

Overview of Quality Control Review for the First Half of the Year Ending March 31, 2006

January 17, 2006

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 ("CPA AOB") to monitor this quality control review from the period beginning April 1, 2004.

At the General Assembly meeting held on July 5, 2005, the JICPA Constitution was revised, changing the role of quality control review from the existing "directional or educational role" to simply "directional role." However, Article 87, 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 or 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 87, Paragraph 2 also states that, "Quality control review has a directional role and shall not be interpreted as intended to detect noncompliance or impose disciplinary actions."

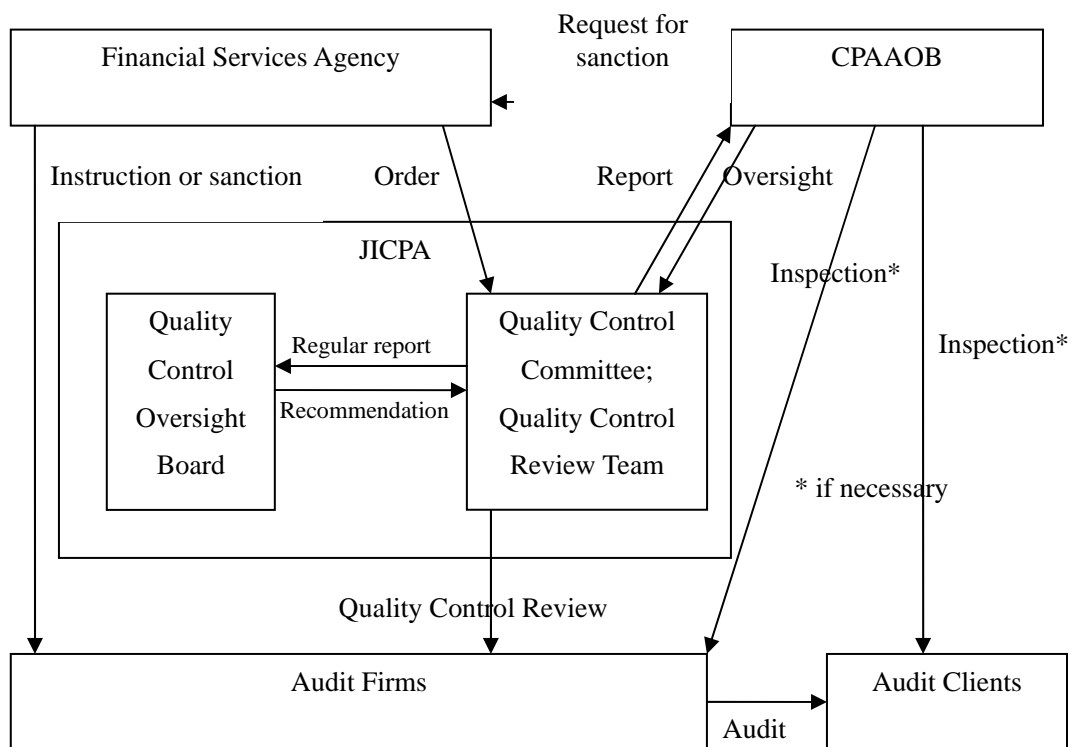
As described above, rather than detecting noncompliance or imposing disciplinary actions, quality control review intends to maintain and improve audit quality as a result of independent reviews by full-time reviewers and not by the individuals involved in the audit engagement subject to the review, because 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, and the receipt of reports from audit firms concerning implementation of actions as a result of reviews conducted by an independent, full-time reviewer.

2. Relationship between the Structure of Quality Control Review for the Year Ending March 31, 2006 and Monitoring by the CPA AOB

For the year ending March 31, 2006, the scope of quality control review has been extended to audit

firms which perform audits of entities stated in Article 87, Paragraph 3 of the Constitution, that is, certain large companies and other entities stipulated in the amended CPA Law. Therefore, we have enhanced the review structure by increasing the number of reviewers and members of the Quality Control Committee in order to handle the increased number of the audit firms subject to quality control review. In August 2005, the number of Quality Control Committee members was increased from 16 to 25. Regarding the chairperson of the Committee, although the Chairman and President of the JICPA was formerly assigned that position, the Deputy President appointed by the Chairman and President of the JICPA shall be assigned as the chairperson, as revised in the Constitution. Since April 2005, the number of reviewers has increased continuously to 20 as of the end of September 2005, including IT professionals. Since July 2005, two assistant chief reviewers have been assigned to reinforce the management of the review staff.

