Public Report

July 2010

Certified Public Accountants and Auditing Oversight Board

About the contents of this Public Report

This Public Report reports on the activities of the Certified Public Accountants and Auditing Oversight Board (CPAAOB) during fiscal 2009 (from April 1, 2009, to March 31, 2010) and to better meet the needs of readers includes information on activities taken before and after fiscal 2009.

Contents

Summary

Examinations and Inspections

The Certified Public Accountants and Auditing Oversight Board (CPAAOB) reviewed and examined reports of quality control reviews by the Japanese Institute of Certified Public Accountants (JICPA). The CPAAOB conducted inspections of seven audit firms; and based on the inspection results, the CPAAOB made recommendations concerning one audit firm to the Commissioner of the Financial Services Agency (FSA) on administrative penalties or any other measures.

It also developed its system for requiring reports from and doing inspections on foreign audit firms, announcing in January 2010 its "Certified Public Accountants and Auditing Oversight Board Basic Guidelines on Reports Required from and Inspections of Foreign Audit Firms etc."

Cooperation with Relevant Organizations in Other Countries

Attended the Fifth Meeting of the International Forum of Independent Audit Regulators (IFIAR) in April 2009 in Basel, the Sixth Meeting in September 2009 in Singapore, and the Seventh Meeting in March 2010 in Abu Dhabi.

CPAAOB also participated in the IFIAR Inspection Workshop held at the Fourth Meeting in February 2010 in Paris.

1 Organization

1.1 *Certified Public Accountants and Auditing Oversight Board*

The Certified Public Accountants and Auditing Oversight Board (CPAAOB) is a council system government institution established by the Financial Services Agency (FSA), based on the Certified Public Accountants Act (CPA Act), and the Act for Establishment of the FSA. (Established April 2004)

The CPAAOB is comprised of a Chairperson and up to 9 Commissioners with understanding and knowledge of matters concerning CPAs who are appointed by the Prime Minister and approved by both Diet houses. They are appointed for a term of three years.

During the second period, the CPAAOB was composed of 10 people: Chairperson Kaneko, Full-time Commissioner Wakita, and 8 part time Commissioners. The period ended on 31 March 2010, and the third period's CPAAOB began on 1 April 2010 with a newly appointed Chairman and Commissioners. (Please see Annex 1.)

The main work of the CPAAOB is as follows:

- Inspect CPAs, audit corporations, JICPA, and foreign audit firms, etc[1].
- Implement the CPA examinations
- Deliberate matters concerning disciplinary actions against CPAs, audit firms, etc.

1.2 *Executive Bureau*

The CPAAOB has an Executive Bureau to handle its administrative duties.

The Executive Bureau is comprised of the Office of Coordination and Examination and the Office of Monitoring and Inspection, under the Secretary-General of the Executive Bureau. The Office of Coordination and Examination is in charge of implementing the CPA examinations, deliberating disciplinary actions against CPAs and audit firms, and general coordination of the Executive Bureau. The Office of Monitoring and Inspection is in charge of monitoring the operation of audit services provided by audit firms, monitoring the compliance of the operation of JICPA, and inspecting JICPA and audit firms.

