

Overview of the Results of Quality Control Review for the Year Ended March 31, 2008

July 9, 2008

Japanese Institute of Certified Public Accountants

1. Introduction

The Japanese Institute of Certified Public Accountants (“JICPA”), taking into consideration the public interest in audits, began conducting quality control reviews of audits (that is, a system of reviewing quality control) performed by audit corporations and sole practitioners (hereinafter, referred to as “audit firms”) beginning April 1999 as a self-regulatory system in order to maintain and improve an appropriate level of quality of members’ audits, which leads to maintaining and ensuring public confidence in audits. At the outset, audit firms that audit public companies were the focus of the system. Subsequently, the Certified Public Accountants Act (“CPA Act”) amended in 2003 legally required this quality control review system, effective April 2004. Furthermore, it also required that the scope of audit firms subject to quality control review be expanded to those auditing private large companies as defined by the CPA Act, and that JICPA’s quality control review be subject to monitoring by the Certified Public Accountants and Auditing Oversight Board (“CPAAOB”).

JICPA’s quality control reviews are to conduct a review of an audit firm’s implementation of quality controls, by utilizing full-time reviewers who are members of the JICPA Quality Control Committee, and not by those individuals involved in the audit engagement subject to the review. Under the system, audit firms are notified of the results after being deliberated by the Quality Control Committee, and recommendations are issued as necessary. In addition, responses are received from audit firms regarding corrective actions to be taken in response to those recommendations; reports are received from audit firms concerning implementation of those actions; and on-site reviews at audit firms are conducted, as necessary, to confirm such implementation. The system has functioned to maintain and improve audit quality.

Although the JICPA attempted to enhance the quality of audit engagements as described above, a series of accounting failures occurring in IT-related companies and in other listed companies that were revealed in the meantime, and confidence in audits by CPAs was called into question. Therefore, the JICPA introduced a “Registration System of Listed Company Audit Firms” in 2007 as a new measure to strengthen quality controls of the audit firms that audit listed companies.

This system requires the audit firms that audit listed companies to register with the Center for Listed Company Audit Firms established within the Quality Control Committee. Whether to permit such registration is determined based on the result of a quality control review. Audit firms that are permitted to register are enrolled as a “listed company audit firm,” and a listing of said firms is posted on the JICPA website. In addition, when a registered listed company audit firm does not implement an appropriate corrective action in response to a negative conclusion or a repeated recommendation resulting from reviews, measures are taken, including disclosure of a summary of recommendation (s) in the register of listed company audit firms, or, the revocation of registration as a listed company audit firm. Results of individual quality control reviews have not been announced in the past, but public exposure of the results of a quality control review is intended to encourage listed company audit firms to improve the quality of their audit engagements.

As this was the initial year of adoption of a registration system of listed company audit firms, under a transitional arrangement, audit firms that had concluded audit contracts with listed companies as of April 1, 2007 were permitted to register after a screening of application documents, upon the condition that the registration was submitted by July 15, 2007. Nevertheless, during this review year, a quality control review or follow-up review was performed for all audit firms that were permitted registration under the transitional arrangement, and measures based on the JICPA Constitution were taken as necessary, depending on the result of such reviews.

2. Relationships between the Quality Control Review System, the Registration System of Listed Company Audit Firms, and Monitoring by the CPAAOB

The quality control review system and the registration system of listed company audit firms of the JICPA were operated by a total of 71 people as of March 31, 2008.

The Quality Control Committee consists of a chairperson and 26 committee members who are all members of the JICPA. As a sub-organization, the Quality Control Review Team has been established, comprised of 29 quality control reviewers. These quality control reviewers are also members of the JICPA. The Quality Control Committee performs quality control reviews of audit firms, and then issues a quality control review report and recommendation report to each audit firm. It also performs follow-up reviews of listed company audit firms, and issues the firm a follow-up review report. Under the registration system of listed company audit firms, the Committee submits proposals to the Quality Control Oversight Board regarding whether certain listed company audit firms be permitted registration, and whether measures ought to be taken against audit firms that are registered with the Center for Listed Company Audit Firms, based on

the results of quality control reviews and follow-up reviews. The Committee regularly reports its activities to the Quality Control Oversight Board, and reports to the CPAAOB in accordance with laws and regulations.

The Quality Control Oversight Board consists of five members who are knowledgeable persons outside the profession and three JICPA members. The Quality Control Oversight Board is informed of quality control review activities by the Quality Control Committee, examines and evaluates such activities, and then submits its recommendations to the Quality Control Committee. The Board also deliberates and makes determinations regarding proposals for acceptance or rejection of registration of a listed company audit firm, and proposals for measures submitted by the Quality Control Committee. The Board reports these results to the Chairman and President of the JICPA.

There are seven staff members of the secretariat for the Quality Control Committee and Quality Control Oversight Board. The CPAAOB monitors the JICPA's operation of these systems.

The following figures illustrate the structure of quality control review and monitoring by the CPAAOB as of March 31, 2008.