The following chart illustrates the structure of quality control review for the year ending March 31, 2006 and monitoring by the CPAAOB:



Notes:

1. The Quality Control Committee consists of the Chairman and President, and 25 committee members.
2. The Quality Control Review Team consists of 20 reviewers: a chief reviewer, two assistant chief reviewers, ten senior reviewers, and seven staff reviewers.

3. The Quality Control Oversight Board is a third-party body composed of six members from academia and other industry segments. The Board examines and evaluates whether quality control review is conducted appropriately, then makes recommendations to the Quality Control Committee.

3. Overview of Quality Control Review Conducted in the First Half of the Review Year

The following table indicates the planned number of audit firms to be reviewed and the actual number of the reviewed audit firms for the first half of the review year.

	Year ending March 31, 2006	Actual number of reviewed audit firms in the first half of the reviewing year				
	Planned number of audit firms to review	Brought forward	Actual number of reviewed firms	Total	Quality control review reports issued (completed)	Not completed and carried forward
Audit corporations	70	4	69	73	4	69
CPAs	70	5	72	77	5	72
Total	140	9	141	150	9	141

Notes:

1. Since the year beginning April 1, 2005, the scope of quality control review has been extended to audit firms which perform audits of entities stated in Article 87, Paragraph 3 of the Constitution, that is, certain large companies and other entities stipulated in the amended CPA Law. Therefore, the number of audit firms subject to quality control review has significantly increased compared with the prior year, which were 94 audit firms.
2. The reasons for differences between the planned and actual number of audit firms subject to quality control review are as follows:
 - Seven increases (e.g., an audit firm was appointed to become the auditor of a large company)
 - Six decreases (e.g., an audit firm no longer is appointed as the auditor of a large company)
3. The actual number of reviewed audit firms for this year increased to 142 because one audit firm was added after September 30, 2005. This arose from the Chairman and President's statement released on October 25, 2005, "Toward the restoration of confidence in audits of CPAs," stating the policy of urgently implementing quality control reviews of the Big 4 firms, and the full cooperation of the JICPA with the monitoring undertaken by the CPAAOB.

Procedures for issuing quality control review reports and recommendation reports remain the same as the prior year. Quality control review reports issued for the period were entirely for nine firms for which the Quality Control Committee did not complete their review by the end of the prior year. The quality control review program for this year began in July as it did last year, and the Review Team had completed field work at 25 audit firms as of September 30, 2005. However, no quality control review reports have yet been issued to audit firms after discussion with the Quality Control Committee because the quality control review reports and recommendation reports for those reviews have not yet been prepared nor examined as of the end of September.

4. Focuses for This Period

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.

4-1. Auditor independence

In response to the requirements of auditor independence as enhanced by the amended CPA Law, the JICPA issued a revised Code of Ethics and implementation guidance with regard to independence. The Ethics Committee of the JICPA also published a "Checklist of auditor independence" as Research Report No. 1 in March 2005.

In the quality control review program this year, the Review Team will evaluate whether an audit firm ascertains the independence of its partners and audit personnel with the checklist described above, 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

As a result of the quality control reviews conducted last year, some audit firms were identified as not properly implementing corrective action from recommendations made in the previous quality control review. Reports of implementation of quality control received during the period ended March 2005 also revealed that some audit firms had not fully implemented corrective actions in response to the recommendations.

The following procedures will be taken to promote improvement in response to the circumstances described above:

- a. To better understand the situation and require early improvement, the Review Team should visit those audit firms which do not respond with "completed" in their report on

implementation of quality control review recommendations made as a result of the quality control review performed in the prior period.

