

# **Overview of the Results of Quality Control Review for the Year Ended March 31, 2007**

July 4, 2007

Japanese Institute of Certified Public Accountants

## **1. Objective of Quality Control Review**

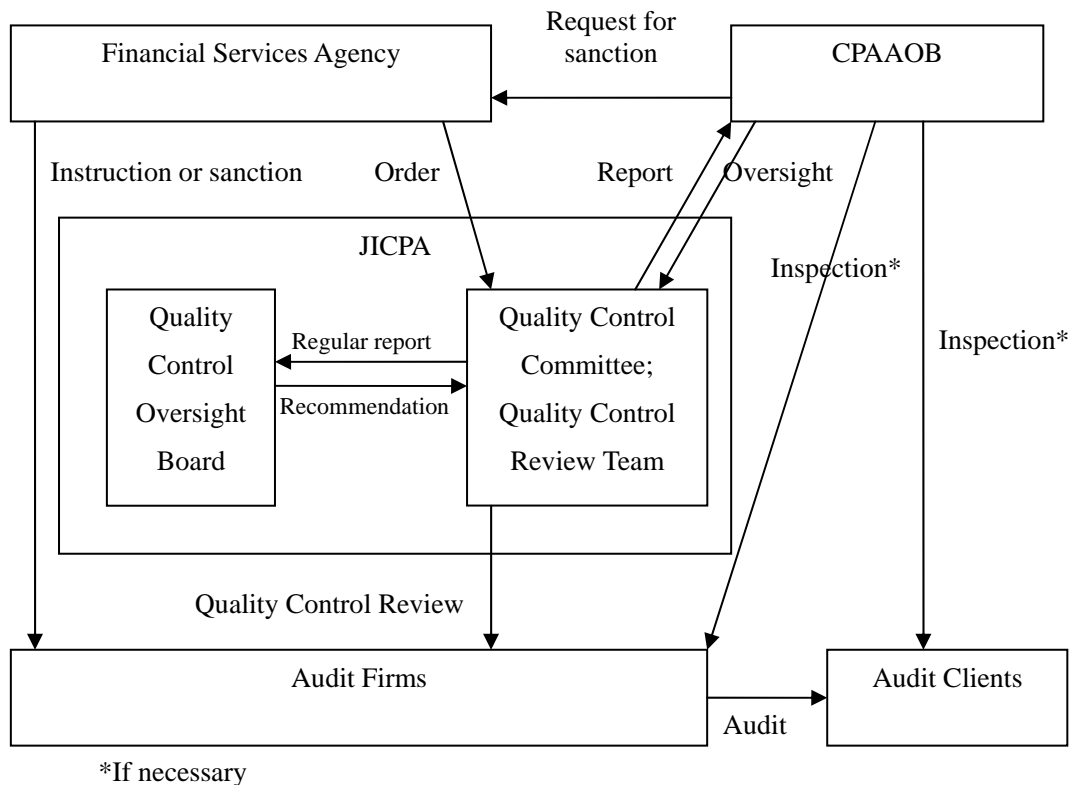
Quality control review performed by the Japanese Institute of Certified Public Accountants ("JICPA") was introduced as a self-regulatory system in 1999. The Certified Public Accountants Law ("CPA Law"), which was amended in 2003, requires the JICPA to conduct this quality control review and, at the same time, the Certified Public Accountants and Auditing Oversight Board ("CPAAOB") to monitor this quality control review.

Article 122, Paragraph 1 of the JICPA Constitution states that, "The JICPA, taking into consideration the purpose of Article 46-9-2 of the CPA Law and the public interest in audits, will conduct quality control reviews of audits performed by certified public accountants and audit corporations ("audit firms"), notify them of the review results, make recommendations as necessary, and receive reports on corrective actions taken with regard to those recommendations, in order to maintain and improve an appropriate level of quality of members' audits, which lead to maintaining and ensuring public confidence in audits." Article 122, Paragraph 2 also provides, as the nature of the review, that, "Quality control review has a directional role and shall not be interpreted as intended to detect noncompliance or impose disciplinary actions."

Quality control review intends to maintain and improve audit quality as a result of independent reviews for an audit firms' implementation of quality controls by full-time reviewers and not by the individuals involved in the audit engagement subject to the review, because the quality control review system encompasses such procedures as making recommendations, receipt of responses from audit firms regarding corrective actions to be taken in response to those recommendations, the receipt of reports from audit firms concerning implementation of actions, and visits to audit firms, as necessary, to confirm such implementation.

## **2. Relationship between the Structure of Quality Control Review and Monitoring by the CPAAOB**

The following chart illustrates the structure of quality control review for the year ended March 31, 2007 and monitoring by the CPAAOB:



Notes:

- The Quality Control Committee consists of a Chairman (Deputy President of the JICPA) and 25 committee members who are members of the JICPA.
- The Quality Control Review Team consists of one chief executive reviewer, two deputy chief reviewers, nine senior reviewers and eight staff reviewers, with each of them being a member of the JICPA.
- The Quality Control Oversight Board consists of a Chairman who is a member of the JICPA and five members who are knowledgeable persons outside the profession. The Board is a third-party body that examines and evaluates whether quality control review is conducted appropriately, then makes recommendations to the Quality Control Committee.

### 3. Overview of Quality Control Reviews Conducted for the Year Ended March 31, 2007

The following table indicates the actual number of the reviewed audit firms and the number of audit firms to which quality control review reports and recommendation reports have been issued for the review year (April 1, 2006 to March 31, 2007). This year's statistical analysis was performed by classifying audit firms into those firms that perform audits of listed companies (hereinafter referred to as "listed" in the text and the tables) and those that audit only non-listed companies (hereinafter referred to as "non-listed").

Listed company audit firms are selected for quality control review primarily based on a cyclic approach, once every three years. Non-listed company audit firms are prioritized when they are considered to have deficiencies based on the results of analyzing reports of implementation of quality control.

#### 3-1. Audit firms by structure

(number of audit firms)

|                    | Number of quality control reviews conducted for the year |        | Number of quality control review reports and recommendation reports issued for the year |                                |                        |                 |
|--------------------|--|--------|---|--------------------------------|------------------------|-----------------|
|                    | Planned  | Actual | Brought forward   | Quality control review reports | Recommendation reports | Carried forward |
| Audit corporations | 31   | 31     | 7   | 37                             | 37                     | 1               |
| Sole practitioners | 111  | 106    | 2   | 105                            | 105                    | 3               |
| Total              | 142  | 137    | 9   | 142                            | 142                    | 4               |

#### 3-2. Listed company audit firms vs. non-listed company audit firms

(number of audit firms)

|                                | Number of quality control reviews conducted for the year |             | Number of quality control review reports and recommendation reports issued for the year |                                |                        |                 |
|--------------------------------|--|-------------|---|--------------------------------|------------------------|-----------------|
|                                | Planned  | Actual      | Brought forward   | Quality control review reports | Recommendation reports | Carried forward |
| Listed company audit firms     | 73<br>(18)   | 73<br>(18)  | 7<br>(2)  | 79<br>(20)                     | 79<br>(20)             | 1<br>(-)        |
| Non-listed company audit firms | 69<br>(69)   | 64<br>(64)  | 2<br>(2)  | 63<br>(63)                     | 63<br>(63)             | 3<br>(3)        |
| Total                          | 142<br>(87)  | 137<br>(82) | 9<br>(4)  | 142<br>(83)                    | 142<br>(83)            | 4<br>(3)        |

## Notes

1. Figures in parenthesis ( ) in the above table denote the number of audit firms that were newly subject to quality control review.
2. Differences between the planned number of audit firms to review and the actual number of reviews arise from the following:
  - One audit firm (a sole practitioner and non-listed company audit firm) was additionally reviewed, as this firm was newly appointed as independent auditor by large companies and other entities;
  - Four audit firms (sole practitioners and non-listed company audit firms) were excluded from the actual number of reviews, due to retirement as independent auditors of large companies and other entities;
  - One audit firm (a sole practitioner and non-listed company audit firm) was excluded from the actual number of reviews, as this sole practitioner died before the quality control review report was issued, although a quality control review was performed;
  - One audit firm (a sole practitioner and non-listed company audit firm) was excluded from the actual number of reviews, as the firm refused to accept the quality control review.
3. The Quality Control Committee is continuing to examine four audit firms for which quality control reviews were not completed and have been carried forward.
4. Refer to the Appendix for the yearly trend of recommendations.

In addition to the above quality control reviews, follow-up visits were conducted with 29 audit firms (23 audit corporations and 6 sole practitioners) as described in Part 4-2 of Section 4, 'Focuses for This Year.'

Special reviews were also conducted in response to six instructions from the Chairman and President of five audit corporations, including instructions issued the previous review year, based on Article 89-2-2, Paragraph 2 of the previous Constitution that was later amended December 11, 2006. These reviews were due to instances of significant issues that had been identified regarding the quality control system of these audit firms through investigations by the Audit Practice and Review Committee.

#### **4. Focuses for This Year**

With reference to the recommendations from the Quality Control Oversight Board in the previous year and from the CPAAOB through its monitoring process, we established the following items on which to focus for the quality control reviews of this year. These key focus items were announced to members in the September 2006 issue of the *JICPA Newsletter* to help members implement quality control of their audit firms.

#### **4-1. Auditor independence**

As a result of the quality control review for the year ended March 31, 2006, the number of recommendations regarding independence (eligibility of personnel engaged in audits) have doubled compared to the prior year.

It should be confirmed during a review whether an audit firm establishes appropriate policies and procedures with respect to an auditor's independence, which were strengthened by the amended CPA Law. Specifically, the Review Team will evaluate whether an audit firm ascertains the independence of its partners and audit personnel with the checklist based on Research Report No. 1 of the Ethics Committee, or, when an audit firm ascertains independence using a different manner, whether all the necessary items have been ascertained.

#### **4-2. Follow-up of recommendations**

Although some progress has been observed in each audit firm in implementing quality control of audits, repeated issues are continually being identified. The Review Team will require an audit firm to identify the reasons for unsatisfactory improvement and to implement changes earlier, and the Review Team will make timely follow-up visits to encourage improvements.