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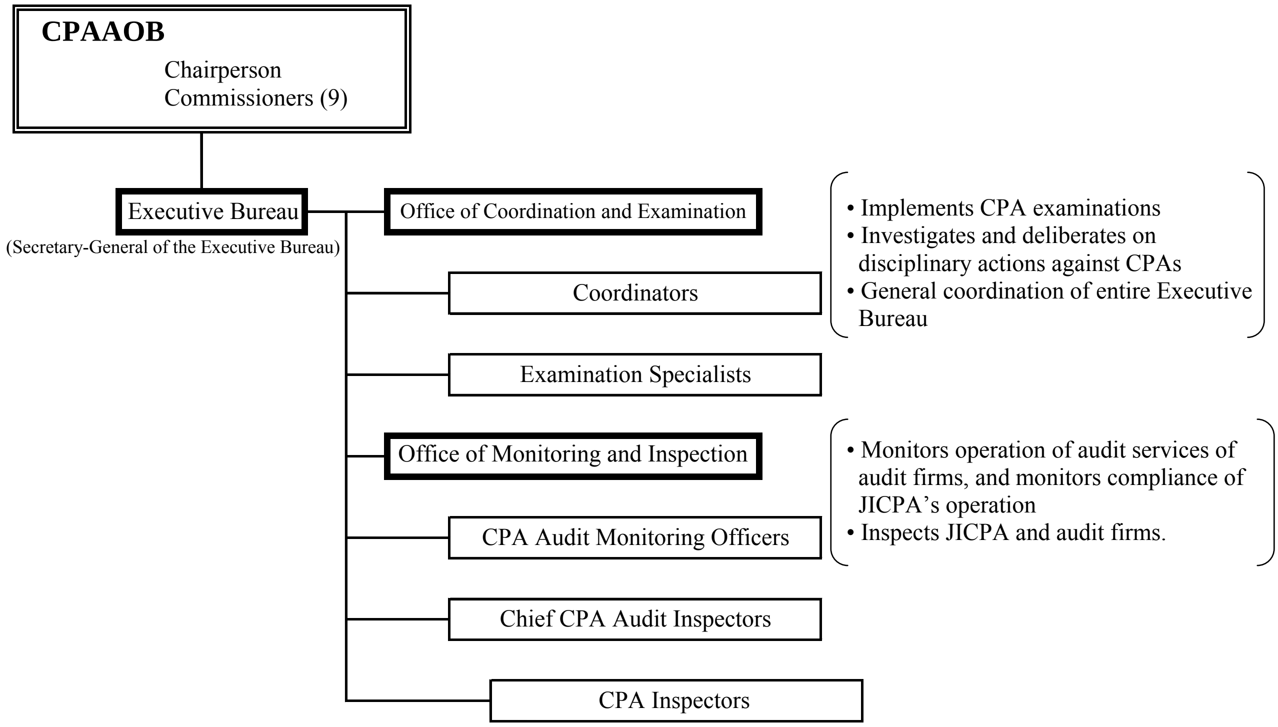
[1] Signifying parties located in a foreign country, which do the work of audit attestation on the financial documents of foreign companies etc. which submit securities reports etc. in Japan.

Reference: Changes in the number of staff members (Fiscal year-end basis)

	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Office of Coordination and Examination	11	12	12	12	12	14
Office of Monitoring and Inspection	29	29	31	35	39	41
Chief Inspectors	4	4	4	4	5	5
Inspectors	18	18	20	24	26	28

Note: Approval was obtained for the Office of Monitoring and Inspection to increase staff in fiscal 2010: 2 more Chief Inspectors, 1 more Inspector, and a Monitoring Unit 3 Section Chief.

Organization Chart of the CPAAOB



2 Examinations and Inspections

2.1 *Outline*

2.1.1 *System*

Under the CPA Act, the authority related to following affairs is delegated from the Commissioner of the FSA to the CPAAOB:

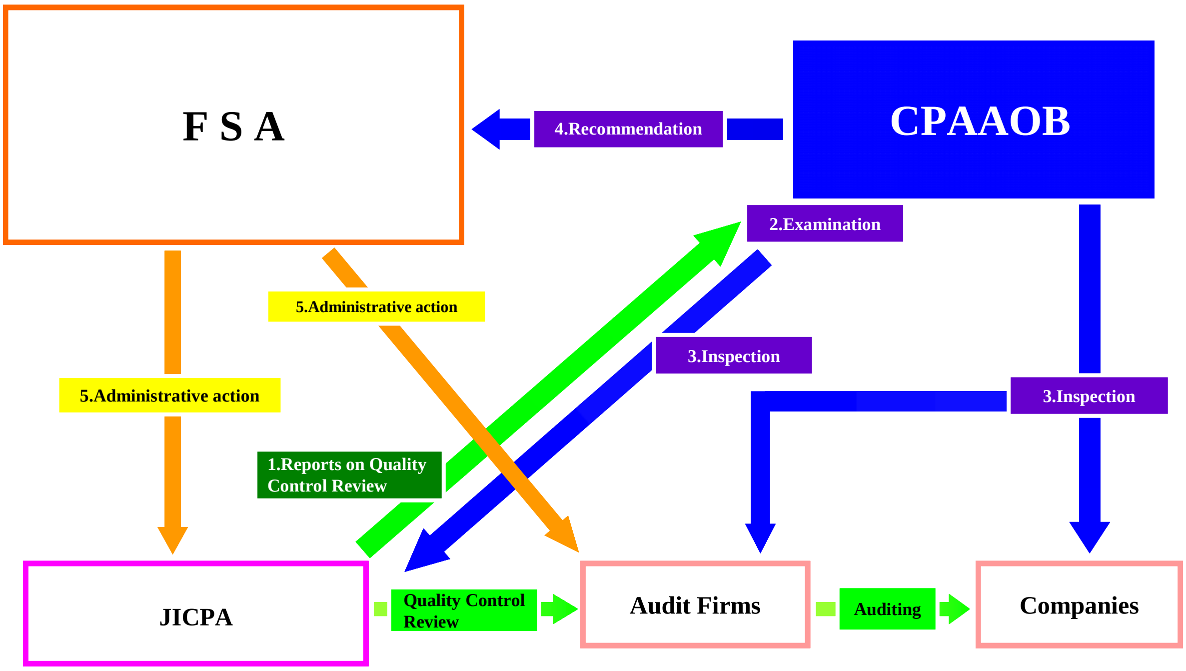
- Receipt of reports on results of JICPA's quality control review[2] regarding the operation of audit and attestation services
- Request for information submission and conduct inspections on the JICPA, CPAs and audit firms (limited to those actions performed in relation to the foregoing JICPA's quality control review)
- Request for information submission and conduct of inspections on foreign audit firms

The CPAAOB examines JICPA's reports on quality control reviews and exercises the authority to request for information submission or conduct inspections, when the CPAAOB finds, from the standpoint of public interest or investor protection, it necessary and appropriate to do so.

Based on the results of the above, the CPAAOB may make recommendations to the Commissioner of the FSA regarding administrative actions or other measures, when the CPAAOB finds it necessary to do so.

[2] A quality control review is a review performed by the JICPA to assess the status of the operation of audit or attestation services. Specifically, with the aim of maintaining and improving the quality level of audit service as well as maintaining and enhancing social reliability in auditing, the JICPA reviews the status of quality control performed by audit corporations and offices of certified public accountants (hereinafter collectively referred to as "audit firms"), makes recommendations to remedy deficiencies, when finding it necessary, and has the relevant audit firm report on the status of the remedial action.

Outline of Examination and Inspection



1. Reports on Quality Control Review

The JICPA reviews and assesses an audit firms' compliance with laws, regulations, auditing standards, and the JIPCA's rules and other related regulations. Once every three years in principle (or once every two years, when the JIPCA finds it necessary); The CPAAOB receives reports on the results of those reviews.

2. Examination

The CPAAOB examines JICPA's reports and ascertains (i) whether the quality control review system is appropriately operated by the JICPA as well as (ii) whether audit services are appropriately provided by audit firms.

The CPAAOB requests the submission of reports or other materials from the JICPA or audit firms, when the CPAAOB finds, in the course of examinations, it necessary to do so.

3. Inspection

Based on the results of examination, the CPAAOB conducts inspections of the JICPA, audit firms and any other related sites (such as those of audited companies), when the CPAAOB considers it necessary and appropriate in light of public interest or investor protection or when the CPAAOB considers it necessary to do so from the view point of securing the appropriate operation of the JICPA.