- b. The Review Team should inquire as to the reasons, require early improvement, and report to the Quality Control Committee when the quality control review for this period identifies that an audit firm's implementation is not satisfactory for the matters which were reported as "completed" or reported that the improvements would be completed by the end of March 2005 in the firm's report on implementation of quality control review for the year ended March 31, 2005.

4-3. Risk-based approach

Although significant deficiencies in audits based upon risk assessment are decreasing, many matters were identified in reviews related to the planning and performing of procedures for control risk assessment and the determination of substantive procedures based on the assessed risk.

The Review Team will carefully examine whether an audit firm has established policies and procedures which will ensure that control assessment procedures and substantive procedures based on the assessed risk are properly performed. It should be noted that a revised review tool (QCP400) for this period requires documentation of the description of any findings for each item. QCP400 has also been revised in the area of the auditor's assessment of control risk regarding information systems with information technology (IT). If an audit firm is considered to have not completed corrective actions for the recommendations made in the last review, the Review Team will require the audit firm to analyze the reasons and eliminate the factors which prevent full implementation.

After consideration of the reports of implementation of quality control for the period ended March 2005, some audit firms who became subject to quality control review as of last year have not yet established policies and procedures for audits using the risk-based approach. Therefore, the Review Team will examine whether those audit firms assess the risks of audit clients and perform audit procedures based on the assessed risks.

4-4. Engagement quality control reviews for expressing an audit opinion

Evaluations of reports of implementation of quality control have disclosed that some audit firms which became subject to quality control review as of last year have not yet established policies and procedures requiring an engagement quality control review, and that some deficiencies in implementation of engagement quality control reviews were identified for audit firms which

previously have been subject to quality control reviews.

The Review Team will carefully evaluate in the course of the quality control reviews this year whether an independent, competent and qualified quality control reviewer implements engagement quality control reviews before expressing an audit opinion. The review tools as revised this year should be utilized which have added some procedures, including: inquiries whether an audit firm ensures that an engagement quality control reviewer is independent from the reviewed audit client (QCQ220); analysis of time spent on an engagement quality control review (QCQ400); and evaluation of the scope of documents to be reviewed by the engagement quality control reviewer (QCP400).

Article 3, Paragraph 4 of the Cabinet Office ordinance regarding audit corporations requires an audit corporation to establish policies and procedures that ensure proper audit engagements and a system which monitors compliance with the audit firm's policies and procedures for engagement quality control reviews. The Review Team should be aware of the need for careful examination as to whether proper monitoring has been implemented in the quality control review of audit corporations.

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

In a stage of advance preparation, the Review Team will review annual securities reports and documents received from an audit firm in particular, matters relating to audits of accounting estimates included in QCQ400, "IV. Documents relating to significant matters serving as references for the review." Subsequently, the Review Team will evaluate whether an auditor performed sufficient appropriate audit procedures, and properly documented in working papers the procedures performed and conclusions reached, with regard to significant audit items and matters which are considered to be 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.

4-6. Audit engagements of certain large companies and other entities by a sole practitioner, including joint audits and audit engagements when an auditor has been long associated with an audit client

From the year ending March 31, 2006, audit firms are required to provide information on the number of years of a partner's association with each audit client that is subject to quality control review in the list of audit engagements submitted to the Quality Control Review Team. When an

audit engagement having a long association by a single partner becomes subject to quality control review, the Review Team will perform reviews with professional skepticism, noting that threats to independence are likely to grow in such circumstances.

With respect to audit engagements of a sole practitioner, most of which are joint audit engagements by two or more CPAs, the Review Team will examine whether the terms of the agreement among auditors are clearly documented, whether written confirmations of the independence of joint auditors have been obtained, and whether the reviews of audit documentation are properly conducted and such documentation is appropriately retained.

5. Significant Issues Identified in Quality Control Review during the First Half of the Review Year

Some deficiencies were identified as qualified conclusion matters in audit firms for which quality control reviews have been completed in the first half of the year that were related to documentation of audit planning based on risk assessment, and engagement quality control reviews for expressing an audit opinion.