In order to confirm improvements, emphasis will be placed on the visits to those audit firms that will be subject to a quality control review in the next review year and that received a quality control review report with a qualified conclusion in the review conducted in the year ended March 31, 2005. As for the audit firms reviewed during the previous review year, follow-up will be performed this year if early confirmation of improvements for recommendations is considered necessary after the examination of reports on implementation of quality control.

#### **4-3. Risk-based approach**

Many matters were identified in particular that are related to the planning and performing of procedures for control risk assessment and the determination of substantive procedures based on the assessed risk. As the review tools were revised with respect to control risk assessment associated with information systems using IT, the number of recommendations in this area has increased.

The Review Team will carefully examine whether an audit firm has established policies and procedures that will ensure control assessment procedures, and that substantive procedures based on the assessed risk are properly performed.

The new or revised Auditing Standards Committee Statements and other pronouncements concerning audit planning based on risk assessment and the control risk assessment associated

with an information system using IT are applicable for audits of periods beginning on or after April 1, 2006. In addition, the implementation of IT expert support by the JICPA will commence this year. Accordingly, the Review Team will verify whether an audit firm revises policies and procedures appropriately in response to these revisions.

#### **4-4. Understanding the design of quality control systems**

Since the *Standards on Quality Control for Audits* were issued by the Business Accounting Council, Quality Control Standards Committee Statement No. 1, *Quality Control for Firms That Perform Audits*, and Auditing Standards Committee Statement No. 32, *Quality Control for Audits* (hereinafter collectively referred to as "Standards of Quality Control") are applicable to audits for periods beginning on or after April 1, 2006, the Review Team will obtain an understanding of whether an audit firm appropriately establishes firm-wide policies and procedures of quality control, and the Review Team will promote early implementation of the Standards of Quality Control in those audit firms that have not fully responded.

In particular, it should be noted that all audit firms including sole practitioners are required to establish policies and procedures regarding the monitoring of their quality control system (replacing the inspections that were established by Auditing Standards Committee Statement No. 12). The Review Team will ascertain whether an audit firm carries out such regular monitoring properly and makes efforts to improve audit quality.

#### **4-5. Sufficiency of audit procedures in forming an audit opinion**

In performing audit procedures of accounting estimates, auditors are required to evaluate carefully whether assumptions used in accounting estimates are reasonable, as such assumptions involve subjective judgments, and to obtain sufficient appropriate audit evidence. Considerable numbers of recommendations on accounting estimates were made in the reviews for the year ended March 31, 2006. The Review Team will continually confirm whether audit procedures of accounting estimates are properly performed.

In the stage of advance preparation for audit engagements selected for review, the Review Team will review annual securities reports and documents received from an audit firm in particular, matters relating to audit procedures of accounting estimates included in QCQ400, *VII. Documents Relating to Significant Matters Serving as References for the Review*. Subsequently, the Review Team will evaluate whether an auditor performed sufficient and appropriate audit procedures, and properly documented in working papers the procedures performed and conclusions reached, with regard to significant audit items and matters that are considered high risk. The Review Team will also ascertain whether matters to be considered and

matters to be corrected are appropriately considered and summarized, and that significant matters are included as the subjects of an engagement quality control review.

The review results of this year's focus points are described in Section 8-3, "Review results relating to the focus areas for the period" under Item 8, "Overview of Recommendation Reports Issued for the Current Period."

## **5. Significant Issues Identified in Quality Control Reviews**

Quality control review reports with a qualified conclusion or a negative conclusion were issued to 69 firms (26 listed and 43 non-listed) and 2 other audit firms (non-listed only), respectively. Matters that led to such a conclusion include the risk-based approach (53 audit firms; 17 listed and 36 non-listed), engagement quality control review for expressing an audit opinion (33 audit firms; 8 listed and 25 non-listed), and audit procedures of accounting estimates (10 audit firms; 3 listed and 7 non-listed). Please refer to Item 8, "Overview of Recommendation Reports Issued for the Current Period." A disclaimer of conclusion was not expressed for any of the current period quality control reviews, as was also the case in the prior period.

There were some cases that the Quality Control Committee reported to the Chairman and President pursuant to Item 5 of the Quality Control Review Standards after the Committee identified a substantial doubt regarding the appropriateness of an audit opinion expressed by a sole practitioner or an audit corporation, as stipulated in Paragraph 3 of Article 88 of the former Constitution, which were discovered as a result of a quality control review. Details are as follows:

- Seven cases related to 7 audit firms (2 listed and 5 non-listed) that were issued quality control review reports with a qualified conclusion; and
- Two cases related to 2 audit firms (non-listed only) that were issued quality control review reports with a negative conclusion.

Matters related to audit procedures of accounting estimates, engagement quality control reviews for expressing an audit opinion, and illegal acts were reported to the Chairman and President regarding the above cases.

In addition, one audit firm refused to be subject to the quality control review, becoming subject to Item 3 (5)-1 of the Quality Control Review Standards. There were two cases where reviewers identified material in relation to quality control of audits, subject to Item 3 (5)-4 of the Quality Control Review Standards.

## **6. Responses to Recommendations from the Quality Control Oversight Board**

In response to "Recommendations for Activities of the Quality Control Committee for the year ended March 31, 2006," which were received from the Quality Control Oversight Board on June 23, 2006 and included in the September 2006 issue of the *JICPA Journal*, the Quality Control Committee and other relevant committees of the JICPA have taken the following steps:

### **Recommendation 1 – Enhancement of auditor independence**

- Recommendation

The number of recommendations on independence (eligibility of personnel engaged in audits) has doubled compared to the prior year. Therefore, the Quality Control Committee should continually confirm that audit firms establish policies and procedures adequately responsive to the enhancement of auditor independence in the amended CPA Law.

- Responses

As described in Item 4, "Focuses for This Year," it was ascertained whether auditor independence is ensured as one focus of quality control reviews conducted this year. The review results are described in Item 8, "Overview of Recommendation Reports Issued for the Current Period" under Section 8-3, "Review results relating to the focus areas for this period," Subpart a., "Auditor independence."

Research Report No. 1, *Checklist of Auditor Independence* issued by the Ethics Committee was revised on May 17, 2006 in response to the implementation of the Companies Act and partial amendment of the *Notes Regarding the Code of Ethics*.

### **Recommendation 2 – Risk-based approach**

- Recommendation

Many recommendations related to the risk-based approach were made during reviews for the year ended March 31, 2006 and the majority were repeatedly identified issues. From the year beginning April 1, 2006, new Auditing Standards Committee Statements No. 27 through No. 31 and the revised Statement No. 5 are applicable. Accordingly, the Quality Control Committee should promote audits with the risk-based approach as well as a proper revision of policies and procedures of the quality control system that are consistent with these Statements.

- Responses

As described in Item 4, "Focuses for This Year," the implementation of audits with the risk-based approach was ascertained as another focus of quality control reviews for this year. The review results are described under Item 8, "Overview of Recommendation Reports Issued for the Current Period" under Section 8-3, "Review results relating to the focus areas for this

period," Subpart c., "Risk-based approach." Review tools were added and revised for early application of Auditing Standards Committee Reports No. 27 through No. 31 that were newly pronounced (see Item 11, Subparts 11-1a, 11-2b, 11-4b, 11-5b and 11-5c).

On January 15, 2007 the Auditing and Assurance Practice Committee Statement issued Research Report No. 19, *Assessment Techniques of the Risks of Material Misstatement* in order to assist practitioners in responding to new standards related to the risk-based approach. Additionally, the JICPA held seminars regarding these standards.

**Recommendation 3 – Support for performing audits based on the assessed control risk associated with information systems using IT**

● Recommendation

Recommendations on the control risk assessment of using IT have increased. The Quality Control Committee should promote the use of IT experts support by the JICPA such as referrals of IT experts and the establishment of an Audit IT Consultation so that each audit firm is able to respond in this area.

● Responses

Review procedures were developed for early application of IT Committee Statement No. 3 that was newly pronounced (see Item 11, Subpart 5b), and reviews were conducted as part of a "risk-based approach" that was another focus of quality control reviews for this year.

With respect to support for audits based on the control risk assessment associated with information systems using IT, the JICPA assists audit firms with referrals to an IT expert and by the creation of an Audit IT Consultation.

**Recommendation 4 – Audit procedures of accounting estimates**

● Recommendation

In performing audit procedures of accounting estimates, auditors are required to evaluate carefully whether assumptions used in accounting estimates are reasonable, as such assumptions involve subjective judgments, and to obtain sufficient, appropriate audit evidence. Considerable numbers of recommendations on accounting estimates were made in the reviews for the year ended March 31, 2006. The Quality Control Committee should promote improvements to ensure that audit procedures of accounting estimates are properly performed.

- Response

As described in Item 4 "Focuses for This Year," whether audit procedures of accounting estimates were properly performed was verified as part of confirming the *Sufficiency of Audit Procedures in Forming an Audit Opinion*. The review results are described in Item 8, "Overview of Recommendation Reports Issued for the Current Period" under Section 8-3, "Review results relating to the focus areas for this period," Subpart e., "Sufficiency of audit procedures in forming an audit opinion."

### **Recommendation 5 – Follow-up of recommendations**

- Recommendation

To make use of reports on implementations of quality control that were implemented in 2004, the Quality Control Committee should enhance follow-up visits to those audit firms that are considered to have made no improvement and to audit firms with unsatisfactory improvement regarding recommendations, in order to provide proper direction to the audit firms. In addition, follow-up should be enhanced for improvement of recommendations made to large audit corporations that audit a number of listed companies, to confirm whether they maintain the proper quality of audits of these corporations with respect to the implementation of quality controls.

- Response

As described in Item 4 "Focuses for This Year," a follow-up of recommendations was conducted including large audit corporations that were subject to a quality control review in the previous year. The review results are described in Item 8, "Overview of Recommendation Reports Issued for the Current Period" under Section 8-3, "Review results relating to the focus areas for this period," Subpart b, "Follow-up of recommendations."

### **Recommendation 6 – Systems of quality control established by small- and medium-sized audit firms**

- Recommendation

New Standards on Quality Control and related implementation guidance are applicable for audits commencing on or after April 1, 2006. As these new standards require all audit firms to strengthen quality control, including the clarification of policies and procedures regarding responsibilities of quality control, the Quality Control Committee should confirm whether audit firms are properly responding to these new standards. In particular, small- and medium-sized audit firms with limited resources should make ongoing efforts to be able to establish a system of quality control, including engagement quality control reviews, before expressing an audit

opinion, and conduct monitoring that is consistent with the new Standards. It is anticipated that the JICPA will undertake robust supportive measures, such as training improvements.