- Flow of quality control reviews
- ===== Flow of the registration system for listed company audit firms
- Flow of monitoring by the CPAAOB

Figure 1. Structure of JICPA’s Quality Control Review and Monitoring by the CPAAOB

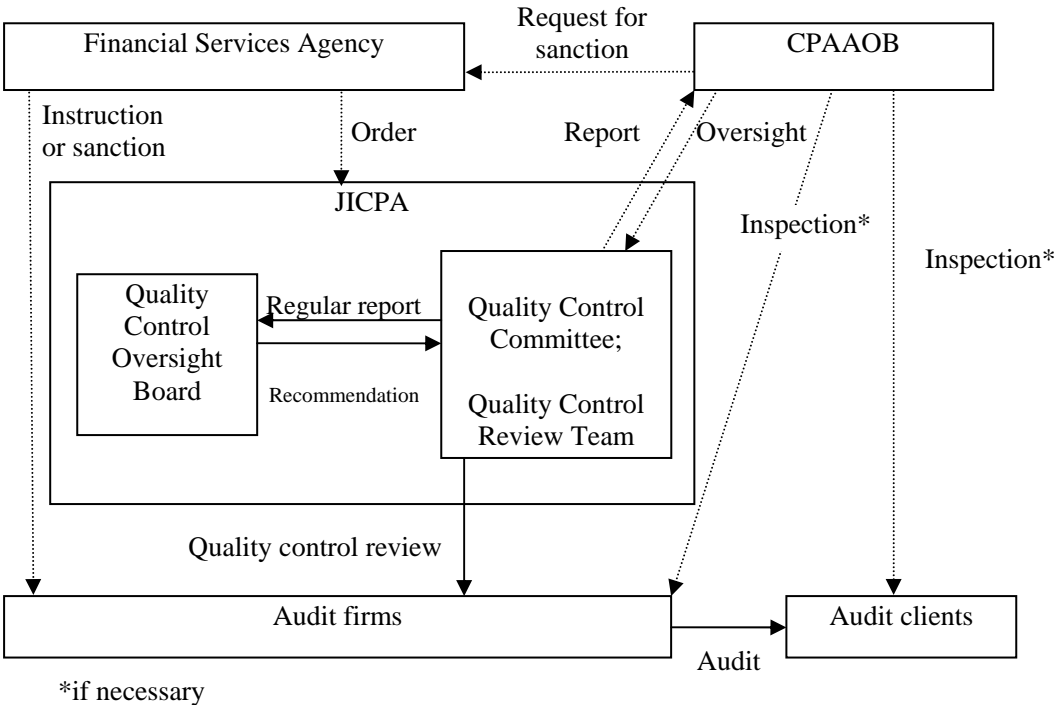
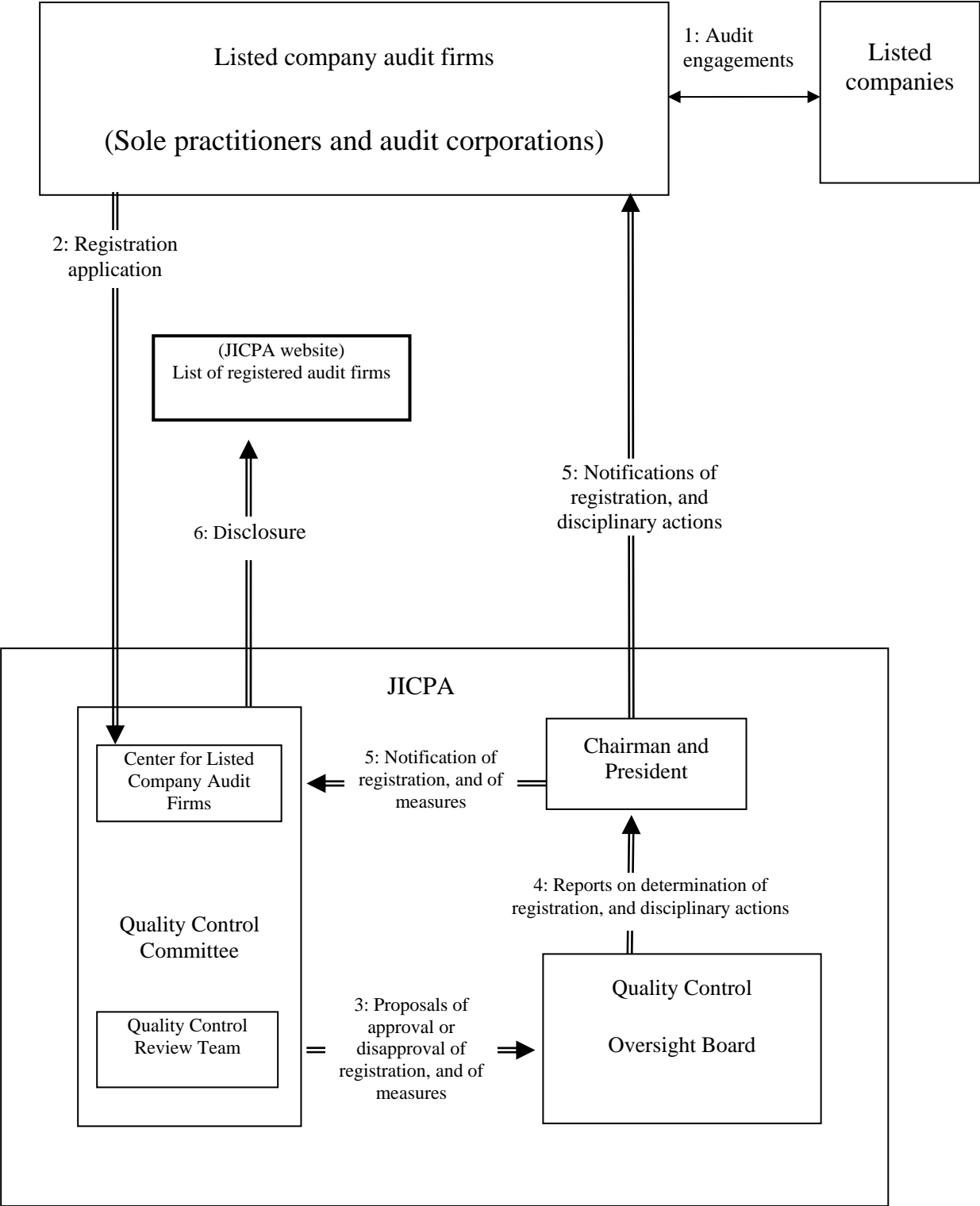