6. Responses to Prior-Period Recommendations from the Quality Control Oversight Board

In response to "Recommendations for Activities of the Quality Control Committee for the year ended in March 2005" which was received on June 16, 2005, the Quality Control Committee and other relevant committees of the JICPA have taken the following steps:

Recommendation 1 – Enhancement of auditor independence

- Recommendation

The Quality Control Committee should confirm that audit firms establish policies and procedures adequately responsive to the enhancement of auditor independence in the amended CPA Law.

- Responses

The Quality Control Committee revised its review tools. Based on Research Report No. 1 "Checklist of auditor independence" issued by the Ethics Committee, the Quality Control Committee increased procedures for "Procedures of quality control review as an audit firm (QCP200, QCP210)" and "Procedures for interviews with auditors and personnel engaged in audits (QCP300)" to be utilized in the quality control reviews this year. Also, independence of an auditor has been set as one focus of quality control reviews for this year.

In response to public scrutiny about auditor independence in the alleged fraudulent accounting of Kanebo, the JICPA Chairman and President issued an announcement entitled, "On the alleged fraudulent accounting at Kanebo" on September 16, 2005. In this release, the Chairman and President urged JICPA members to once more recognize their independence as auditors in their relationship with audit clients and to ask themselves whether they maintain their independence of mind as rigorously as their independence in appearance.

Recommendation 2 – Risk-based approach

- Recommendation

Although significant deficiencies in audits based on risk assessment are decreasing, many matters were identified in quality control reviews relating to the planning and performing of procedures for control risk assessment based on a preliminary assessment of control risk and the determination of substantive procedures based on the assessed risk.

The Review Team should consider carefully whether an audit firm has established policies and procedures which ensure that control assessment procedures and substantive procedures responsive to the assessed risk are properly performed. If an audit firm's implementation is considered unsatisfactory, the Review Team should require the audit firm to analyze the reasons and eliminate the factors which prevent implementation.

- Responses

As described in Item 4, the risk-based approach is also set as another focus of quality control reviews for this year.

The JICPA also held seminars on Auditing Standards Committee Report No. 27, "Audit Planning"; No. 28, "Audit Risk"; No. 29, "Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement"; No. 30, "Auditor's Procedures in Response to Assessed Risks"; No. 31, "Audit Evidence"; and No. 5, "Audit Risk and Materiality (Revised)" which were issued on March 31, 2005 and effective for years beginning on or after April 1, 2006. (Early application is permitted.) In response to these Auditing Standards Committee Reports, IT Committee Report 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" was issued on July 6, 2005. The JICPA also plans to provide seminars on this report.

Recommendation 3 – Audits of accounting estimates

- Recommendation

Recommendations related to accounting estimates are increasing. The Quality Control Committee should promote improvement to ensure that audits of accounting estimates are properly performed.

- Response

As described in Item 4, audits of accounting estimates are included in "Sufficiency of audit procedures in forming an audit opinion" as a focus of quality control reviews this year.

Recommendation 4 – Follow-up of recommendations

- Recommendation

To make use of reports of implementation of quality control which were implemented last year, the Quality Control Committee should follow-up on the improvements resulting from recommendations on a continuing basis.

- Response

As described in Item 4, the follow-up of recommendations is also set as a focus of the quality control reviews for this year.

Recommendation 5 – System of quality control established by small- and medium-sized audit firms

- Recommendation

Audit firms and the JICPA should make further efforts to enable small- and medium-sized audit firms with limited resources to establish a system of quality control including engagement quality control reviews before expressing an audit opinion.

- Response

At the General Assembly meeting held on July 5, 2005, the JICPA Constitution was revised to establish the Committee for Small- and Medium-Sized Practitioners as a standing committee. The Committee started its activities on October 6, 2005 and considers the necessary means of applying a quality control system in ways suitable to small- and medium-sized practitioners.