- Response

As for the readiness to implement the Standards of Quality Control, the Review Team obtained an understanding of the design of quality control systems of all audit firms that are subject to quality control review, with the scope of such systems not limited to small- and medium-sized audit firms, as one focus of the quality control reviews for this year. If an audit firm delayed readiness, it was urged to improve.

A Coordinating Committee for Small- and Medium-Sized Practitioners was established within the Committee for Small- and Medium-Sized Practitioners, and meetings including seminars were held on two occasions to provide assistance for small- and medium-sized audit firms to establish a quality control system. The Committee for Small- and Medium-Sized Practitioners issued two research reports on November 1, 2006: Report No. 1, *Audit Tools for Small- and Medium-Sized Practitioners: An Example of an Audit Quality Control Manual*, and Report No. 2, *Audit Tools for Small- and Medium-Sized Practitioners: Checklist for Periodic Monitoring for Audit Engagements*. The Coordinating Committee for Small- and Medium-Sized Practitioners conducted a seminar regarding these research reports.

## **7. Reporting to the CPAAOB**

The Quality Control Committee responded to the CPAAOB, which monitors the results of the JICPA quality control reviews, as follows.

7-1. The Committee submitted to the CPAAOB the annual report on quality control review for the year ended March 31, 2006 and monthly reports from April 2006 through March 2007, pursuant to the Cabinet Office Ordinance related to the JICPA. These monthly reports were accompanied by copies of quality control review reports, recommendation reports, and responses from members for each month.

7-2. The Committee submitted review working papers that the CPAAOB considered necessary, and replied to inquiries from the CPAAOB.

7-3. The Committee reflected the findings and recommendations from the CPAAOB in revisions of the Quality Control Review Standards, the Quality Control Review Procedures, and the review tools.

7-4. The JICPA announced comments of the Chairman and President on the same dates as the CPAAOB issued the following three review and inspection results: *Quality Control of Audits of the Four Largest Audit Firms* on June 30, 2006; *Regarding Quality Control of Audits by Small Scale Audit Firms* on November 8, 2006; and *Regarding Quality Control of Audits by Small and Medium Scale Audit Firms* on March 16, 2007.

#### **8. Overview of Recommendation Reports Issued for the Current Period**

The following tables indicate the numbers of recommendations by item and content for the current period. The review results related to the focus areas of quality control reviews for this year are described in Section 8-3. Yearly trends of recommendations are described in the Appendix.

It should be noted that the results of statistical analyses of non-listed company audit firms may not necessarily reflect the circumstances of all the non-listed company audit firms, due to the selection policy of audit firms that are subject to quality control review, as described in Item 3, "Overview of Quality Control Reviews Conducted for the Year Ended March 31, 2007."

## 8-1. Number of recommendations by item

### a. By structure of audit firm

(number of audit firms)

|  | Audit corporations        |           | Sole practitioners        |           | Total                     |            |
|--|---------------------------|-----------|---------------------------|-----------|---------------------------|------------|
|  | Recom-<br>menda-<br>tions | Recurring | Recom-<br>menda-<br>tions | Recurring | Recom-<br>menda-<br>tions | Recurring  |
| Performance of audit engagements   |                           |           |                           |           |                           |            |
| Risk-based approach  | 35<br>(11)                | 20<br>(4) | 84<br>(42)                | 16<br>(6) | 119<br>(53)               | 36<br>(10) |
| Assessing control risks in relation to use of information technology                               | 30                        | -         | 62                        | -         | 92                        | -          |
| Discussion with management and communication with corporate statutory auditors or their equivalent | 25                        | -         | 63                        | -         | 88                        | -          |
| Audit procedures of accounting estimates   | 24<br>(3)                 | 4<br>(1)  | 55<br>(7)                 | 2<br>(-)  | 79<br>(10)                | 6<br>(1)   |
| Instructions to members of engagement teams  | 11<br>(-)                 | 1<br>(-)  | 46<br>(1)                 | 3<br>(-)  | 57<br>(1)                 | 4<br>(-)   |
| Development and maintenance of audit work papers   | 29<br>(-)                 | 7<br>(-)  | 59<br>(2)                 | 6<br>(-)  | 88<br>(2)                 | 13<br>(-)  |
| Preparation of the summary of audit findings   | 9<br>(1)                  | 1<br>(-)  | 16<br>(-)                 | 4<br>(-)  | 25<br>(1)                 | 5<br>(-)   |
| Management representations   | 26                        | -         | 68                        | 2         | 94                        | 2          |
| External confirmations   | 21                        | 5         | 36                        | 3         | 57                        | 8          |
| Other  |                           |           |                           |           |                           |            |
| Overall quality control system   | 10                        | 3         | -                         | -         | 10                        | 3          |
| Engagement quality control review for expressing an audit opinion                                  | 24<br>(5)                 | 2<br>(-)  | 67<br>(27)                | 3<br>(1)  | 91<br>(32)                | 5<br>(1)   |
| Qualification of auditors and personnel engaged in audits  | 17<br>(-)                 | 1<br>(-)  | 51<br>(5)                 | 2<br>(-)  | 68<br>(5)                 | 3<br>(-)   |
| Acceptance and continuance of audit engagements  | 23<br>(-)                 | 2<br>(-)  | 61<br>(1)                 | 5<br>(-)  | 84<br>(1)                 | 7<br>(-)   |
| Joint audit arrangements   | 4                         | -         | 21                        | -         | 25                        | -          |
| Monitoring of implementation of quality control  | 23                        | 8         | -                         | -         | 23                        | 8          |
| Number of quality control review reports   | 37                        |           | 105                       |           | 142                       |            |

**b. By listed and non-listed company audit firms**

(number of audit firms)

|  | Listed company audit firms |            | Non-listed company audit firms | Total             |            |
|--|----------------------------|------------|--------------------------------|-------------------|------------|
|  | Recom-menda-tions          | Recurring  | Recommendations                | Recom-menda-tions | Recurring  |
| Performance of Audit engagements   |                            |            |                                |                   |            |
| Risk-based approach  | 60<br>(17)                 | 36<br>(10) | 59<br>(36)                     | 119<br>(53)       | 36<br>(10) |
| Assessing control risks in relation to use of information technology                               | 58                         | -          | 34                             | 92                | -          |
| Discussion with management and communication with corporate statutory auditors or their equivalent | 42                         | -          | 46                             | 88                | -          |
| Audit procedures of accounting estimates   | 39<br>(3)                  | 6<br>(1)   | 40<br>(7)                      | 79<br>(10)        | 6<br>(1)   |
| Instructions to members of engagement teams  | 27<br>(-)                  | 4<br>(-)   | 30<br>(1)                      | 57<br>(1)         | 4<br>(-)   |
| Development and maintenance of audit work papers   | 40<br>(-)                  | 13<br>(-)  | 48<br>(2)                      | 88<br>(2)         | 13<br>(-)  |
| Preparation of the summary of audit findings   | 13<br>(1)                  | 5<br>(-)   | 12<br>(-)                      | 25<br>(1)         | 5<br>(-)   |
| Management representations   | 52                         | 2          | 42                             | 94                | 2          |
| External confirmations   | 37                         | 8          | 20                             | 57                | 8          |
| Other  |                            |            |                                |                   |            |
| Overall quality control system   | 8                          | 3          | 2                              | 10                | 3          |
| Engagement quality control review for expressing an audit opinion                                  | 40<br>(7)                  | 5<br>(1)   | 51<br>(25)                     | 91<br>(32)        | 5<br>(1)   |
| Qualification of auditors and personnel engaged in audits  | 27<br>(-)                  | 3<br>(-)   | 41<br>(5)                      | 68<br>(5)         | 3<br>(-)   |
| Acceptance and continuance of audit engagements  | 45<br>(-)                  | 7<br>(-)   | 39<br>(1)                      | 84<br>(1)         | 7<br>(-)   |
| Joint audit arrangements   | 7                          | -          | 18                             | 25                | -          |
| Monitoring of implementation of quality control  | 19                         | 8          | 4                              | 23                | 8          |
| Number of quality control review reports   | 79                         |            | 63                             | 142               |            |

Notes:

1. The figures in parenthesis in the table indicate the number of qualified items that led to a qualified conclusion or a negative conclusion in the quality control review reports.
2. The table indicates that qualified conclusions or negative conclusions were expressed to 37% (53/142) of audit firms on a risk-based approach and 23% (32/142) of audit firms for an engagement quality

control review of expressing an audit opinion. These do not indicate that 37% or 23% of individual audit engagements received qualified conclusions or negative conclusions, but rather that the audit firms themselves received qualified conclusions or negative conclusions regarding their quality control review.

## 8-2. Major items of recommendation

Details of the risk-based approach, audit procedures of accounting estimates, and engagement quality control review for expressing an audit opinion are illustrated as follows:

### a. Risk-based approach

|  | (number of audit firms)          |                                      |             |
|--|----------------------------------|--------------------------------------|-------------|
|  | Listed<br>company<br>audit firms | Non-listed<br>company<br>audit firms | Total       |
| Setting criteria for materiality                   | 28<br>(13)                       | 34<br>(30)                           | 62<br>(43)  |
| Assessing inherent risks                           | 19<br>(11)                       | 38<br>(33)                           | 57<br>(44)  |
| Assessing preliminary control risks                | 30<br>(11)                       | 46<br>(35)                           | 76<br>(46)  |
| Planning and performing tests of controls          | 50<br>(17)                       | 43<br>(32)                           | 93<br>(49)  |
| Determining substantive procedures                 | 47<br>(16)                       | 54<br>(35)                           | 101<br>(51) |
| Consistency and reasonableness of the overall plan | 4<br>(2)                         | 10<br>(8)                            | 14<br>(10)  |

Notes:

1. The figures in parenthesis indicate the number of qualified items that led to a qualified conclusion or a negative conclusion in the quality control review reports.
2. As there are multiple recommendations to individual audit firms, the total recommendations do not correspond to the number of recommendations indicated in the above table under Section 8-1, "Number of recommendations by item."
3. The determination of a qualified conclusion is based on an overall consideration of the items shown in the above table. Qualified conclusions are not determined by the above individual classifications.