4. Recommendation

Based on the results of examination or inspection, the CPAAOB may make recommendations to the Commissioner of the FSA for administrative actions or any other measures for securing fair operation of audit services by audit firms or that of administrative operations of the JICPA, when the CPAAOB considers it necessary.

5. Administrative action (by the FSA)

When an audit firm's operation is found to be grossly inappropriate, the FSA may issue an admonition, order an improvement of its operation control structure, order the suspension of its services for a period not exceeding two years, or order its dissolution. The FSA may also give necessary instruction to a firm, when the FSA finds that its operation is grossly inappropriate and that such instruction is necessary for securing its fair operation.

Note: Regarding requests for information submission and inspections on foreign audit firms, refer to section 3. "Basic Guidelines on Information Requirements and Inspections on Foreign Audit Firms, etc."

2.1.2 *Basic Policies for Examination and Inspection*

The CPAAOB established and published in June 2004 the "Basic Policies for Examination and Inspection – To Ensure Reliability of Audits –," and announced its basic viewpoints and the goals of the activities during the first term (from April 2004 to March 2007) as well as the basic guideline for examination and the framework for inspection.

In its second term (from April 2007 to March 2010), based on the results of examination and inspection during the first term, the CPAAOB established and published the "Basic Policies for Examination and Inspection– For Further Improvement of Audit Quality" (hereinafter referred to as the "Basic Policies for Examination and Inspection").

In the "Basic Policies for Examination and Inspection," the following basic perspectives and goals regarding examinations and inspections were mentioned:

- Perspectives

  In carrying out examinations and inspections, the CPAAOB makes the most use of its authority in pursuit of the public interest and endeavors to ensure and improve the audit quality. Also the CPAAOB proactively responds to international trends, endeavors to obtain information regarding overseas countries, and disseminates necessary information at home and abroad.

- Goals

  In carrying out examinations and inspections, the CPAAOB focuses on, as its basic goals, promoting further improvement of quality control review functions by the JICPA from the public standpoint, instead of directly focusing on reviewing whether or not individual audit opinions are appropriate.

2.1.3 *Activities up to fiscal year 2008*

Since its establishment in April 2004, the CPAAOB carried out 43 inspections of audit firms, and in 13 cases made to the Commissioner of FSA recommendations for administrative actions or any other measures. Also the CPAAOB conducted inspections of the JICPA in the fiscal years of 2004 and 2007.

2.2 *Examinations and Inspections in fiscal year 2009*

2.2.1 *Quality Control Reviews by the JICPA*

In fiscal year 2009, the JICPA performed 83 quality control reviews of audit firms (42 audit corporations (including joint audit offices) and 41 CPAs). By March 31, 2010, 64 reports on quality control reviews were submitted to the CPAAOB.

All of the 64 cases reported to the CPAAOB included recommendations to remedy deficiencies. The conclusions of those reports were as follows.

- Unqualified conclusion: 45 cases (26 audit firms and 19 CPAs)
- Qualified conclusion: 19 cases (6 audit firms and 13 CPAs)
- Negative conclusion (none)

Also, in fiscal year 2009, the JICPA performed follow-up reviews[3] (including secondary follow-up reviews) of 81 audit firms (60 audit corporations and 21 CPAs). The results of 69 reviews, which were reported to the CPAAOB by March 31, 2010, are as follows.

- Remedial actions completed: 53 cases (46 audit corporations and 7 CPAs)
- Remedial actions insufficiently conducted: 16 cases (10 audit corporations and 6 CPAs)

[3] A Follow-up review is a review conducted by the JICPA as part of its quality control review to assess the status of remedial action performed by an audit firm. To be specific, the JICPA assesses the status of remedial action by reviewing the status of (i) improvement of the quality control system, (ii) communication to auditors (including education and training of them), and (iii) remedial actions implemented in relation to monitoring of the quality control system, etc., which have been performed in accordance with the remedial plan described in the firm's response to the JICPA in the course of the quality control review.