Figure 2. Registration System of Listed Company Audit Firms



3. Overview of Quality Control Reviews Conducted for the Year Ended March 31, 2008

3-1. Regular quality control reviews

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, 2007 to March 31, 2008).

Quality control reviews	Conducted during the year ended March 31, 2008					
	Brought forward	Audit firms subject to quality control review for the year	Total	Quality control review reports issued	Recommendation reports issued	Carried forward
Listed company audit firms	1	108	109	109	109	-
Non-listed company audit firms	3	23	26	26	26	-
Total	4	131	135	135	135	-

Notes:

1. Among the 131 audit firms in the column "Audit firms subject to quality control review for the year," 64 audit firms were newly subject to quality control review for the year ended March 31, 2008, including 43 listed company audit firms (hereinafter referred to as "listed" in the text and the tables) and 21 non-listed company audit firms ("non-listed").
2. Among the 109 listed company audit firms to which quality control review reports were issued during the year ended March 31, 2008, 83 audit firms were registered with the Center for Listed Company Audit Firms as of May 31, 2008.

The number of audit firms that were subject to a quality control review in the above table can be further classified by audit corporations and sole practitioners, as follows:

Quality control review	Conducted during the year ended March 31, 2008					
	Brought forward	Audit firms subject to quality control review for the year	Total	Quality control review reports issued	Recommendation reports issued	Carried forward
Audit corporations	1	55	56	56	56	-
Sole practitioners	3	76	79	79	79	-
Total	4	131	135	135	135	-

Note: Joint audit firms are included in audit corporations.

3-2. Follow-up of quality control reviews

a. Follow-up reviews

Due to the introduction of the registration system for listed company audit firms in 2007, follow-up reviews became mandatory based on Article 7 of the Regulations of the Quality

Control Committee, in order to ensure that corrective actions described in an audit firm’s response to a previous quality control review have been implemented. Follow-up reviews for the year ended March 31, 2008 were conducted of listed company audit firms that were not covered by a regular quality control review, among those audit firms registered with the Center for Listed Company Audit Firms.

Listed company audit firms	Conducted during the year ended March 31, 2008		
	Audit firms subject to follow-up review	Follow-up review reports issued	Carried forward
Audit corporations	72	72	-
Sole practitioners	32	32	-
Total	104	104	-

Note: Among these 104 audit firms, 100 audit firms (70 audit corporations and 30 sole practitioners) were registered with the Center for Listed Company Audit Firms as of May 31, 2008.

b. Reports on implementation of quality control

Until the previous year, all audit firms subject to review were required to submit reports on implementation of quality control. However, this review year, this requirement applied only to 185 non-listed company audit firms (23 audit corporations and 162 sole practitioners) that were not covered by follow-up reviews, due to the introduction of the registration system of listed company audit firms. A summary is described in Item 10, “Overview of Reports on Implementation of Quality Controls. ”

4. Recommendations from the Quality Control Oversight Board and the JICPA’s Responses

Listed below are each of the items included in “Recommendations for Activities of the Quality Control Committee for the year ended March 31, 2007,” which were received from the Quality Control Oversight Board on June 7, 2007 and included in the September 2007 issue of the *Accounting and Auditing Journal*, a monthly publication of the JICPA.

The Quality Control Committee and other relevant committees of the JICPA have taken actions, such as making these recommendations, the items of focus in quality control reviews conducted during the year ended March 31, 2008.

Recommendations:

- 4-1. Design and implementation of quality control systems
- 4-2. New risk-based approach
- 4-3. Consideration of significant matters in forming audit opinions
- 4-4. Follow-up reviews related to the registration system of listed company audit firms
- 4-5. Thorough notification to those audit firms newly subject to a quality control review of the fundamental issues regarding quality control
- 4-6. Assistance to small and medium-sized audit firms in establishing systems of quality control

5. Reporting to the CPAAOB

Under the CPA Act, the JICPA is subject to monitoring by the CPAAOB with regard to the results of its quality control review.

