriate actions based on the “Rules concerning Trading Participants' Listing Eligibility Examination Systems, etc.,” and we conduct checks in practice. However, because we must rely on the perspectives of the company and the views of the newly appointed auditing firm regarding the background of such changes, there are inherent limitations in making a fair judgment. For improved communication, it would be helpful if the lead underwriter securities company could speak with the previous auditing firm. We would greatly appreciate the auditors' cooperation in facilitating this dialogue.

When communicating with auditing firms, we face the barrier of confidentiality obligations. Additionally, audit opinions are understood to address the financial statements as a whole rather than individual matters, which presents a challenge for us. Given these constraints, we, as a securities company, appreciate the cooperation of auditing firms within the limits of what can be discussed during interviews. Ideally, our communication would help in detecting fraud, but due to the different roles and positions involved, it is essential for each party to focus on fulfilling their own responsibilities.

Regarding the early detection and prevention of accounting fraud, collaborating with auditing firms to reach any form of conclusions is challenging due to confidentiality obligations and other factors. With the large amount of information coming into the Exchange, it is important for the three parties involved to at least maintain close coordination. There have been instances where the information we received helped us prevent a company from going public, indicating that the system functions to some extent. However, we haven't been able to completely prevent fraud from being discovered after a company goes public. So, while it's important for everyone involved to stay alert and work together on this, it is quite unrealistic to prevent situations where the company's internal control system is rendered ineffective by the company’s management, solely through external monitoring. There is not a magic bullet or quick fix for this issue. Everyone working with companies preparing for an IPO needs to stay vigilant and keep a healthy level of skepticism.

Hayase, Senior Manager, Listing Examination Department, JPX-R:

We will continue to work on effectively coordinating the information provided to the Exchange with the relevant parties. Additionally, as has already been pointed out, we are considering initiatives to educate executives to address the risk of the company's internal control system being undermined by its management.

Securities company:

Regarding the change of auditors, we, as a securities company, would like the opportunity to hear from the previous auditing firm. While we understand the confidentiality obligations involved, we strongly ask for further efforts to ensure the healthy development of the IPO platform.

I believe that whistleblowing information should act as the final safeguard before a company goes public, giving us the ability to stop the listing if necessary. This is essentially how the system should work. However, it's also true that information can sometimes be fake or misused, as seen with malicious letters. Therefore, the key lies in how we can receive reliable information and assess the need for investigation among IPO stakeholders. In September, the Exchange updated its information provision platform to include contact information of the information provider. Our request is that after TSE receives information, you engage with the information provider to clarify what risks are present, and then coordinate with IPO stakeholders. We would greatly appreciate your efforts in this regard. Additionally, while we are currently unable to inform the issuer that information has been received, I believe it might be worth reconsidering this approach. While it's crucial to avoid investigation methods that could reveal the identity of whistleblowers, I believe there are instances where auditing firms share information with auditors and continue with their investigations. We would greatly appreciate it if you could consider developing a system that allows for more detailed investigations.

Furthermore, although I understand it is challenging, I believe we should still consider reviewing and strengthening penalties for fraud. Although it may not be the ideal mindset, I believe that ensuring there is no advantage to committing fraud, when considering risk and return, could serve as a deterrent.

Additionally, during the IPO preparation process or at the time of submitting a listing application to the Exchange, it would be beneficial to establish a moment to thoroughly inform executives about the risks of committing fraud. This approach could provide an opportunity for executives to pause and reflect on the significance of going public.

Hayase, Senior Manager, Listing Examination Department, JPX-R:

I agree that it is essential for executives to understand the importance of strengthened penalties as well as risks associated with fraud.

Regarding the whistleblowing system, as suggested, we have been preparing to enhance communication with information providers, such as by incorporating a checkbox for additional information. We aim to ensure that all information held by the provider shall be submitted before we proceed with investigations. When it comes to how much information can be disclosed to the company, I believe that protecting the whistleblower is of utmost importance, and maintaining a balance in this regard is crucial. Additionally, the current information provision platform seeks the

whistleblower's consent to inform the applicant company that the investigation has started based on a report. I know that it is the practice of auditing firms to share information with the audit committee during investigations. From reviewing their whistleblower protection policies, I see that they don't share the information exactly as received. They handle it carefully, always considering the protection of the whistleblower. We're looking into ways to compile and share case studies on how whistleblower reports are handled.

Auditing firm:

I think that increasing penalties for executives could be a strong deterrent. If it cannot be legislated like in the United States, perhaps the Exchange could regulate it through its own rules. Rather than penalizing the company, we might consider penalties against the executives, such as prohibiting any company they are involved with from going public.