**b. Audit procedures of accounting estimates**

(number of audit firms)

|   | Listed<br>company<br>audit firms | Non-listed<br>company<br>audit firms | Total     |
|---|----------------------------------|--------------------------------------|-----------|
| Deferred tax assets   | 18<br>(1)                        | 13<br>(4)                            | 31<br>(5) |
| Employee retirement benefits                                    | 20<br>(-)                        | 21<br>(2)                            | 41<br>(2) |
| Allowance for doubtful accounts                                 | 12<br>(2)                        | 7<br>(2)                             | 19<br>(4) |
| Investments in affiliates or unlisted entities                  | 8<br>(1)                         | 6<br>(1)                             | 14<br>(2) |
| Impairment of fixed assets                                      | 8<br>(-)                         | 5<br>(1)                             | 13<br>(1) |
| Derivatives   | 5                                | 3                                    | 8         |
| Accrued bonuses   | 2                                | 4                                    | 6         |
| Accrued retirement benefits to directors and corporate auditors | 4                                | 2                                    | 6         |
| Other   | 9                                | 6                                    | 15        |

Notes:

1. Please refer to Notes 1 and 2 of Subpart 8-2a, "Risk-based approach."
2. "Employee retirement benefits" includes necessary audit procedures such as external confirmations in order to examine the appropriateness of basic data used in the accounting estimate.
3. Major items classified as "Other" in the above table include five cases of slow-moving inventory (2 listed and 3 non-listed) and three cases of property held for sale (2 listed and 1 non-listed).

**c. Engagement quality control review for expressing an audit opinion**

(number of audit firms)

|   | Listed<br>company<br>audit firms | Non-listed<br>company<br>audit firms | Total      |
|---|----------------------------------|--------------------------------------|------------|
| Lack of an adequate engagement quality control review system  | 9<br>(3)                         | 16<br>(16)                           | 25<br>(19) |
| Lack of engagement quality control reviews of semi-annual audits                                    | -                                | 5<br>(4)                             | 5<br>(4)   |
| Lack of engagement quality control reviews of audits under the Commercial Code                      | 2<br>(2)                         | 2<br>(2)                             | 4<br>(4)   |
| Lack of engagement quality control reviews of (annual) audits under the Securities and Exchange Law | -                                | 1<br>(1)                             | 1<br>(1)   |
| Lack of adequate items to be reviewed   | 25<br>(2)                        | 21<br>(1)                            | 46<br>(3)  |
| Inadequate documentation of engagement quality control reviews                                      | 15<br>(-)                        | 10<br>(1)                            | 25<br>(1)  |
| Other   | 8                                | 11                                   | 19         |

Notes:

1. Please refer to Notes 1 and 2 of Item 8-2a, "Risk-based approach."
2. The classification, "Lack of adequate items to be reviewed" includes many cases where audit plans were not reviewed, or audit plans were not included in the review documents. The classification, "Inadequate documentation of engagement quality control reviews" includes a number of cases where the conclusion of the engagement quality control review was not clearly documented.
3. Major items classified as "Other" include 15 cases (4 listed and 11 non-listed) where confidentiality requirements of engagement quality control reviewers and their responsibilities were not confirmed in writing, or no contracts were concluded with engagement quality control reviewers.

**8-3. Review results relating to the focus areas for the period**

**a. Auditor independence**

Recommendations were made to 68 audit firms (27 listed and 41 non-listed) with regard to qualification of auditors and personnel engaged in audits. As for listed company audit firms, none were found to be qualified items. Previously issued recommendations were repeated to 3 firms (all listed), 49 of these audit firms (8 listed and 41 non-listed) were newly subject to quality control review beginning this period. The reason why there was a high percentage of recommendations issued to non-listed company audit firms derives from the fact that audit firms which were regarded to have some concern over independence were selected as a priority.

#### **b. Follow-up of recommendations**

The Review Team visited 26 audit firms to which were issued quality control review reports with a qualified conclusion resulting from the prior quality control review, and also subject to quality control reviews for the review year beginning April 1, 2007. It was required for those audit firms to improve without delay the identified deficiencies by implementation of corrective actions.

Follow-ups were similarly conducted at audit firms that were subject to quality control review during this year regarding implementation of corrective actions. While there were 61 qualified items related to the risk-based approach, and 24 qualified items related to engagement quality control review during the year ended March 31, 2004, there were 10 qualified recurring items related to risk-based approach and one recurring qualified item related to engagement quality control review during the year ended March 31, 2007 for listed company audit firms. Therefore, the evaluation was reached that existing firms have made improvements.

Follow-ups were conducted at three large audit corporations that audit many listed companies with regard to the implementation of corrective actions for recommendations issued in the quality control review during the previous year.

When on-site reviews are conducted to confirm the reports on implementation of quality control submitted by the audit firms, an understanding is obtained as to the implementation of a quality control system based on Standards of Quality Control that were applicable for the period beginning April 1, 2006, as well as the implementation of corrective actions.

The results of quality control reviews during this period indicated that some of the implementations were assessed as continuing to be unsatisfactory, although these audit firms had reported in their reports submitted during the previous year regarding implementation of quality control that either implementation was already completed, or would be completed by March 2006. These cases are included in the table in Section 8-1, "Number of recommendations by item" under the column heading, "Recurring." Identification of the reasons for unsatisfactory implementation and prompt improvements for recurring recommendations are required for such audit firms (see below, "Risk-based approach").

#### **c. Risk-based approach**

Recommendations were made to 119 audit firms (60 listed and 59 non-listed), 36 (all listed) of which received the same recommendations as previously. Although the number of repeated recommendations was higher than expected, the percentage of audit firms that received repeated recommendations for the year ended March 31, 2007 was about 60%. This is a decrease by 20% compared with those of the previous year, and improvements were noted for existing firms. If a firm received repeated recommendations as in prior years, identification of

the reasons for unsatisfactory implementation as well as prompt improvement is required. Major reasons for unsatisfactory improvements include failure to implement corrective actions fully, in spite of ongoing efforts. Therefore, further improvements are needed at audit firms.

These 119 audit firms include 75 audit firms (16 listed and 59 non-listed) that were newly subject to a quality control review beginning this period. As described in Section 2 of the Appendix, "Major items of recommendations," many findings were regarding matters of planning and performing procedures designed for control risk assessment and the determination of substantive procedures based on the assessed risk.

As for control risk assessment of information systems using IT, recommendations were made to 92 audit firms (58 listed and 34 non-listed) that included 45 listed company audit firms that have been reviewed previously, 13 listed company audit firms newly subject to a quality control review, and 34 non-listed company audit firms newly subject to a quality control review. There were many recommendations for control risk assessment of information systems using IT, as there also were last year, as a result of the development of our review tools for this area, and reviews conducted by the JICPA's IT professional. Although progress was observed in the understanding of audit responses to information systems using IT, it was considered that concrete responses in audit engagements were yet to be fully implemented.

#### **d. Understanding of the design of quality control systems**

The Review Team obtained an understanding regarding whether audit firms properly established a quality control system in the course of quality control reviews for this period. When a delay was identified in response to Quality Control Standards Committee Statement No. 1, *Quality Control for Firms That Perform Audits*, Auditing Standards Committee Statement No. 32, *Quality Control for Audits*, Statement No. 33, *Change of Auditors*, and Statement No. 34, *Related Parties*, improvements were urged. Implementation of the new Standards of Quality Control was not covered by quality control review reports, and was not considered as part of any recommendation. This is because the quality control review is to review compliance of audit firms with the Standards of Quality Control regarding audit engagements covered by auditor reports for dates that occur within the review period.

#### **e. Sufficiency of audit procedures in forming an audit opinion**

Recommendations on audit procedures of accounting estimates were made to 79 audit firms (39 listed and 40 non-listed). Recommendations for preparation of the summary of audit findings were issued to 24 audit firms (12 listed and 12 non-listed). Of these 79 and 24 audit firms, 50 (10 listed and 40 non-listed) and 16 audit firms (4 listed and 12 non-listed), respectively, were newly subject to a quality control review this review period. The percentage of audit firms that

received recommendations on audit procedures of accounting estimates was higher than expected.

## 9. Overview of Reports on Implementation of Quality Controls

### 9-1. Submission of "Reports on implementation of quality controls"

In accordance with Article 3-2 of the former Quality Control Committee regulations, audit firms which perform audits of entities stated in Article 87, Paragraph 3 of the Constitution prior to amendment (i.e., certain large companies and other entities stipulated in the CPA Law) are required to report by December 31 of every year on implementation of quality controls for each year ended September 30, in the form, "Reports on implementation of quality controls."

The number of audit firms that submitted reports on implementation of quality controls for the current period is 448 audit firms, with a breakdown as follows:

(number of audit firms)

|                    | Prior-reviewed firms |                   | Newly-reviewed firms |                   |
|--------------------|----------------------|-------------------|----------------------|-------------------|
|                    | Number of firms      | Reports submitted | Number of firms      | Reports submitted |
| Audit corporations | 129                  | 129               | 12                   | 12                |
| Sole practitioners | 246                  | 246               | 61                   | 61                |
| Total              | 375                  | 375               | 73                   | 73                |

There were no audit firms that did not submit reports on the implementation of quality controls.

The following table lists the breakdown of submitted reports, classified by the period in which quality control reviews were conducted.

(number of audit firms)

| Year ended March 31  | Number of firms | Reports submitted |
|--|-----------------|-------------------|
| (Audit firms for which quality control reviews were conducted)     |                 |                   |
| 2006 and 2005  | 184             | 184               |
| 2007   | 118             | 118               |
| Subtotal   | 302             | 302               |
| (Audit firms for which quality control reviews were not conducted) |                 |                   |
| Subject to review from 2005  | 58              | 58                |
| Subject to review from 2006  | 15              | 15                |
| Subject to review from 2007  | 73              | 73                |
| Subtotal   | 146             | 146               |
| Total  | 448             | 448               |

Notes:

1. A quality control review for the year ended March 31, 2007 was conducted of 137 audit firms, but the above table indicates 118 audit firms due to the exclusion of 19 audit firms that had terminated agreements by the time reports on implementation of quality controls were collected. These 118 audit firms include one audit firm to which a quality control review report was not issued due to the death of the auditor after the quality control review was performed.
2. The number of audit firms in "Subject to review from 2007" for which a quality control review was not conducted includes one firm that was excluded as the subject of a review due to the termination of an agreement after the quality control review was conducted during the year ended March 31, 2003, as this firm concluded an agreement with a company subject to review during the year ended March 31, 2007.