The Quality Control Committee responded to the CPAAOB as follows:

- 5-1. The Quality Control Committee submitted to the CPAAOB monthly reports on the results of its quality control reviews and an annual report on quality control reviews for the year ended March 31, 2007, pursuant to the Cabinet Office Ordinance related to the JICPA.
- 5-2. The Quality Control Committee submitted review working papers that the CPAAOB considered necessary, and replied to inquiries from the CPAAOB.
- 5-3. The Quality Control Committee explained the contents of the annual report on quality control reviews for the year ended March 31, 2007.
- 5-4. The Quality Control 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.
- 5-5. The Quality Control Committee addressed the inspection of the JICPA by the CPAAOB performed as of the cut-off date of April 26, 2007. The Committee also considered the method of response to the report entitled *Status of Improvement in JICPA Quality Control Reviews* announced by the CPAAOB on July 31, 2007. As a result, the Committee published *JICPA's Responses to the CPAAOB's "Status of Improvement in JICPA Quality Control Reviews"* on August 2, 2007 (included in the October 2007 issue of *Accounting and Auditing Journal*).

6. Focuses of the Quality Control Reviews for This Year, and the Results

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. The results of the quality control review items of focus are as follows:

6-1. Responses to professional standards, laws, and regulations

a. Responsibility of quality control

New quality control standards, such as 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*, were effective for audits of financial statements for periods beginning on or after April 1, 2006. Therefore, every audit firm, including a sole practitioner, is required to appropriately design and implement an audit quality control system that is tailored for each audit firm's circumstances in order to clarify responsibilities for audit quality control.

The result of the quality control review indicated that no audit firms were issued qualified items related to the development of the manual of the quality control system. However, recommendations for the development of the manual of the quality control system were made to 32 audit firms (25 listed and 7 non-listed) that were deemed to have items to be improved, either in the development of the manual of the quality control system, update of the quality control system, or the communication of policies or procedures regarding quality control.

b. New risk-based approach

In response to the new Auditing Standards Committee Statements on the risk-based approach that are applicable to audits for periods beginning on or after April 1, 2006, reviewers evaluated during quality control reviews whether audit firms have revised audit manuals and performed audits based on the new risk-based approach in compliance with their audit manuals. As a result, although the number of audit firms has decreased, qualified conclusions were issued to 27 audit firms (19 listed and 8 non-listed). Recommendations regarding the risk-based approach were issued to 88 audit firms (74 listed and 14 non-listed) that were deemed to have items to be improved in their risk-based approach, while no qualified items were issued to these audit firms.

Items to be improved regarding tests of controls, determination of substantive procedures, and the assessment of IT control risk were identified in a number of audit firms.

c. Monitoring of the quality control system

In response to quality control standards such as 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*, it is required that audit firms have in place the policies and procedures for ongoing monitoring of the quality control system and periodic monitoring of audit engagements, and also to take appropriate corrective actions against deficiencies identified through the monitoring process of the quality control system, in order to ensure that the audit quality control system is operating effectively.

The results of quality control reviews indicated that recommendations for monitoring of the quality control system were issued to 65 audit firms (53 listed and 12 non-listed) that were deemed to have items to be improved regarding the monitoring of the quality control system, although no qualified items were issued to any audit firm.

Major recommendations included: (1) ongoing monitoring and/or periodic monitoring were not performed; (2) documentation was insufficient, although ongoing and periodic monitoring were performed; (3) in the case of periodic monitoring, monitoring was not performed by the appropriate personnel, that is, those who were neither engaged in the audit nor the engagement quality control reviewer of a particular audit engagement; and (4) follow-up was insufficient with regard to both the assessment of identified deficiencies, and consideration of the necessity for corrective action.

d. Education and training of auditors and other personnel engaged in audits

Beginning in 2006, certain mandatory training subjects were established as part of the Continuing Professional Education (“CPE”) system. Audit firms are required to ensure that every person who is obligated to fulfill CPE requirements obtains 40 credits per year, including four credits in the subjects of professional ethics and quality control of audits (beginning in 2007, four credits per year for auditors and for personnel engaged in statutory audits), respectively.

Quality control reviews examined the administration and supervision of audit firms regarding CPE and the status of fulfillment of CPE requirements by auditors and personnel engaged in audits. As a result, recommendations were issued to 52 audit firms (46 listed and 6 non-listed) that were deemed to have items to be improved, although no audit firms were concluded to be significantly inappropriate.

6-2. Responses to significant matters related to reorganizations of audit firms

a. Auditor independence

Audit firms are required to timely ascertain their independence with regard to companies that newly become audit clients due to a reorganization, and the independence of auditors and personnel engaged in audits who newly join the firm.

As a result of quality control reviews, recommendations were issued to six audit firms (all listed) that were deemed to have items to be improved, although no qualified items were issued to any audit firms.

b. Compliance with Auditing Standards Committee Statement No. 33, *Change of Auditors*

Auditing Standards Committee Statement No. 33, *Change of Auditors* has been applicable to audits for periods beginning on or after April 1, 2006. Considering the growing number of auditor changes due to the reorganization of audit firms, quality control reviews evaluated whether audit firms appropriately complied with this Statement. As a result, a negative conclusion or a qualified conclusion was issued to three audit firms (all listed) having a quality control system regarding a change of auditors that was considered significantly inappropriate.

Recommendations regarding two items related to Statement No. 33, *Change of Auditor* (acceptance of new audit engagements; communications between predecessor auditor and successor auditor) were also issued to 23 audit firms (21 listed and 2 non-listed) that had items to be improved regarding a change of auditors.