2.2.2 *Examination of Quality Control Reviews*

2.2.2.1 *Scope and Perspective of Examination*

In fiscal year 2009, the CPAAOB examined quality control reviews performed by the JICPA during the fiscal years of 2008 and 2009.

In the process of examination, the CPAAOB reviews reports on quality control review and assesses the results of interviews and requests for information submission in order to ascertain the following points:

- Appropriateness of JICPA's quality control reviews.
- Status of development and operation of quality control systems established for ensuring the quality of audit services.
- Implementation of quality control by each audit firm in relation to the performance of respective engagement.

2.2.2.2 *Request for Information Submission*

With a view to reinforcing the quality control system of each firm, the CPA Act was amended as of April 2008 to introduce the obligation for audit firms to establish policies and procedures regarding the monitoring of engagement quality control. In light of this amendment, the CPAAOB determined as its key focus in the examination of audit corporations the "monitoring of quality control systems" and, regarding CPAs, the "development of quality control systems." In October 2009, the CPAAOB requested 19 audit firms and 17 CPAs to submit information.

* 1:Information was requested from those audit firms (i) whose quality control system desing appeared to be significantly insufficient, (ii) whose quality control system operation appeared to be significantly insufficient, (iii) whose attitudes toward the improvement of quality control were questionable, and (iv) whose quality control system appeared to have deficiencies in quite a few areas.

* 2:The CPAAOB noted that two CPAs, out of those to which requests were made, had deficiencies in their periodic monitoring of quality control systems. The CPAAOB later ascertained rectification of those deficiencies.

2.2.3 *Status of Inspections*

Based on the "Basic Plan on Examination and Inspection, Fiscal Year 2009," the CPAAOB conducted inspections on 7 audit firms in fiscal year 2009 (2 inspections related to JICPA's quality control reviews in fiscal year 2007 and 5 inspections related to those in fiscal year 2008).

2.2.4 *Recommendations to the Commissioner of FSA*

Under Article 41-2 of the CPA Act, the CPAAOB made recommendations to the Commissioner of FSA for administrative actions or any other measures regarding the following audit firm, after deliberating the results of inspection conducted in fiscal year 2009.

- November 17, 2009: Prime Audit Corporation

Note 1: The chief executive partner and the person in charge of quality control were not fully aware of the need to establish the firm's quality control system. Also the firm's internal rules were not appropriately established and the firm's instructions to and supervision of audit support staff were insufficient. A large number of deficiencies were identified in relation to the firm's quality system and its operation was not managed in a systematic manner.

Note 2: Administrative action by the FSA; Suspension of acceptance of a new engagement for one year (June 4, 2010 through June 3, 2011) and order for improvement of the operation control structure.

2.2.5 *Revision of the "Report on Deficiencies concerning Audit Quality Control Identified through Inspections"*

In June 2010, the CPAAOB published a revised version of the "Report on Deficiencies concerning Audit Quality Control Identified through Inspections." In the revised version, certain examples of issues were added or deleted to incorporate the issues identified in the inspections completed in fiscal year 2009 and to reflect the revisions of accounting standards, etc.

The CPAAOB intends to promote awareness of the importance of audit quality control through having meetings with related parties and other measures.

The CPAAOB will revise the above document every fiscal year, and add and delete the examples, as deemed necessary. (Please see Annex 2.)

2.3 *Basic Guidelines on Information Requirements and Inspections on Foreign Audit Firms, etc.*

In relation to the supervision/inspection of foreign audit firms, the CPAAOB and the FSA published the "A Framework for Inspection/Supervision of Foreign Audit Firms, etc." on September 14, 2009, based on the "Basic Plan on Examination and Inspection, Fiscal Year 2009."