7. Reporting to the CPAAOB

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

7-1. Submitted monthly reports to the CPAAOB from April through September 2005 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 the month;

7-2. Submitted review working papers which the CPAAOB considered necessary and replied to inquiries from the CPAAOB;

7-3. Received on May 25, 2005 notification of the inspection results conducted by the CPAAOB from March 23 through 25, 2005. The Quality Control Committee considered what corrective actions could be taken to address the matters identified as requiring improvement. The Committee summarized its considerations as "Corrective actions to address the inspection results," reported them to the CPAAOB on June 24, 2005, and published them in the JICPA Journal, September 2005 issue.

8. Amendment of the Constitution, Regulations, Detailed Rules, Quality Control Review Standards, Quality Control Review Procedures, and Administrative Manual of the Committee

8-1. Amendment of the Constitution

At the General Assembly meeting held on July 5, 2005, amendment of the Constitution was resolved (effective August 11, 2005), to amend the role of quality control review from "directional or educational" to "directional" (Paragraphs 1 and 2 of Article 87). The Quality Control Committee had been required to report the facts to the Chairman and President when it identifies substantial doubt about the appropriateness of an audit opinion expressed by a CPA or an audit corporation (Paragraph 3 of Article 88). In addition to this, the Constitution was amended so that the Chairman and President could direct the Quality Control Committee to take the necessary actions when the Chairman and President is notified by the Audit Practice and Review Committee that it has identified significant issues with regard to the quality control system of a particular firm during its investigation (Paragraph 2 of Article 89-2-2). This amendment is aimed at enhancing the effective collaboration between the Quality Control Committee and the Audit Practice and Review Committee. Previously, the Chairman and President chaired the Quality Control Committee; however, following these amendments, a Deputy President appointed by the Chairman and President of the JICPA will now chair the Committee (Paragraph 2 of Article 88-2).

8-2. Amendment of the Regulations of the Quality Control Committee

Quality control review reports and recommendation reports will now require the approval of the Chairman and President before issuance pursuant to Paragraph 1 of Article 2, and Article 6 of the revised Regulations of the Quality Control Committee. This revision took place in conjunction with amendment of the Constitution (effective August 11, 2005).

8-3. Amendment of Detailed Rules of the Quality Control Committee

Detailed Rules of the Quality Control Committee were revised on April 6, 2005 to establish the new position of Assistant Chief Reviewer in order to address administrative issues arising from the increased number of reviewers.

8-4. Amendment of the Quality Control Review Standards

The role of quality control review, established in the Quality Control Review Standards, was changed from "directional or educational" to one of "directional" in accordance with the amendment of the Constitution. This change was approved by the Council meeting held on July 20, 2005.

8-5. Amendment of the Quality Control Review Procedures

The Quality Control Committee made necessary amendments to the Quality Control Review Procedures, which were approved by the Council meeting held on July 20, 2005. Following are the major amendments:

- a. Divide norms to be complied with when performing an audit into auditing norms and accounting norms (judgmental criteria). Before this revision, they were defined collectively as "auditing and accounting norms." In the course of quality control reviews, it is to be evaluated whether an audit is performed in compliance with these auditing norms. Where significant noncompliance is identified as to an auditor's judgment of fair presentation when reviewing its process of forming an audit opinion, there should be an additional evaluation of the adherence to accounting standards. [References: I. Preface, 2. Definition of quality control standards, auditing norms and accounting norms (Paragraphs 14 to 17); IV. Procedures for issuing a quality control review report, 2. Expressing a conclusion in a quality control review report, "Modified conclusion" (Paragraphs 399 to 407) and "Adverse conclusion" (Paragraphs 408 to 419), and 4. Evaluation of the design and implementation of policies and procedures of quality control in an audit, "Guidelines to evaluate compliance with auditing norms" (Paragraphs 479 to 483)];
- b. Ascertain the justification for an audit corporation having different, multiple policies and procedures in relation to quality control, and whether there is an intention to unify these policies and procedures, if applicable [I. Preface, 3. Audit engagements subject to quality control reviews, "When a number of policies and procedures of quality control exist in a single audit corporation" (Paragraphs 32 to 37)];
- c. Established the position of Chief Assistant Reviewer, and made revisions necessary to administer the Review Team by groups [II. General procedures, 3. Composition of reviewers (Paragraphs 61 to 70)];