Major recommendations included issues of (1) predecessor auditors did not obtain notice of the designation of a successor auditor; (2) successor auditor communicates with a predecessor auditor after accepting an engagement; and (3) confidentiality requirements were not confirmed in writing.

6-3. Responses to significant matters in auditing and accounting

(Significant matters in forming an audit opinion)

Audit procedures of accounting estimates, and engagement quality control review, are significant matters in forming an audit opinion. There were five audit firms (four listed and one non-listed) to which qualified items were issued regarding audit procedures of accounting

estimates, and ten audit firms (six listed and four non-listed) to which qualified items were issued regarding engagement quality control review.

There were 94 audit firms (78 listed and 16 non-listed) that were deemed to have items to be improved regarding audit procedures of accounting estimates; 29 audit firms (25 listed and 4 non-listed) regarding preparation of the summary of audit findings; and 80 audit firms (64 listed and 16 non-listed) regarding engagement quality control review, although no qualified items were issued to any of the firms.

6-4. Introduction of follow-up reviews

(Follow-up reviews of listed company audit firms)

Follow-up reviews for the year ended March 31, 2008 were conducted to ascertain whether the quality control system was updated by audit firms in response to newly issued Standards of Quality Control, and whether such updates were communicated to auditors and personnel engaged in audits, as well as whether corrective actions were implemented as described in the submitted response by an audit firm when the previous quality control review was conducted. The results of follow-up reviews are analyzed in Item 9, "Overview of Improvements Identified in Follow-Up Reviews."

6-5. Assistance to small and medium-sized audit firms

(Ongoing and effective assistance to small and medium-sized audit firms in designing quality control systems, including audit firms that are newly subject to a quality control review)

As part of providing assistance for the design of the quality control system of small and medium-sized audit firms, a seminar on the annual report of the Quality Control Committee was conducted in cooperation with the CPE Council in order to enhance the quality control of audits. In addition, materials were provided for use at seminars organized by the Coordinating Committee for Small and Medium-Sized Practitioners, in collaboration with the Committee for Small and Medium-Sized Practitioners.

Furthermore, quality control reviewers visited listed company audit firms that will be newly subject to a quality control review for the year ending March 31, 2009, and outlined the quality control review. At the same time, reports on implementation of quality control submitted by audit firms that were newly subject to a quality control review, including non-listed company audit firms, were analyzed and necessary guidance was provided.

7. Significant Issues Identified in Quality Control Reviews

7-1. Regular quality control reviews

The numbers of audit firms being issued a qualified conclusion or a negative conclusion as a result of quality control reviews are as follows:

Quality control reviews	Year ended March 31, 2007			Year ended March 31, 2008		
	Listed company audit firms	Non-listed company audit firms	Total	Listed company audit firms	Non-listed company audit firms	Total
Negative conclusion	-	2	2	2	1	3
Qualified conclusion	26	43	69	23	10	33
Total	26	45	71	25	11	36
Reference: Number of quality control review reports	79	63	142	109	26	135

Note: Among the 3 audit firms with negative conclusions and 33 audit firms with qualified conclusions for the year ended March 31, 2008, 13 audit firms were newly subject to a quality control review.

Qualified items for which a negative conclusion or a qualified conclusion was issued included the risk-based approach (27 audit firms; 19 listed and 8 non-listed), engagement quality control review (10 audit firms; 6 listed and 4 non-listed), and audit procedures of accounting estimates (five audit firms; four listed and one non-listed) (refer to Item 8, “Overview of Recommendations of Regular Quality Control Reviews”). 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.

7-2. Follow-up reviews

Follow-up reviews were conducted of 104 listed company audit firms. Results indicated that 55 audit firms (38 audit corporations and 17 sole practitioners) were deemed to have implemented corrective actions insufficiently, although some corrective action for each recommendation was undertaken. A summary is described in Item 9, “Overview of Improvements Identified in Follow-Up Reviews.”

7-3. Cases reported to the Chairman and President

In accordance with Paragraph 6 of the Quality Control Review Standards, some cases were reported to the Chairman and President of the JICPA after concluding that “as a result of a quality control review, significant doubt has arisen as to the reasonableness of audit opinions expressed by the sole practitioner or audit corporation” as stipulated in Article 123, Paragraph 3

of the JICPA Constitution. Similarly, cases were also reported to the Chairman and President of the JICPA after concluding that “significant doubt has arisen as to the compliance by the sole practitioner or audit corporation with the JICPA Constitution and rules as a result of a follow-up review” (between April 2007 and May 2008). The numbers of such cases are as follows:

Cases reported to the Chairman and President for the year ended March 31, 2008	Listed company audit firms	Non-listed company audit firms	Total
Regular quality control review	3	4	7
Follow-up review	2	-	2
Total	5	4	9

Cases that were reported to the Chairman and President of the JICPA related to violations of law and regulations, acceptance of new audit engagements, audit procedures of accounting estimates, and engagement quality control review of expressing an audit opinion.

8. Overview of Recommendations of Regular Quality Control Reviews

The following tables indicate the number of recommendations by item and content for the year ended March 31, 2008. Compared with the totals of the previous year, qualified items decreased in number regarding engagement quality control review, risk-based approach, and audit procedures of accounting estimates, yet there were still many recommendations. In the application of Standards of Quality Control, the number of recommendations increased regarding development of manuals on the quality control system, and monitoring of the quality control system.