## **9-2. Improvement of audit firms at which quality control reviews were conducted**

### **a. Audit firms at which quality control reviews were conducted in the current period**

Implementations of corrective actions are examined as part of the quality control review and recommendation reports are delivered if further improvements are necessary. Additional details and the degree that improvements were achieved, including the number of recurring recommendations, are described in Item 8, "Overview of Recommendation Reports Issued for the Current Period."

Note:

There were 54 audit firms that submitted a report on implementation of quality control during the year ended March 31, 2006 among the audit firms for which a quality control review was performed, excluding those for which a quality control review was not completed during the review period. Almost all these reports indicated that corrective actions were implemented, but in fact, corrective actions were found to be inadequate after a quality control review was conducted, and these cases were pointed out as repeated recommendations.

**b. Audit firms for which quality control reviews were conducted for the years ended March 31, 2005 and 2006**

The following table indicates an analysis of implementation of corrective actions that were reported.

(number of audit firms)

|                    | All corrective actions implemented | A portion of corrective actions implemented | No corrective actions implemented | Total |
|--------------------|------------------------------------|---|-----------------------------------|-------|
| Audit corporations | 68                                 | 31  | 1                                 | 100   |
| Sole practitioners | 57                                 | 25  | 0                                 | 82    |
| Total              | 125                                | 56  | 1                                 | 182   |

Note:

The difference between the total of 182 in the above table and the figure of 184 that is shown in Section 9-1, "Submission of reports on implementation of quality controls" conducted for the years ended March 31, 2005 and 2006, is due to two audit firms not receiving recommendation reports, as no specific matters subject to recommendation were found in the course of the quality control review.

Implementations of corrective action for major recommendations are reported as follows (compared with the previous year):

(number of audit firms)

|  | Year ended March 31 |                 |             |                 |
|--|---------------------|-----------------|-------------|-----------------|
|  | 2006                |                 | 2007        |                 |
|  | Implemented         | Not implemented | Implemented | Not implemented |
| Performance of audit engagements                 |                     |                 |             |                 |
| Risk-based approach                              | 107<br>(50)         | 18<br>(15)      | 132<br>(44) | 17<br>(10)      |
| Audit procedures of accounting estimates         | 63<br>(2)           | 3<br>(-)        | 93<br>(4)   | 6<br>(-)        |
| Instructions to members of engagement teams      | 37                  | 12              | 47          | 6               |
| Development and maintenance of audit work papers | 89                  | 7               | 87          | 10              |
| Preparation of the summary of audit findings     | 20                  | 3               | 15          | 2               |
| External confirmations                           | 71                  | 2               | 82          | 8               |

|   | Year ended March 31 |                 |             |                 |
|---|---------------------|-----------------|-------------|-----------------|
|   | 2006                |                 | 2007        |                 |
|   | Implemented         | Not implemented | Implemented | Not implemented |
| Other   |                     |                 |             |                 |
| Overall quality control system                                    | 22                  | 3               | 21          | 6               |
| Engagement quality control review for expressing an audit opinion | 64<br>(26)          | 1<br>(1)        | 95<br>(31)  | 5<br>(-)        |
| Qualification of auditors and personnel engaged in audits         | 39<br>(-)           | 2<br>(-)        | 70<br>(1)   | 5<br>(-)        |
| Acceptance and continuance of audit engagements                   | 26                  | 1               | 55          | 9               |
| Monitoring of implementations of quality control                  | 38                  | 5               | 58          | 12              |

Notes:

1. The figures in parenthesis indicate the number of qualified items that led to a qualified conclusion in a quality control review report.
2. The figures in the 2006 column show the number of corrective actions implemented as of September 30, 2005 by audit firms for which a quality control review was performed for the years ended March 31, 2004 and 2005. Similarly, the figures in the 2007 column refer to those audit firms for which quality control reviews were performed for the years ended March 31, 2005 and 2006, and reports on implementation of quality control were collected from 184 firms. However, 2 joint firms were judged to be equivalent to audit corporations, and 19 firms and 2 other firms were counted as one firm each. As a result, the number of audit firms that were analyzed above was 165 firms.
3. Six audit firms responded that they are not making progress in improvements for risk-based approach among those audit firms that received qualified conclusions, twice consecutively.

In considering the implementation of corrective actions, the Review Team conducted onsite visits to 29 audit firms, as described in Item 8-3, "Review results relating to the focus areas for the period," Subpart b, "Follow-up of recommendations." During those visits, the Review Team obtained an understanding of the implementation for corrective actions and the design of the quality control system based on the Standards of Quality Control, and required early implementation by the audit firms where unsatisfactory matters were identified.

### **9-3. Audit firms for which quality control reviews were not conducted**

Quality control reviews were not conducted of 146 audit firms (12 audit corporations and 134 sole practitioners). The reports on implementation of quality control and accompanying documents obtained from those audit firms were analyzed. Quality control reviews were not conducted at 73 audit firms (12 audit corporations and 61 sole practitioners) newly subject to

quality control review for the year ended March 31, 2007. Quality control system questionnaires (QCQ200, QCQ220) were added to the accompanying documents for these audit firms.

The audit firms in the following circumstances will be subject to quality control review for the year ending March 31, 2008; in addition, they will be requested to implement corrective actions:

- confirmation of independence is inadequate;
- engagement quality control reviews are inadequate; or
- there is some reason to conclude that only one partner is involved in audit engagements.

#### **9-4. Analysis of responses to Standards of Quality Control and other pronouncements**

As new Standards of Quality Control and new risk-based approach standards are applicable for audits of periods beginning on or after April 1, 2006, responses to these requirements were obtained as follows:

##### **a. Application of new Standards of Quality Control**

(number of audit firms)

|                                   | Audit firms for which quality control reviews were conducted | Audit firms for which quality control reviews were not conducted | Total |
|-----------------------------------|--|--|-------|
| Early application was adopted     | 13   | 8  | 21    |
| Early application was not adopted | 152  | 138  | 290   |
| Total                             | 165  | 146  | 311   |

It was reported that about 60% of audit firms have not established a quality control system among audit firms that have not adopted early application.

##### **b. Application of new risk-based approach standards**

(number of audit firms)

|                                   | Audit firms for which quality control reviews were conducted | Audit firms for which quality control reviews were not conducted | Total |
|-----------------------------------|--|--|-------|
| Early application was adopted     | 19   | 15   | 34    |
| Early application was not adopted | 146  | 131  | 277   |
| Total                             | 165  | 146  | 311   |

About 20% of audit firms among audit firms that have not adopted early application were expected to have delayed their responses to Auditing Standards Committee Statement No. 27 through No.

31. As for questions on application of IT Committee Statement No. 3, it was reported that a majority were estimated not to have established practical procedures that are necessary to determine and perform control risk assessment procedures regarding information systems using IT.

## **10. Amendment and Abolishment of the portions of the Constitution, Regulations, Detailed Rules, Quality Control Review Standards, Quality Control Review Procedures and Committee Operation Manuals**

### **10-1. Amendment of the Constitution and the Regulations of the Quality Control Committee at the General Assembly meeting on July 4, 2006**

At the General Assembly meeting held on July 4, 2006, provisions of the Constitution and Regulations relating to governance reform of the JICPA were amended. With respect to quality control reviews, publishing of the overview of the Quality Control Committee's activities provided under Article 88, Paragraph 6 was changed from after the approval of the Council, to after the approval of the Executive Board. As for the Regulations of the Quality Control Committee, Article 2, Paragraphs 2 and 3 of the Regulations of the Quality Control Committee was amended to provide that standards of quality control review and quality control review procedures developed by the Quality Control Committee would be approved by the Council (Paragraph 2) and by the Executive Board (Paragraph 3), respectively. These amendments will be effective after the General Assembly meeting to be held in 2007, in accordance with other amendments of governance reform.

Furthermore, "a substantial doubt regarding the compliance with the Constitution and Regulations" was added to Article 88, Paragraph 3 stipulating that, when the Committee identifies a substantial doubt regarding the appropriateness of an audit opinion expressed by a sole practitioner or an audit corporation as a result of a quality control review, it should be reported to the Chairman and President. Therefore, Paragraph 3 was revised to clarify its meaning. This Paragraph also states that the Chairman and President takes appropriate actions after receiving such a report, however, the text was revised to state, "the Chairman and President takes appropriate actions including recommendations or instructions pursuant to Article 33 after receiving such a report," in order to clarify that the actions taken by the Chairman and President include recommendations or instructions pursuant to Article 33. (These amendments took effect upon the approval of the Commissioner of the Financial Services Agency on August 21, 2006.)

Article 89-2-2, Paragraph 2 stipulated that, when a significant issue is identified in a quality control system through the investigations of the Audit Practice and Review Committee, this fact shall be reported to the Chairman and President, who shall then instruct the Quality Control Committee to take the necessary measures. This text was revised to state, "the Chairman

and President shall instruct the Quality Control Committee to conduct a review pursuant to Article 87, Paragraph 1 of the Constitution and to take other necessary measures," in order to specify the content of necessary instructions. It was also clarified that sole practitioners and audit corporations subject to review under Article 89-2-2, Paragraph 2 shall be obligated to provide full cooperation for a quality control review (Article 87, Paragraph 4) and take corrective actions in response to recommendations (Article 87, Paragraph 5). (These amendments took effect upon the approval of the Commissioner of the Financial Services Agency on August 21, 2006.)

In addition, Article 2-3, Item 9 of the Regulations of the Quality Control Committee lists audit engagements subject to a quality control review pursuant to Article 87, Paragraph 3, Item 6 of the Constitution, and Item 9, "Government Pension Investment Fund" was eliminated due to the reorganization of the Fund into an independent administrative agency, which is listed in Item 5. This amendment is applicable to audits for periods commencing on or after April 1, 2006.