On October 2, 2009, the CPAAOB posted a draft of "Proposed Basic Guidelines on Information Requirements and Inspection on Foreign Audit Firms etc. by the CPAAOB" for public consultation on the CPAAOB website, which was drafted on the basis of "A Framework for Inspection/Supervision of Foreign Audit Firms, etc." to provide the concrete procedures and points to be considered regarding information requirements and inspection of foreign audit firms. The CPAAOB received comments from October 2 to November 2, 2009. Taking into account the comments thus received, the CPAAOB published on January 14, 2010, the "Basic Guidelines on Information Requirements and Inspection on Foreign Audit Firms etc. by the CPAAOB."

In the above framework and basic guidelines, it is stated that when arrangements of information exchange are prepared with the competent authority of the firm's home jurisdiction and when reciprocity is ensured, the CPAAOB will rely on information requirements and inspections conducted by the competent foreign authority and, in principle, will not conduct such actions on foreign audit firms itself.

3 Cooperation with Relevant Organizations in Other Countries

3.1 *Outline*

Sparked by a series of accounting scandals around the world, such as the Enron and WorldCom scandals, the importance of audit oversight has increased, and audit oversight institutions independent of the audit profession have been established in various countries, to ensure and enhance audit quality.

In this environment, the first meeting of the International Forum of Independent Audit Regulators (IFIAR) (with 22 countries participating) was held in Tokyo in March 2007, and hosted by the CPAAOB. Seven of these meetings had been held by March 2010, and as of the end the same month, its membership had expanded to 35 countries and regions. The Chairman and the Full-time Commissioner of the CPAAOB have attended the meetings.

The CPAAOB is making efforts to construct and reinforce a cooperative relationship with regulators in other countries in order to improve the quality of international auditing.

3.2 *International Forum of Independent Audit Regulators (IFIAR)*

(See Reference IFIAR website: http://www.ifiar.org/).

<u>IFIAR past meetings</u>

• First meeting	March 22-23, 2007	Tokyo, Japan
• Second meeting	September 24-25, 2007	Toronto, Canada
• Third meeting	April 9-11, 2008	Oslo, Norway
• Fourth meeting	September 22-24, 2008	Cape Town, South Africa
• Fifth meeting	April 27-29, 2009	Basel, Switzerland
• Sixth meeting	September 14-16, 2009	Singapore
• Seventh meeting	March 22-24, 2010	Abu Dhabi

IFIAR past inspection workshops

• First workshop	May 30-31, 2007	Amsterdam, the Netherlands
• Second workshop	January 29-30, 2008	Berlin, Germany
• Third workshop	February 11-13, 2009	Stockholm, Sweden
• Fourth workshop	February 9-12, 2009	Paris, France

3.3 *Other*

In addition to participating in the IFIAR meetings, the CPAAOB is actively exchanging views and experience with audit regulators and other organizations of different countries on a bilateral basis.

Particularly in response to the enforcement of the revised CPA Act in April 2008, the representatives of the CPAAOB and the FSA jointly held meetings with foreign audit regulators to discuss issues concerning the inspection and supervision of foreign audit firms.

Annex 1

List of Members of Certified Public Accountants and Auditing Oversight Board (CPAAOB) (As of April 1, 2010)

Chairperson (full-time)	Yoshimasa Tomosugi	Former Professor WASEDA Graduate School of Accountancy
Commissioner (full-time)	Toshiro Hiromoto	Former Professor Graduate School of Commerce and Management Hitotsubashi University
Commissioner (part-time)	Yasuyoshi Ichikawa	Partner Deloitte Touche Tohmatsu LLC
Commissioner (part-time)	Mami Indo	Executive Officer & Head of Consulting Division Daiwa Institute of Research Ltd.
Commissioner (part-time)	Michiyoshi Sakamoto	Professor Keio University Graduate School of Business & Commerce
Commissioner (part-time)	Hisakatsu Sakurai	Professor Graduate School of Business Administration, Kobe University
Commissioner (part-time)	Yuko Tashima	Lawyer Outside Director Meiji Yasuda Life Insurance Company
Commissioner (part-time)	Naoko Nemoto	Managing Director Financial Services Ratings Standard & Poor’s
Commissioner (part-time)	Yasuyuki Fuchita	Senior Managing Director Nomura Institute of Capital Markets Research
Commissioner (part-time)	Kazunori Yagi	Director, Chief Financial Officer Executive Vice President Management Administration Headquarters Yokogawa Electric Corporation