Recommendations of quality control reviews for the year ended March 31, 2008		Listed company audit firms and non-listed company audit firms			Structure of audit firms		
		Listed	Non-listed	Total	Audit corporations	Sole practitioners	Total
Quality control at audit firms	Development of manuals on the quality control system	25	7	32	9	23	32
	Professional ethics and independence	31 (-)	14 (3)	45 (3)	21 (-)	24 (3)	45 (3)
	Acceptance and continuance of audit engagements	40 (3)	15 (-)	55 (3)	23 (1)	32 (2)	55 (3)
	Recruitment, education and training, evaluation and assignment of auditors and personnel engaged in audits	47	9	56	33	23	56
	Engagement quality control review	70 (6)	20 (4)	90 (10)	41 (4)	49 (6)	90 (10)
	Monitoring of the quality control system	53	12	65	22	43	65
	Communication between predecessor auditor and successor auditor	14 (3)	2 (-)	16 (3)	6 (1)	10 (2)	16 (3)
	Joint audit arrangements	22	4	26	7	19	26
Performance of audit engagements	Risk-based approach	93 (19)	22 (8)	115 (27)	51 (10)	64 (17)	115 (27)
	Communication with company auditors or their equivalent	25	9	34	18	16	34
	Audit procedures of accounting estimates	82 (4)	17 (1)	99 (5)	45 (2)	54 (3)	99 (5)
	Direction and supervision of engagement team members and review of documentation	44	10	54	26	28	54
	Development and retention of engagement documentation	54 (2)	13 (-)	67 (2)	33 (-)	34 (2)	67 (2)
	Preparation of the summary of audit findings	25	4	29	16	13	29
	Management representations	76	20	96	44	52	96
	External confirmations	49 (2)	5 (-)	54 (2)	25 (-)	29 (2)	54 (2)
	Presentation and disclosure of financial statements	47	7	54	23	31	54
	Audit procedures of related parties	30	10	40	17	23	40
Reference: Number of quality control review reports		109	26	135	56	79	135

Note: The figures in parenthesis in the table indicate the number of qualified items that led to a negative conclusion or a qualified conclusion in the quality control review reports.

9. Overview of Improvements Identified in Follow-Up Reviews

9-1. Major improvements of listed company audit firms

Follow-up reviews for the year ended March 31, 2008 were conducted of listed company audit firms that were not subject to a regular quality control review during the current year. As a

result, among recommendations previously issued for the years ended March 31, 2006 or March 31, 2007, there was a relatively large number of audit firms that had not sufficiently improved upon or did not implement a risk-based approach, nevertheless, some corrective action was taken generally based upon each recommendation.

Recommendations of a previous quality control review		Audit corporations		Sole practitioners		Total	
		Improved	Not improved	Improved	Not improved	Improved	Not improved
Performance of audit engagements	Risk-based approach	42 (9)	25 (12)	13 (-)	10 (1)	55 (9)	35 (13)
	Inquiries to management and communication with company auditors or their equivalent	39	3	14	-	53	3
	Audit procedures of accounting estimates	41 (2)	14 (1)	17 (2)	1 (-)	58 (4)	15 (1)
	Development and retention of engagement documentation	41	10	9	8	50	18
	Presentation and disclosure of financial statements	23	-	4	4	27	4
	Management representations	41	6	15	-	56	6
	External confirmations	39	4	11	2	50	6
Other	Monitoring of the quality control system	36	8	1	-	37	8
	Engagement quality control review	42 (5)	2 (1)	13 (3)	2 (-)	55 (8)	4 (1)
	Acceptance and continuance of audit engagements	39	3	16	-	55	3
Reference: Number of follow-up review reports		72		32		104	

Note: The figures in parenthesis in the table indicate the number of qualified items that led to a negative conclusion or a qualified conclusion in a previous quality control review report that was subject to a follow-up review.

9-2. Design of quality control systems

In conjunction with a follow-up review, the quality control system was evaluated that an audit firm designed in response to the application of Quality Control Standards Committee Statement No. 1, *Quality Control for Firms that Perform Audits*. The results indicated that 16 audit firms (11 audit corporations and 5 sole practitioners) were identified as having deficiencies in the design of the quality control system. The details are as follows:

Design of quality control system	Audit corporations	Sole practitioners	Total
Development of manuals on the quality control system	2	-	2
Preparation of the summary of audit findings	1	-	1
Engagement quality control review	8	3	11
Monitoring of the quality control system	-	2	2
Reference: Number of follow-up review reports	72	32	104

Note: In addition to the above, violations of laws and regulations (in relation to independence) were identified at two audit corporations.

10 . Overview of Reports on Implementation of Quality Controls

Reports on implementation of quality controls were submitted by 185 non-listed company audit firms (23 audit corporations and 162 sole practitioners) for the current period.

Non-listed company audit firms	Year review was performed		Review not performed	Total
	Year ended March 31, 2008	Year ended March 31, 2007 or prior		
Audit corporations	4	10	9	23
Sole practitioners	21	45	96	162
Total	25	55	105	185

The results of analyses and consideration of the implementation of quality controls at non-listed company audit firms based upon the reports on implementation of quality controls are as follows.