**10-2. Amendment of the Constitution and Regulations of the Quality Control Committee pursuant to the introduction of the Registration System of Listed Company Audit Firms at the Special Assembly meeting on December 11, 2006 and establishment of relevant Regulations and Detailed Rules**

From the perspective of ensuring confidence in CPA audits, the JICPA decided to introduce a system that requires sole practitioners and audit corporations that conduct audit engagements of listed companies to register with the Center for Listed Company Audit Firms (the "Center") that was established within the Quality Control Committee, in order to strengthen the quality control system of firms that audit listed companies which may have significant influence over capital markets. Under this system, the audit firms are listed and disclosed that have been admitted for registration in the register of Listed Company Audit Firms. Article 88, Paragraph 1 of the Constitution that provides the responsibilities of the Quality Control Committee was revised to include matters related to the registration of listed company audit firms. Article 88-3 that provides for the Quality Control Oversight Board was revised regarding composition of members and their responsibilities, and a system of alternates was added. Chapter 17-2, "Registration of Listed Company Audit Firms" was created to provide for the establishment of the Center, registration application, examination and deliberation of registration, requirements of registered audit firms, related actions, treatment of a registered audit firm that becomes subject to disciplinary actions, treatment of audit firms that are not registered with the Center, associate registered firms, and appeals. Also established were the Regulations of the Quality Control Oversight Board; Regulations of Listed Company Audit Firms Registration and Detailed Rules; Detailed Rules related to Actions for Listed Company Audit Firms; and agreements that are to be followed by registered audit firms and agreements by associate registered firms. In addition,

necessary revisions were made to the Regulations of the Quality Control Committee in order to put this system into practice.

Once these amendments were completed, a review was performed to reorganize the Constitution and other regulations, and correlate the various articles of the Constitution, Regulations of the Quality Control Committee, Operation Manuals of the Quality Control Committee, Regulations of the Quality Control Oversight Board, Regulations of Listed Company Audit Firm Registration and Detailed Rules, Detailed Rules Related to Actions for Listed Company Audit Firms, and the agreements that are to be followed by registered audit firms and the agreements by associate registered firms.

### **10-3. Amendment of the Quality Control Review Standards**

The Quality Control Committee made necessary revisions, which were approved by the Council on July 19, 2006, with the major revisions as follows.

It was stipulated that Auditing Standards Committee Statement No. 12, *Quality Control for Audit Work*, and Audit Special Committee for Banks Statement No. 5, *Practical Guideline for the Quality Control of Audits of Financial Institutions including Banks*, are the standards to be complied with by audit firms in particular, among the Constitution and other Regulations. As the following standards will become the applicable Standards for Quality Control of Audits: Quality Control Standards Committee Statement No. 1, *Quality Control for Firms That Perform Audits*, and Auditing Standards Committee Statement No. 32, *Quality Control for Audits*, some provisions were changed, as these are the standards to be complied with by audit firms, collectively referred to as the "Standards of Quality Control."

In order to conform with the amendments of the Constitution, cases to be reported to the Chairman and President are classified into those in which the Committee has identified "a substantial doubt regarding the appropriateness of an audit opinion," and, "a substantial doubt regarding compliance with the Constitution and Regulations" under Item 5, "5. Reporting to the Chairman and President." Also, Item 6, "Conduct of Reviews in Accordance with Article 87, Paragraph 1, pursuant to Article 89-2-2, Paragraph 2 of the Constitution (Special Reviews)" was established as a new item to conform to the revision of Article 89-2-2, Paragraph 2 of the Constitution.

### **10-4. Amendment of the Quality Control Review Procedures**

The Quality Control Committee prepared necessary amendments to the Quality Control Review Procedures that were approved by the Council meeting held on July 19, 2006. Following are the major amendments.

- a. Necessary revisions were made based on the Standards of Quality Control, including *Standards on Quality Control for Audits*, Quality Control Standards Committee Statement No. 1, *Quality Control for Firms That Perform Audits*, and Auditing Standards Committee Statement No. 32, *Quality Control for Audits*. [I. Preface, 2. Definition of quality control standards, auditing norms and accounting norms (Paragraph 9); III. Quality control review procedures, 2. Requests for audit firms to submit documents, "Questionnaires on the quality control of audits (QCQ200)," (Paragraph 156) and others]
- b. Necessary revisions were made to conform to the addition of "cases in which the Quality Control Committee identifies a substantial doubt regarding compliance with the Constitution and Regulations" to Article 88, Paragraph 3 of the Constitution. [IV. Procedures for issuing a quality control review report, 2-2. Cases where the Committee identifies a substantial doubt regarding the appropriateness of an audit opinion, "Examination by the Quality Control Committee" (Paragraph 420-3)]
- c. Necessary revisions were made to conform to the addition of "reviews in accordance with Article 87, Paragraph 1 (Special Reviews)" to Article 89-2-2, Paragraph 2 of the Constitution. [VI. Reviews in accordance with Article 87, Paragraph 1, pursuant to Article 89-2-2, Paragraph 2 of the Constitution (Paragraph 561-2 through Paragraph 561-4)]
- d. Necessary revisions were made to conform to the revision of the Regulations of the Quality Control Committee. [I. Preface, 1. The objective, application and definitions of Quality Control Review Procedures, "Objectives," (Paragraph 1)]
- e. Names were modified of laws and other terminology in accordance with the enactment of the Companies Act. [I. Preface, 2. Definition of quality control standards, auditing norms and accounting norms, "Definitions of auditing norms and accounting norms," (Paragraph 17), 3. Audit engagements subject to quality control reviews, "Audit engagements pursuant to laws related to audits performed by audit firms subject to quality control reviews," (Paragraph 19), and other changes]
- f. The composition was revised of review working papers and documents to be submitted by an audit firm in order to conform to the additions and revisions of the review tools. [III. General procedures, 7. Review working papers, "Normal components of review working papers" (Paragraph 116); III. Quality control review procedures, 2. Requests for audit firms to submit documents, "Documents requested to be submitted" (Paragraphs 144), and other changes]
- g. Requirements were added to describe qualified items in addition to items that led to a negative conclusion in a quality control review report, when issuing a negative conclusion. [IV. Procedures for issuing a quality control review report, 5. Guidelines for the preparation of a quality control review report, "Reasons for issuing a qualified conclusion or negative conclusion" (Paragraph 513), Appendices I and II]

- h. Modifications were made to "Appendix IV: Reporting format pursuant to Article 3-2 of the Regulations of the Quality Control Committee."

## **11. Development and Amendment of Review Tools**

Based on the application of the new Standards of Quality Control, the amendment of the Constitution and other Regulations, the quality control reviews conducted to date, and recommendations made in the course of monitoring by the CPAAOB, new review tools were added or revised on May 19 and June 16, 2006 in order to further enhance quality control reviews in the future. These tools have already been used in quality control reviews conducted this year. Major amendments are as follows.

### **11-1. Amendment of questionnaires regarding the quality control of an audit (QCQ200 – Audit corporations; QCQ210 – Details for an audit corporation; QCQ220 – Sole practitioners; and QCQ230 – Performing audit engagements (common use), supplement)**

- a. Portions were separated relating to the performance of audit engagements from the former QCQ200, 210, 220. QCQ230 was established, "Performing audit engagements (common use)" as a common questionnaire and added to QCQ230 questionnaires on implementation of amended Auditing Standards Committee Statement No. 27, *Audit Planning*; Statement No. 28, *Audit Risk*; Statement No. 29, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*; Statement No. 30, *Auditor's Procedures in Response to Assessed Risks*; and Statement No. 31, *Audit Evidence*.
- b. A supplement was designed to confirm the implementation of Quality Control Standards Committee Statement No. 1, *Quality Control for Firms That Perform Audits*, and Auditing Standards Committee Statement No. 32, *Quality Control for Audits*, for which early application is permitted, although they are applicable for periods beginning on or after April 1, 2006.

### **11-2. Amendment of audit engagement profiles**

#### **(QCQ400, QCQ480 –Independent administrative agencies, and QCQ485 –National universities)**

- a. Required information was improved for personnel engaged in audits, such as the number of years that an engagement quality control reviewer engaged in a particular audit, and for the lead engagement partner.
- b. A description is requested of the overview of early application of Auditing Standards Committee Statements No. 27 through 31, major transaction cycles, and the assessment of control risk.

- c. A description is requested regarding accounting for impairment of fixed assets in an annex of QCQ400, and the format and notes for the descriptions contained in the annex were modified.

### **11-3. Amendment of review procedures for implementation**

#### **(QCP200 –Audit corporations, QCP210 –Sole practitioners)**

- a. Review procedures were added in accordance with Quality Control Standards Committee Statement No. 1, *Quality Control for Firms That Perform Audits*, Auditing Standards Committee Statement No. 32, *Quality Control for Audits*, and Statement No. 33, *Change of Auditors*.
- b. It is now required that matters relating to the establishment of audit manuals and monitoring of quality control to be considered in principle, although formerly these issues were permitted to be overlooked, when a sole practitioner (QCP210) subject to review has a limited number of audit engagements.

### **11-4. Amendment and addition of procedures for interviews with personnel engaged in an audit (QCP300 –Audit corporations, QCP310 –Audit corporations)**

- a. A description was added of the evaluation of the results of interviews, in order to clarify the relationship between the results of interviews and other review procedures.
- b. Procedures were established (QCP310) to respond to audit firms that apply Auditing Standards Committee Statement No. 27 through No. 31.

### **11-5. Amendment and addition of audit engagement review procedures (QCP400, and others)**

- a. Review procedures were added to QCP418 that address investments in investment funds, SPCs, and other investment vehicles.
- b. The following review procedures were added to address earlier application by audit firms of new Statements:
  - (1) QCP420, to review audit documentation on audit planning when an audit firm applies Auditing Standards Committee Statements No. 27 through No. 31;
  - (2) QCP421, to review an auditor's procedures of the risk assessment for material misstatements in relation to information systems using IT, and the auditor's procedures in response to assessed risks when an audit firm applies IT Committee Statement No. 3;
  - (3) QCP422, to review a change of auditors when an audit firm applies Auditing Standards Committee Statement No. 33;
  - (4) QCP423, for an audit firm that applies Auditing Standards Committee Statement No. 34, *Related Parties*.