Annex 2

Case Report：Deficiencies in Audit Quality Control

(English version)

July 2010

Certified Public Accountants and Auditing Oversight Board

Introduction

Since its establishment in April 2004, the Certified Public Accountants and Auditing Oversight Board ("CPAAOB") has been conducting inspections of Japanese audit firms from the view point of enhancing the audit quality in Japan and securing the public interests.

In the course of those inspections, the CPAAOB has identified various deficiencies in audit firms concerning their audit engagement performance as well as their quality control system, especially in the areas of (i) responsibility of quality control, (ii) ethical requirements and independence, (iii) audit files, (iv) engagement quality control review and (v) monitoring the firm's quality control system. To make those deficiencies public, the CPAAOB issued, in Japanese, the first edition of the "Case Report: Deficiencies in Audit Quality Control" in February 2008, its second edition in June 2009, and its third edition in June 2010.

In this English version of "Case Report: Deficiencies in Audit Quality Control", we selected out of those mentioned in our third edition of the report in Japanese the deficiencies, which, in our analysis, are not peculiar to Japanese audit firms but might also be found in foreign audit firms. In Part I of this English version, we introduce the deficiencies concerning the firms' quality control system, and, in Part II, the deficiencies concerning audit engagement performance.

The CPAAOB trusts that this English version of the report is useful for foreign audit firms, especially those having provided to the Financial Services Agency the notification required the Certified Public Accountants Act of Japan, in making their continuous efforts to enhance the audit quality.

Chairperson of the CPAAOB
Yoshimasa Tomosugi

Part I Quality Control System

Responsibility for Quality Control

1. In relation to the firm's quality control system, the firm did not clearly define the responsibility to be assumed by each member of the Board of Partners, the CEO and the partner in charge of quality control, and neither of them performed proper oversight over the system. Consequently certain deficiencies were caused in relation to the development of the firm's compliance system, information control system, monitoring system, the establishment and notification of internal rules and the retention of audit files.

2. The CEO of the firm did not give the partner in charge of quality control specific instruction as to how the quality control system should be established and managed. The CEO did not appropriately supervise how the partner assumed his responsibilities as the one in charge of the quality control system, either.

3. Only the representative partner of the firm took charge of the administrative matters of the firm, such as the establishment and abolition of internal rules, the arrangement of partners' meetings, the preparation of the minutes for the meetings, while the other partners shared no responsibilities for those matters. Some of the internal rules and manuals did not appropriately reflect the latest business operations of the firm or the recent amendments to the audit standards.

Compliance with regulations and rules

4. The internal rules of the firm provided that, when a new employee joined the firm or the firm's policies and procedures concerning its quality control system were amended, the partner in charge of the firm's quality control had to explain those policies and procedures to the audit staff; however, the partner did not make timely explanation of those policies and procedures.

5. The internal rules of the firm did not reflect the recent amendment to or abolishment of relevant laws and regulations.

6. The most recent audit manual of the firm did not provide for the procedures concerning audit of internal control over financial reporting, which had to be conducted in relation to the fiscal years beginning on or after April 1, 2008.

7. A firm auditing the consolidated financial statement of a company concurrently provided the company with the service of "compiling the company's financial statements," by receiving the financial documents from the company and calculating and providing to it the figures to be shown in the consolidated financial statements.

8. The CEO of the firm did not recognize that the consulting company, the shares of which were mostly owned by the CEO, was deemed to be the firm's affiliated entity. Due to this lack of recognition, the CEO did not notice that the firm's audit of a company and the affiliated company's concurrent performance of compiling the financial statements of the same company violated the rule regarding restriction on concurrent provision of audit and non-audit services.