- d. Obtain copies of relevant materials and working papers which are necessary to describe findings in a sheet of finding records or essential to advance the examination, and file them in the review working papers [II. General procedures 7. Review of working papers, "Form and content of review working papers" (Paragraphs 110 to 115)];
- e. Revise the composition 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 [II. 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 (Paragraphs 144 to 164)];
- f. Revise the reorganization of reviewed audit firms, the addressee when a joint audit firm becomes subject to quality control review, date and period of the review described in a quality control review report or a recommendation report [IV. Procedures for issuing a quality control review report, 5. Guidelines for the preparation of a quality control review report (Paragraphs 496 to 513), 7. Guidelines for the preparation of a recommendation report (Paragraphs 528 to 541), Appendix I. Example of a quality control review report, Appendix II. Example of a recommendation report].

8-6. Amendment of the Quality Control Committee Administration Manual

Provisions relevant to assistant chief reviewers and matters described in the annual report and the semi-annual report were revised on August 19, 2005 in order to reflect actual practice.

9. Development and Amendment of Review Tools

Based on the quality control reviews conducted to date and recommendations made in the course of monitoring by the CPAAOB since April 2004, review tools were added and revised on May 20, June 17, and July 12, 2005 in order to further enhance quality control reviews in the future and to respond to the expansion of review engagements in this review year and hereafter.

9-1. Amendment of audit engagement profiles (QCQ100 – Audit corporations; QCQ110 – CPAs)

An amendment was made in relation to the expansion of review engagements this year.

Guidelines for completing profile data were moved to the last page.

9-2. Amendment of questionnaires about the quality control of an audit (QCQ200 – Audit corporations; QCQ210 – Details for an audit corporation; QCQ220 – CPAs)

- a. Improved consistency of questions among QCQ200, QCQ210 and QCQ220;
- b. Modified QCQ200 and QCQ210 which might have been interpreted as allowing different, multiple quality control policies and procedures, clarifying instead that uniform policies and

procedures should be designed and implemented;

- c. Developed questions on the assessment of control risk associated with information systems using IT;
- d. Added questions of engagement quality control reviews for expressing an audit opinion to QCQ220 as well as the documentation as to entrusted matters when CPAs make use of the system of entrusted engagement quality control review, which has been implemented by the JICPA;
- e. Added questions on designated partners to QCQ200 and QCQ210;
- f. Added questions to ascertain that the person responsible for monitoring the implementation of quality control is not engaged in an audit and to illustrate the relationship between that person and an engagement quality control reviewer.

9-3. Amendment to the list of audit engagements subject to quality control review (QCQ300)

- a. Added a form for non-listed companies, such as non-listed large companies, corresponding to the expansion of the reviewed audit engagements;
- b. Added years of association of audit partners, audit fees, fees for non-audit services, and hours spent on an audit engagement;
- c. Added consolidated financial information, in addition to the non-consolidated information;
- d. Requested explanatory documents for the reasons of change of auditor, if due to audit risk or disagreement with an audit client;
- e. Requested a description that a reviewed audit client adopts accounting principles generally accepted in countries other than Japan or if listed on a foreign capital market, if applicable.

9-4. Amendment and addition of audit engagement profiles (QCQ400, QCQ480 and QCQ485)

- a. Requested a description of written confirmation of independence obtained from all personnel engaged in an audit;
- b. Requested a description of the number of CPE credit units obtained in the prior year by all personnel engaged in an audit;
- c. Requested a description of the hours spent on engagement quality control review during planning, the year's interim, and the year-end phases, respectively, and the dates of issuance of the auditor's report and management representation letter;
- d. Improved consistency between "III. Summary of significant matters considered in the course of an audit" and "2. Determination of significant items to be examined" of QCP400;
- e. Requested detailed information on comparatives of significant items such as financial statements and accounting estimates based on work papers to increase information included in the Appendix;

- f. Added audit engagement profiles for an independent administrative institution (QCQ480) and a national university (QCQ485) corresponding with the expansion of reviewed audit engagements.