- c. QCP481 (Independent administrative agencies) and QCP486 (National universities) were added as review procedures that address earlier application of Auditing Standards Committee Statement No. 27 through No. 31, with regard to review procedures for audit engagements for independent administrative agencies (QCP480) and national universities (QCP485). Also added were QCP482 (Independent administrative agencies) and QCP487 (National universities) as review procedures of accounting for impairment of fixed assets.

#### **11-6. Necessary modifications to conform to the enactment of the Companies Act**

#### **11-7. Addition of QCF140 on October 23, 2006 to record findings for follow-up reviews, after the last amendment in June 2006**

Beginning this year, members and associate members can view and download quality control review tools without charge from the JICPA website.

### **12. Activities of the Quality Control Committee and review working groups**

The table below indicates the number of meetings of the Quality Control Committee that were held for the year ended March 31, 2007. The composition of working groups is as follows:

- General committee: Chair, and 25 members;
- Review working groups: five working groups, consisting of the Chair, Deputy Chair, and three members each;
- Working group for independent administrative agencies: Chair, and one member;
- Working group for revision of quality control review standards and procedures: Chair, Deputy Chair, and three members;
- Working group for revision of quality control review tools: Chair, Deputy Chair, and nine members;
- Working group for the JICPA Annual Conference: Chair, and three members;
- Review working group Chairs' meeting: Chair of the Committee, and each Chair of the five working groups.

On December 18, 2006, the "Working group for revision of quality control review standards and procedures" and the "Working group for revision of quality control review tools" were established in order to revise the Standards of Quality Control Review, Quality Control Review Procedures, and Quality Control Review Tools in response to the following pronouncements: Quality Control Standards Committee Statement No. 1, *Quality Control for Firms That Perform Audits*, and Auditing

Standards Committee Statement No. 32, *Quality Control for Audits*, No. 33, *Change of Auditor*, and No. 34, *Related Parties*, which are applicable for audits of periods beginning April 1, 2006, and due to the introduction of the registration system of listed company audit firms with a view toward the quality control reviews to be conducted in the year ending March 31, 2008. The Working group for the JICPA Annual Conference was established on March 16, 2007 in order to prepare for a session entitled "Practices of Quality Control in Audit Firms" that will be presented at the Annual Conference to be held in October 2007.

|   | Number of meetings held |
|---|-------------------------|
| General committee   | 12                      |
| Review working groups   | 69                      |
| Working group for independent administrative agencies                         | 2                       |
| Working group for revision of quality control review standards and procedures | 2                       |
| Working group for revision of quality control review tools                    | 3                       |
| Working group for the JICPA Annual Conference                                 | 1                       |
| Review working group Chairs' meeting  | 2                       |

### 13. Quality Control Review Team

#### 13-1. Composition of the Quality Control Review Team

On June 30, the chief executive reviewer, one deputy chief reviewer, two senior reviewers, and a staff reviewer resigned. A new chief executive reviewer, two senior reviewers, and a staff reviewer were appointed on July 1, 2006, and a senior reviewer was promoted to deputy chief reviewer. A new staff reviewer was appointed on July 24, 2006.

The composition of the quality control review team as of March 31, 2007 was as follows:

|                          | Number of staff |
|--------------------------|-----------------|
| Chief executive reviewer | 1               |
| Deputy chief reviewers   | 2               |
| Senior reviewers         | 9               |
| Staff reviewers          | 8               |
| Total                    | 20              |

#### 13-2. Total number of days spent on reviews

The total number of days by reviewers conducting reviews is as follows:

(number of actual days)

|                    | Year ended<br>March 31, 2006 | Year ended<br>March 31, 2007 |
|--------------------|------------------------------|------------------------------|
| Audit corporations | 2,073                        | 1,848                        |
| Sole practitioners | 462                          | 570                          |
| Total              | 2,535                        | 2,418                        |

The total number of days conducting reviews this year decreased because there were no additions of audit firms that were subject to review after the annual quality control review plan was finalized.

### **13-3. Training within the Quality Control Review Team**

The following training was provided to reviewers:

- a. new risk-based approaches;
- b. IT Committee Statement No. 3, *Auditor's Assessment of the Risks of Material Misstatement and Procedures in Response to Assessed Risks Related to Information Systems Using Information Technology in an Audit of Financial Statements*; and
- c. Standards of Quality Controls.

### **14. Future Challenges of the Quality Control Review System**

The review year that will end March 31, 2008 will mark the beginning of the second cycle after the quality control review system conducted by the JICPA was established as a legal obligation under the CPA Law, and became subject to monitoring by the CPAAOB. The Quality Control Committee sincerely has accepted recommendations from the CPAAOB and the Quality Control Oversight Board, and made every effort to implement necessary reforms and to enhance the effectiveness of quality control reviews for the past three years.

The JICPA commenced its operations of the registration system of listed company audit firms in April 2007 as a measure that strengthens self-regulation amid a series of accounting scandals, and instructions and administrative sanctions imposed against members. The system requires audit firms providing audit services to listed entities to register with the Center for Listed Company Audit Firms and takes certain measures against audit firms when significant concerns about the firm's quality control are identified as a result of a quality control review. The measures include disclosure of this fact to the public via the register. Through these measures, the system is designed to improve and maintain the high quality of audits. The JICPA quality control system will function as a crucial infrastructure for the sound development of auditing systems in Japan by assuming a new role of examination regarding registration and actions under the system, in addition to the effective and rigorous quality control reviews which assist audit firms in maintaining and improving audit quality.

Issues related to the quality control review system, based on the registration system, that need to be addressed in the review year ending March 31, 2008 include the following.

**14-1. Enhancement of the review team structure and ensuring the necessary human resources**

- Utilize 30 quality control review team members, an increase of 10 reviewers, in order to address the expanding responsibilities of the Quality Control Committee, particularly transitional actions during the period after the registration system of listed company audit firms has commenced;
- Divide review teams into four groups and strengthen management by placing a Deputy Chief Reviewer as head of each group.

**14-2. Confirming establishment and implementation of the quality control system of audit firms**

- Performing focused reviews of whether audit firms appropriately establish and implement a firm-wide system of quality control in accordance with the Standards of Quality Control;
- Confirming whether audit firms conduct internal quality control monitoring adequately and promote improvement of audit quality regarding compliance with the quality control system of audit firms.

**14-3. Ensuring full implementation of corrective actions by performing follow-up measures**

- As for listed company audit firms, the Review Team shall confirm the implementation of corrective actions described in the responses to the previous quality control review report and recommendation report by performing follow-up reviews of audit firms that are not subject to a quality control review during the review year ending March 31, 2008. Furthermore, the Review Team shall confirm its readiness to meet the new Standards of Quality Control.
- As for non-listed audit firms, the Review Team shall confirm the improvement of audit firms that are subject to a quality control review the following review year. At the same time, when some issues are identified in the report on implementation of quality control submitted by an audit firm of which a quality control review has not been conducted, the quality control review of such an audit firm will be scheduled to occur sooner.

**14-4. Consideration of actions against listed company audit firms**

- When substantial concerns are identified regarding quality control of certain listed company audit firms as a result of quality control reviews or follow-up reviews performed during the review year ending March 31, 2008, draft conclusions for actions to be taken against such firms will be prepared and submitted to the Quality Control Oversight Board.

#### **14-5. The readiness of audit firms for audits based on new risk assessment approaches**

- The Review Team will confirm whether audit firms update their audit manuals, checklists, and other materials to enhance auditing practices using a new risk-based approach and perform audits in accordance with such risk assessment approaches.

#### **14-6. Implementation of special reviews**

- With regard to the cases reported to the Chairman and President by the Audit Practice and Review Committee and for which the Chairman and President provides directions to the Quality Control Committee pursuant to Paragraph 2 of Article 139 of the Constitution, an appropriate response should be implemented on an individual case basis. Especially for audit firms or audit engagements not subject to quality control review, the Committee will make the necessary responses after careful consideration as to whether special quality control reviews should be conducted.

## 1. Yearly Trends of Major Recommendations

## a. Yearly trends

(number of audit firms)

|  | Year ended March 31 |                  |                  |                   |                   |
|--|---------------------|------------------|------------------|-------------------|-------------------|
|  | 2003                | 2004             | 2005             | 2006              | 2007              |
| Performance of audit engagements   |                     |                  |                  |                   |                   |
| Risk-based approach  | 118 (95%)<br>(102)  | 82 (95%)<br>(61) | 77 (89%)<br>(23) | 114 (82%)<br>(50) | 119 (83%)<br>(53) |
| Assessing control risks in relation to use of information technology                               | -                   | -                | 24 (27%)         | 85 (61%)          | 92 (64%)          |
| Discussion with management and communication with corporate statutory auditors or their equivalent | -                   | -                | 26 (30%)         | 79 (56%)          | 88 (62%)          |
| Audit procedures of accounting estimates   | 45 (36%)<br>(7)     | 32 (37%)<br>(3)  | 54 (62%)<br>(5)  | 71 (51%)<br>(9)   | 79 (55%)<br>(10)  |
| Instructions to members of engagement teams  | 64 (51%)<br>(-)     | 28 (32%)<br>(-)  | 28 (32%)<br>(-)  | 41 (29%)<br>(2)   | 57 (40%)<br>(1)   |
| Development and maintenance of audit work papers   | 88 (70%)<br>(-)     | 55 (63%)<br>(-)  | 63 (73%)<br>(-)  | 77 (55%)<br>(2)   | 88 (62%)<br>(2)   |
| Preparation of the summary of audit findings   | 43 (34%)<br>(-)     | 21 (24%)<br>(1)  | 9 (10%)<br>(-)   | 20 (14%)<br>(2)   | 25 (18%)<br>(1)   |
| Management representations   | 16 (12%)            | 10 (11%)         | 33 (38%)         | 69 (49%)          | 94 (66%)          |
| External confirmations   | 42 (33%)<br>(-)     | 28 (32%)<br>(-)  | 50 (58%)<br>(-)  | 72 (51%)<br>(1)   | 57 (40%)<br>(-)   |
| Other  |                     |                  |                  |                   |                   |
| Overall quality control system   | 8 (6%)              | 18 (20%)         | 14 (16%)         | 16 (11%)          | 10 (7%)           |
| Engagement quality control review for expressing an audit opinion                                  | 82 (66%)<br>(64)    | 39 (45%)<br>(24) | 43 (50%)<br>(11) | 86 (61%)<br>(37)  | 91 (64%)<br>(32)  |
| Qualification of auditors and personnel engaged in audits  | 30 (24%)<br>(-)     | 19 (22%)<br>(-)  | 29 (33%)<br>(-)  | 63 (45%)<br>(4)   | 68 (48%)<br>(5)   |
| Acceptance and continuance of audit engagements  | 49 (39%)<br>(-)     | 32 (37%)<br>(-)  | 10 (11%)<br>(-)  | 68 (48%)<br>(2)   | 84 (59%)<br>(1)   |
| Joint audit arrangements   | 18 (14%)<br>(-)     | 8 (9%)<br>(-)    | 4 (4%)<br>(-)    | 20 (14%)<br>(1)   | 25 (17%)<br>(-)   |
| Monitoring of implementations of quality control   | 40 (32%)            | 16 (18%)         | 32 (37%)         | 46 (33%)          | 23 (16%)          |
| Number of quality control review reports   | 124                 | 86               | 86               | 139               | 142               |