10-1. Reports from audit firms that were reviewed in the year ended March 31, 2007 or prior

Of the 55 non-listed company audit firms that were requested to submit a report on the implementation of quality controls, 42 audit firms responded that all recommendations had been implemented. The remainder of audit firms reported that improvement was delayed with regard to developing audit plans based on a risk-based approach. As for those audit firms whose corrective actions and timing of corrections were deemed significantly inappropriate, additional inquiries were made regarding the status of corrections, and the firms responded that either corrective actions were already implemented, or, actions were to be implemented during the current period or immediately subsequent period. The JICPA plans to ascertain the improvement at these audit firms by performing quality control reviews during the year ending March 31, 2009 or later.

10-2. Reports from audit firms at which a quality control review has not been performed

Non-listed company audit firms at which a quality control review has not been performed were requested to respond to a questionnaire that listed 50 basic items with regard to their system of quality control. As a result, it was found that many answered 'No' to questions regarding the performance of engagements (development of an audit plan and assessment of IT risk), and monitoring of the quality control system (failure to perform periodic monitoring of audit engagements).

Based upon the results of analyzing responses to five issues that were listed as significant, including: prohibition of audits by only one partner, rotation of key personnel who audit large companies, auditor's consideration of the going concern assumption, audit procedures of accounting estimates, and scope of the engagement quality control review, 26 audit firms answered 'No' to one or more of the questions in these five areas. As for these audit firms, additional procedures were performed, such as reviewing the securities reports of their audit clients and making additional inquiries. The audit firms were requested to make improvements as necessary, and will be included in the schedule of audit firms that will be subject to a quality control review during the year ending March 31, 2009.

11. Center for Listed Company Audit Firms

The JICPA implemented a registration system of listed company audit firms beginning in 2007 as a measure to strengthen self-regulation.

11-1. Registration of listed company audit firms

Registrations and deletions of listed company audit firms for the year ended March 31, 2008 were as follows:

Registration system of listed company audit firms		As of July 27, 2007	Increase	Decrease	As of May 31, 2008
Firms having an audit engagement with a listed company	Registered audit firms	202	4	22	184
	Unregistered audit firms	-	1	-	1
	Those regarded as associate registered firms	8	26	9	25
	Total	210	31	31	210
Firms not having an audit engagement with a listed company	Associate registered firms	10	8	3	15

Note: “Registered audit firms” in the table indicate the number of listed company audit firms that were permitted to register as a listed company audit firm.

a. Listed company audit firms

The registration system of listed company audit firms was implemented in 2007, and 202 audit firms (124 audit corporations, 1 joint audit firm, and 77 sole practitioners) were registered as listed company audit firms based on a transitional arrangement. Subsequently, 22 audit firms (7 audit corporations and 15 sole practitioners) applied for deletion from the register, for reasons such as the cancelation of audit engagements.

Additionally, a quality control review was performed of four audit firms (two audit corporations, one joint audit firm, and one sole practitioner) among audit firms that concluded audit engagements with listed companies after April 1, 2007 and submitted an application for registration with the Center for Listed Company Audit Firms. These four firms were permitted to register with the Center for Listed Company Audit Firms.

As a result, the number of listed company audit firms that were registered with the Center for Listed Company Audit Firms as of May 31, 2008 was 184 audit firms (119 audit corporations, 2 joint audit firms, and 63 sole practitioners).

b. Unregistered audit firms

The registration of one audit corporation with the Center for Listed Company Audit Firms was revoked due to a measure taken as prescribed in Article 131, Paragraph 3, Item 4 of the Constitution, “Revocation of registration with the Center for Listed Company Audit Firms, and disclosure of the facts and reasons.” This firm’s name has been included on the list of unregistered audit firms as of May 31, 2008.

c. Those regarded as associate registered firms

Those regarded as associate registered firms are audit firms based on Article 3 of the Regulations for the Registration System of Listed Company Audit Firms, and are defined as audit firms that concluded audit engagements with listed companies after April 1, 2007; there were 25 such audit firms (8 audit corporations and 17 sole practitioners) as of May 31, 2008. These firms will be subject to a quality control review for the year ending March 31, 2009.

d. Associate registered firms

Audit firms that do not have an audit engagement with a listed company but will attempt to conclude audit engagements with listed companies in the future are permitted to register as an associate firm. The JICPA began accepting applications for this register on June 1, 2007, and 15 audit firms (eight audit corporations and seven sole practitioners) have been registered as of May 31, 2008.

11-2. Measures under the registration system of listed company audit firms

When considerable doubt has arisen regarding the audit quality controls of an audit firm registered with the Center for Listed Company Audit Firms based on the results of a regular quality control review or follow-up review, the Quality Control Committee reviews whether it is necessary to take measures as prescribed in Article 131, Paragraph 3 of the JICPA Constitution, in order to encourage audit firms to establish and maintain a system of quality control. If the Committee determines the need to take measures, its proposals are submitted to the Quality Control Oversight Board, which deliberates and makes decisions about said measures.

The following table indicates various measures undertaken through May 31, 2008. In the register of listed company audit firms, details were disclosed of measures as prescribed in Article 131, Paragraph 3, Item 4 of the Constitution, “Revocation of registration with the Center for Listed Company Audit Firms, and disclosure of the facts and reasons,” and measures as prescribed in Article 131, Paragraph 3, Item 3 “Disclosure of overview of qualified items.”