9-5. Additions of review planning procedures (QCP100)

Procedures for planning a review and advanced preparation were added as QCP100. This addition caused the renumbering of the former QCP100 as QCP200, QCP200 as QCP300, and QCP300 as QCP400.

9-6. Amendment of procedures for interviews with personnel engaged in an audit (QCP300)

- a. Organized matters relating to the amended CPA Law;
- b. Added questions regarding independence.

9-7. Amendment and addition of audit engagement review procedures (QCP400)

- a. Clarified review procedures, matters to be noted, and the relationship with audit engagement profiles (QCQ400);
- b. Added procedures for changes of accounting policies (QCP416) and the percentage of completion method (ACP417);
- c. Added industry-specific review programs for banking (QCP450), general insurance (QCP460) and life insurance (QCP470) along with an independent administrative institution (QCP480) and a national university (QCP485) corresponding with the expansion of reviewed audit engagements.

Quality control review tools that are sold to JICPA members in the form of CD-ROMs or bound volumes were also amended.

10. Future Challenges of the Quality Control Review System

The quality control review system, which plays a significant role in the sound development of audits in Japan, has been legally required under the amended CPA Law since 2004 while maintaining the framework of a self-regulatory system. Quality control review conducted by the JICPA is a more transparent system because it is subject to independent monitoring by the CPAAOB. Starting from the year beginning April 1, 2005, audits of certain large companies and other entities stipulated by the CPA Law have become subject to quality control review. The quality control review program this year has been progressing based on the "Focuses for this period" as described in Item 4. In order to respond to "Measures to ensure appropriate disclosures and rigorous audits of financial statements" issued by the Financial Services Agency and CPAAOB on October 25, 2005 and the Chairman and

President's statement published on October 25, 2005, "Toward the restoration of confidence in audits of CPAs," further improvements are required in the quality control review process.

Based on "Quality Control Standards for Audits" issued by the Business Accounting Council on October 28, 2005, the Auditing Standards Committee and Quality Control Committee are developing practical guidelines to improve practices. When the standards and practical guidelines are put into effect, the design and implementation of audit firms' policies and procedures will be reviewed in future quality control reviews.

Issues related to the quality control review system that need to be addressed in the future include the following:

10-1. Improvement of follow-up actions to recommendations:

- Understanding the implementation of corrective actions taken by audit firms through the analysis of reports of implementation of quality controls submitted annually;
- Encouraging improvements through:
 - analyses of implementation, and the reasons for not implementing improvements;
 - providing appropriate advice; and
 - visiting audit firms when necessary;
- On-site confirmation of improvements related to previous recommendations in the course of a quality control review based on reports on implementation of quality controls.

10-2. Improvement in the reviewing quality level of quality control reviews based on past performance

- a) Consistency with the Quality Control Standards in policies and procedures as determined by audit firms:
 - Whether audit firms update their audit manuals, checklists, and other materials to enhance auditing practices using a risk-based approach;
 - Whether audit firms instruct their engagement teams to identify factors which may cause material misstatements and to focus on high-risk areas;
 - Whether audit firms properly respond to new topics in audit areas, such as accounting estimates and going concern assumptions;
 - Whether audit firms take appropriate actions when assessing control risks in relation to information systems using information technology.
- b) Compliance with policies and procedures of quality control determined by audit firms:
 - Whether audit firms try to improve not only documentation but actual auditing practices in relation to the implementation of the risk-based approach, that is, verifying whether

appropriate risk assessments are performed;

- Whether audit firms conduct internal quality control monitoring adequately and promote improvement of audit quality.

10-3. Collaboration with the Audit Practice and Review Committee

- Promote collaboration through "consultative meetings between the Audit Practice and Review Committee and Quality Control Committee" which was established to supplement the execution of duties by the Chairman and President on October 6, 2005 and take the necessary actions.

In order to maintain the quality control review system conducted by the JICPA as a self-regulatory professional body, the most important challenges are rigorously conducting quality control review, initiating the appropriate responses to monitoring by the CPAAOB, and demonstrating to the public the effects of quality control review.