## Notes:

1. The percentage figures in parenthesis (%) indicate the percentage of the number of recommendations to the number of quality control reports. The figures in parenthesis in the lower portion of each field indicate the number of qualified items that led to a qualified conclusion or negative conclusion in a quality control review report.
2. Since the year beginning April 1, 2005, the scope of quality control review has been extended to audit firms that perform audits of certain large companies and other entities stipulated in the CPA Law. Therefore, the number of quality control review reports has increased.

## b. Details of yearly trends by listed and non-listed company audit firms

(number of audit firms)

|  | Year ended March 31 |                 |                 |                 |
|--|---------------------|-----------------|-----------------|-----------------|
|  | Listed              |                 | Non-listed      |                 |
|  | 2006                | 2007            | 2006            | 2007            |
| Performance of audit engagements   |                     |                 |                 |                 |
| Risk-based approach  | 94(82%)<br>(33)     | 60(76%)<br>(17) | 20(80%)<br>(17) | 59(94%)<br>(36) |
| Assessing control risks in relation to use of information technology                               | 72(63%)             | 58(73%)         | 13(52%)         | 34(54%)         |
| Discussion with management and communication with corporate statutory auditors or their equivalent | 62(54%)             | 42(53%)         | 17(68%)         | 46(74%)         |
| Audit procedures of accounting estimates   | 61(54%)<br>(6)      | 39(49%)<br>(3)  | 10(40%)<br>(3)  | 40(63%)<br>(7)  |
| Instructions to members of engagement teams  | 36(32%)<br>(2)      | 27(34%)<br>(-)  | 5(20%)<br>(-)   | 30(48%)<br>(1)  |
| Development and maintenance of audit work papers   | 58(51%)<br>(2)      | 40(51%)<br>(-)  | 19(76%)<br>(-)  | 48(76%)<br>(2)  |
| Preparation of summary of audit findings   | 18(16%)<br>(2)      | 13(16%)<br>(1)  | 2(8%)<br>(-)    | 12(19%)<br>(-)  |
| Management representations   | 64(56%)             | 52(66%)         | 5(20%)          | 42(67%)         |
| External confirmations   | 58(51%)<br>(1)      | 37(47%)<br>(-)  | 14(56%)<br>(-)  | 20(32%)<br>(-)  |
| Other  |                     |                 |                 |                 |
| Overall quality control system   | 14(12%)             | 8(10%)          | 2(8%)           | 2(3%)           |
| Engagement quality control review for expressing an audit opinion                                  | 67(59%)<br>(27)     | 40(51%)<br>(7)  | 19(76%)<br>(10) | 51(81%)<br>(25) |
| Qualification of auditors and personnel engaged in audits  | 49(43%)<br>(3)      | 27(34%)<br>(-)  | 14(56%)<br>(1)  | 41(65%)<br>(5)  |
| Acceptance and continuance of audit engagements  | 54(47%)<br>(2)      | 45(57%)<br>(-)  | 14(56%)<br>(-)  | 39(62%)<br>(1)  |
| Joint audit arrangements   | 11(10%)<br>(-)      | 7(9%)<br>(-)    | 9(36%)<br>(1)   | 18(29%)<br>(-)  |
| Monitoring of implementations of quality control   | 38(33%)             | 19(24%)         | 8(32%)          | 4(6%)           |
| Number of quality control review reports   | 114                 | 79              | 25              | 63              |

Note:

The percentage figures in parenthesis (%) indicate the percentage of the number of recommendations to the number of quality control reports. The figures in parenthesis in the lower portion of each field indicate the number of qualified items that led to a qualified conclusion or negative conclusion in a quality control review report.

## 2. Major items of recommendation

### a. Risk-based approach

(number of audit firms)

|  | Year Ended March 31 |                  |                  |                  |
|--|---------------------|------------------|------------------|------------------|
|  | Listed              |                  | Non-listed       |                  |
|  | 2006                | 2007             | 2006             | 2007             |
| Setting criteria for materiality                   | 46 (40%)<br>(26)    | 28 (35%)<br>(13) | 13 (52%)<br>(12) | 34 (54%)<br>(30) |
| Assessing inherent risks                           | 36 (32%)<br>(23)    | 19 (24%)<br>(11) | 16 (64%)<br>(15) | 38 (60%)<br>(33) |
| Assessing preliminary control risks                | 43 (38%)<br>(30)    | 30 (38%)<br>(11) | 17 (68%)<br>(15) | 46 (73%)<br>(35) |
| Planning and performing tests of controls          | 77 (68%)<br>(33)    | 50 (63%)<br>(17) | 18 (72%)<br>(15) | 43 (68%)<br>(32) |
| Determining substantive procedures                 | 71 (62%)<br>(32)    | 47 (59%)<br>(16) | 21 (84%)<br>(16) | 54 (86%)<br>(35) |
| Consistency and reasonableness of the overall plan | 13 (11%)<br>(6)     | 4 (5%)<br>(2)    | 2 (8%)<br>(-)    | 10 (16%)<br>(8)  |

Notes:

1. The percentage figures in parenthesis (%) indicate the percentage of the number of recommendations to the number of quality control reports. The figures in parenthesis in the lower portion of each field indicate the number of qualified items that led to a qualified conclusion or negative conclusion in a quality control review report.
2. As there are multiple recommendations to individual audit firms, the total recommendations do not correspond to the number of recommendations indicated in the above Table 1.b, "Details of yearly trends by listed and non-listed company audit firms. "
3. The determination of qualified items is based on an overall consideration of the items shown in the above table. Qualified items are not determined by each individual classification.

## b. Audit procedures of accounting estimates

(number of audit firms)

|   | Year Ended March 31 |                 |                 |                 |
|---|---------------------|-----------------|-----------------|-----------------|
|   | Listed              |                 | Non-listed      |                 |
|   | 2006                | 2007            | 2006            | 2007            |
| Deferred tax assets   | 34 (30%)<br>(3)     | 18 (23%)<br>(1) | 5 (20%)<br>(-)  | 13 (21%)<br>(4) |
| Employee retirement benefits                                    | 43 (38%)<br>(-)     | 20 (25%)<br>(-) | 5 (20%)<br>(-)  | 21 (35%)<br>(2) |
| Allowance for doubtful accounts                                 | 15 (13%)<br>(5)     | 12 (15%)<br>(2) | 10 (40%)<br>(3) | 7 (11%)<br>(2)  |
| Investments in affiliates or unlisted entities                  | 19 (17%)<br>(2)     | 8 (10%)<br>(1)  | 8 (32%)<br>(-)  | 6 (10%)<br>(1)  |
| Impairment of fixed assets                                      | -                   | 8 (10%)<br>(-)  | -               | 5 (8%)<br>(1)   |
| Derivatives   | -                   | 5 (6%)          | -               | 3 (5%)          |
| Accrued bonuses   | -                   | 2 (3%)          | -               | 4 (6%)          |
| Accrued retirement benefits to directors and corporate auditors | 3 (3%)              | 4 (5%)          | -               | 2 (3%)          |
| Other   | 17 (15%)<br>(2)     | 9 (11%)         | 1 (4%)          | 6 (10%)         |

Note:

Please refer to Notes 1, 2 and 3 of Item 8-2 b "Audit procedures of accounting estimates."

**c. Engagement quality control review for expressing an audit opinion**

(number of audit firms)

|   | Year Ended March 31 |                 |                 |                  |
|---|---------------------|-----------------|-----------------|------------------|
|   | Listed              |                 | Non-listed      |                  |
|   | 2006                | 2007            | 2006            | 2007             |
| Lack of an adequate engagement quality control review system  | 21 (18%)<br>(4)     | 9 (11%)<br>(3)  | 2 (8%)<br>(-)   | 16 (25%)<br>(16) |
| Lack of engagement quality control reviews of semi-annual audits                                    | 7 (6%)<br>(7)       | -               | 3 (12%)<br>(3)  | 5 (8%)<br>(4)    |
| Lack of engagement quality control reviews of audits under the Commercial Code                      | 4 (4%)<br>4         | 2 (3%)<br>(2)   | 5 (20%)<br>(5)  | 2 (3%)<br>(2)    |
| Lack of engagement quality control reviews of (annual) audits under the Securities and Exchange Law | 6 (5%)<br>(6)       | -               | -               | 1 (2%)<br>(1)    |
| Lack of adequate items to be reviewed   | 35 (31%)<br>(-)     | 25 (32%)<br>(2) | 11 (44%)<br>(-) | 21 (33%)<br>(1)  |
| Inadequate documentation of engagement quality control reviews                                      | 25 (22%)<br>(-)     | 15 (19%)<br>(-) | 4 (16%)<br>(1)  | 10 (16%)<br>(1)  |
| Engagement quality control reviews after an audit opinion was expressed                             | 13 (11%)<br>(13)    | -               | 1 (4%)<br>(1)   | -                |
| Other   | 1 (1%)<br>(1)       | 8 (10%)<br>(-)  | -               | 11 (17%)<br>(-)  |

Note:

Please refer to Notes 1, 2 and 3 of Item 8-2c "Engagement quality control review for expressing an audit opinion."