Measures	Audit corporations	Sole practitioners	Total
No measures taken	60	36	96
Measures taken	61	32	93
Item 4 (Revocation of registration, and disclosure)	(1)	(-)	(1)
Item 3 (Disclosure of overview of qualified items)	(7)	(3)	(10)
Item 1 (Admonishment)	(53)	(29)	(82)
To be reviewed the following year	1	-	1
Total	122	68	190

Note: In the above table, one audit corporation was subject to measures as prescribed by Item 4 and Item 1, but is listed only as Item 4. Seven audit firms (six audit corporations and one sole practitioner) were subject to measures as prescribed by Item 3 and Item 1, but are grouped only as Item 3.

11-3. Disclosure of disciplinary actions by the Financial Services Agency against listed company audit firms

Under Article 132 of the Constitution and Article 14 of the Regulations for the Registration System of Listed Company Audit Firms, the JICPA disclosed in the register of listed company audit firms the following disciplinary actions that have been taken against audit firms for the year ended March 31, 2008 (including cases subsequently disclosed through May 31, 2008):

- Six audit corporations were subject to a recommendation by the CPAAOB to the Commissioner of the Financial Services Agency (“FSA”) that an administrative sanction or other action be taken against them;
- Five audit corporations were subject to disciplinary actions or instructions to improve operations by the FSA;
- Two audit corporations were subject to JICPA disciplinary actions, including suspension of membership for two months and a request to the FSA for disciplinary action and a reprimand.

12. Amendment and Abolishment of the Constitution, Regulations, Quality Control Review Standards, Quality Control Review Procedures, Committee Operation Manuals, and Quality Control Review Tools

Pursuant to amendments of the CPA Act and the implementation of the Financial Instruments and Exchange Act, at a Special Assembly meeting held December 10, 2007, the JICPA amended its Constitution, Regulations of the Quality Control Committee, and Regulations for the Registration System of Listed Company Audit Firms.

The JICPA also amended its Constitution in order to respond to the Business Accounting Council’s *Standards on Quality Control for Audits* issued October 28, 2005; 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*, which are applicable for periods beginning on or after April 1, 2006, as well as to enhance self-regulation. The JICPA further amended the Quality Control Review Standards, Quality Control Review Procedures, Committee Operation Manuals, and Quality Control Review Tools in order to respond to the registration system of listed company audit firms implemented beginning April 1, 2007.

13. Activities of the Quality Control Committee and Review Working Groups

The Quality Control Committee reorganized its composition at a meeting held August 2, 2007, and now has one chairperson and 26 members, with one member being added. Five review working groups were established as before, with five members each.

This past year, 14 meetings of the General Committee of the Quality Control Committee were held, and 71 meetings of review working groups were held, in total.

14. Quality Control Review Team

14-1. Change of quality control reviewers

Changes in quality control reviewers for the year ended March 31, 2008 are as follows. The number of reviewers was increased in order to respond to the implementation of the follow-up review system.

(number of staff)

Review team during the year ended March 31, 2008	March 31, 2007	Increase	Decrease	March 31, 2008
Chief executive reviewer	1	-	-	1
Deputy chief reviewers	2	2	-	4
Senior reviewers	9	8	4	13
Staff reviewers	8	5	2	11
Total	20	15	6	29

14-2. Total number of days spent on reviews

The following table indicates the total number of days by reviewers conducting reviews for the year ended March 31, 2008. The total number of days by reviewers conducting reviews increased due to the implementation of the follow-up review system.

(number of days)

Total number of days by reviewers conducting reviews for the year ended March 31, 2008	Regular quality control review	Follow-up review	Total
Listed company audit firms	2,304	791	3,095
Non-listed company audit firms	185	-	185
Total	2,489	791	3,280
Reference: Total for the year ended March 31, 2007	2,418		2,418

Note: The total number of days in the above table aggregates the work hours for quality control reviews at audit firms and the related office work hours until the issuance of a report; seven hours are deemed as one day of work.

15. Future Challenges of the Quality Control Review System

The JICPA introduced a registration system of listed company audit firms in April 2007 as a measure to strengthen self-regulation, and undertook necessary measures against audit firms in response to results of quality control reviews for the year ended March 31, 2008 under this system. As the period ending March 31, 2009 will mark the second year since this system was introduced, it is necessary to operate the system more appropriately, based on the experiences learned in the initial year. Therefore, the challenge for the JICPA will be to confirm improvements at each audit firm in relation to the measures taken, and to take further necessary and appropriate measures against audit firms at which the improvement is considered inadequate.

While the JICPA has attempted to strengthen its self-regulatory function and to enhance and improve the quality control system of audit firms as mentioned above, we faced incidents of insider trading by a CPA, and the simultaneous provision of both audit and non-audit services to audited companies that are defined as a large company by the CPA Act. These incidents pose quality control issues within audit firms, as well as compliance issues with the professional code of conduct. Therefore, it will also be a challenge to strengthen the reviews of an audit firm's system of ensuring compliance with laws and regulations.

As a self-regulatory body, we are considering methods for making use of quality control reviews in order to improve the audit services of audit firms that are not required to be subject to a quality control review under the current regulations. For example, we recognize that one of our future challenges is to perform quality control reviews of audit firms that audit companies with a public interest, in a framework that is separate from what is currently the case, with the aim of establishing a mechanism that plays a directional role for the improvement of audit quality.