When auditing firms change, the handover process is governed by established rules under general auditing standards, which mandate a handover obligation. Therefore, I want to emphasize that, as a rule, this handover is consistently carried out, ensuring that the successor auditing firm receives all necessary information.

Hayase, Senior Manager, Listing Examination Department, JPX-R:

When auditing firms change, the handover process usually starts with the successor auditing firm asking questions, which the predecessor auditing firm answers. Thus, how the successor firm frames its questions is quite important. As the Exchange, we start by confirming with the successor auditing firm what kind of handover has taken place. If there are any issues that remain unresolved, we then check with the predecessor auditing firm. This is the order we believe should be followed.

Auditing firm:

I strongly believe that penalties for executive fraud need to be tougher. If the penalties are higher than the reasons for committing fraud, they could effectively deter such actions. I remember an experience with an American CEO who was aiming for a Nasdaq listing. He told the auditing firm, “Please conduct a thorough audit, because if any fraud or falsification is discovered after listing, I'll end up in jail.” This really highlighted the differences between the U.S. and Japan. In Japan, criminal penalties for economic crimes are often considered light. Without strong deterrents, the real culprits of fraud might escape accountability, while those around them unfairly take the blame. This is not a good situation.

Securities company:

Following our earlier discussion, strengthening penalties is one option. But I also think it's worth considering rules to limit stock sales by executives. For companies looking to list on the Growth Market, if executives are mainly focused on getting rich by selling their shares, they might be tempted to commit fraud to make the IPO happen. We should think about setting up rules to stop this kind of motivation.

Auditing firm:

After listening to everyone's discussions, I've realized once again that there are many different perspectives on these issues. Instead of just pinpointing where responsibility lies, I believe it's important for all stakeholders to collaborate and work together.

Strengthening penalties for executives is one approach, but it's crucial for auditing firms, securities companies, and exchanges to collaborate. This teamwork should help executives realize that committing fraud could jeopardize their own positions. It is true that more companies are now adopting the attitude of “we are willing to pay for a thorough audit.” However, some companies don't have this mindset. When problems happen, it is the executives' attitude and awareness that are questioned. By leveraging these opportunities, we would like to raise the awareness and responsiveness of all stakeholders, thereby contributing to better IPOs in Japan.

Ikeda, Senior Manager, Listing Department, TSE:

I believe the key is to address these issues without causing the IPO market to shrink. After the FOI Corp. incident in 2010, we had similar discussions. While it's easy to focus on technical solutions, we must remember that fraud isn't limited to accounting issues. Apart from the issue of fraud, there's also frequent discussion these days about whether we are truly achieving IPOs that enable companies to grow after going public. Overall, considering these various points, we need to focus on educating startup leaders about these challenges.

In terms of specifics, we have received several specific suggestions, including ways of managing auditing firm transitions, sharing case studies, utilizing external evaluations, and leveraging external directors and auditors. We will first organize these insights internally at TSE, and then share them with everyone.

Regarding the strengthening of penalties, while I agree with the points raised, it is challenging because the Exchange's listing contracts are made with the listed companies, not directly with the executives. Therefore, the executives are not directly subject to the listing rules. That said, since legal reforms on statutory penalties and fines can take a lot of time, I think we should first and foremost focus on what we can do ourselves.

Yoshida, Senior Manager, New Listing Department, TSE

Speaking from the perspective of the department responsible for attracting listings, which is different from those that create market systems or conduct reviews, I would like to share some insights.

Our department often gets invited to seminars with executives and representatives from companies getting ready to go public. Recently, we have been receiving a lot of questions about how we handle whistleblower reports. More people are aware of the channels for whistleblower reports, which seems to be having a certain deterrent effect. However, when executives are involved in fraud, it can undermine internal controls. As we discussed earlier today, educating executives is key to preventing this. Given this context, we need to carefully consider what our department can effectively communicate. In terms of accounting, it's crucial for executives not to leave everything to the CFO; they should have a basic understanding of financial matters themselves. More fundamentally, discussions should start with the mindset and integrity expected of executives of listed companies. In a way, these discussions are fundamentally about common sense, much like returning to the basics, and I believe many of you are already working on these aspects. However, it's crucial for everyone here today to come together and continue making steady efforts. In many public seminars, there are numerous technical sessions focused on how to pass reviews. However, alongside these, it is important for us to also create opportunities to convey what is truly important.

Hayase, Senior Manager, Listing Examination Department, JPX-R:

We are almost out of time, so we will conclude the meeting here. As Senior Manager Ikeda mentioned earlier, we will consider today's opinions and organize the points that need to be addressed going forward. We appreciate your cooperation.

[End]