9. The firm had no procedures to confirm whether or not the service provided by the firm violated the regulation prohibiting certain concurrent provision to a single client of the assurance service and the non-assurance service. Rather, the firm completely relied on each partner's judgment as to whether the service provided by him/her violated the above regulation.

Policy for Information Security

10. The firm rented the PCs to its audit staff without taking appropriate security measures.

11. The firm did not monitor the data saved on each of the PCs rented to its audit staff.

12. In relation to the audit services, the firm did not establish an information security policy nor develop the system of information security control.

Quality Control Review by Japanese Institute of Certified Public Accountants

13. The firm did not adequately communicate to its audit staff the deficiencies identified in the inspection process conducted by the Japanese Institute of Certified Public Accountants (“JICPA”) nor the remedial actions which had to be taken in relation to those deficiencies.

14. The firm confirmed in writing that it would perform sufficient and appropriate measures to remedy deficiencies identified in the course of JICPA’s quality control review, such as communicating the identified deficiencies to the audit staff, strengthening monitoring over the quality control system and so on; however, the firm did not develop a detailed action plan for implementing the above measures or appropriately communicate those deficiencies to its staff.

Ethical Requirements and Independence

15. In the course of annual confirmation of independence, the partner in charge of the confirmation process failed to collect sufficient information necessary to appropriately conduct the process.

16 In confirming the independence of new employees, the firm did not confirm their independence over the subsidiaries, etc. of the audited companies.

17. The firm failed to confirm the independence of audit assistants, who engaged in the input of the audited company’s financial figurer for use in the audit files.

18. In changing the assignment of a temporarily-employed audit staff, the firm did not confirm his/her independence in relation to the company newly assigned to him/her.

19. The firm did not establish the procedures for confirming the independence of a person who joined the audit team subsequent to its initial formation, and failed to confirm his/her independence over the engagement.

20. In confirming the independence of audit staff over a new engagement by email, the firm mentioned only the name of the prospective client but failed to

mention the names of those affiliated with the prospective client.

Human Resources

21. In selecting the engagement partner for a new engagement, the firm did not pay sufficient consideration to the characteristics of the business conducted by the prospective client or to the competence and experience of the partner.

Acceptance and Continuance of Client Relationships and Specific Engagements

22. The firm did not establish policies and procedures for acceptance and continuance of a new engagement or document the results of risk assessment conducted in the course of its acceptance or continuance.

23. The firm provided audit services to certain companies and schools without executing engagement agreements, performing risk assessments or obtaining internal resolutions required under the firm's rules.

24. Under the firm's rules a partner was required, when accepting a new client, to submit to the board of partners a report describing the outline of business and financial status of the new client and thereafter obtain the board's approval. However, some of the engagement agreements were executed without obtaining the board's approval. In some cases completed versions of the reports were not submitted to the board in the process of obtaining the board's approval.

Audit Files

25. A reviewer of the firm failed to give instructions to the audit team when it was apparent from the audit files that some of the necessary procedures had not been appropriately conducted by the team.

26. Some of the audit files had no description as to who conducted the relevant audit procedures or when and by whom the audit files were reviewed.

27. A senior member of the audit team, who was in charge of the review of the audit files, failed to point out the deficiencies of the audit procedures apparent

from the audit files.

28. During an on-site audit period, an audit team continued to keep the audit files in the lockers of the audited company without taking hold of their keys.

29. Some of the audit files of the firm were stored by its representative partner in the cabinets at the office used for his personal practice.

Engagement Quality Control Review

30. A person involved in an audit engagement as an assistant subsequently acted as an engagement quality control reviewer of the same.

31. The internal rules of the firm provided that an engagement quality control review had to be conducted by the firm's review committee. However, for each engagement the review was conducted substantially by a single member and only its chief commissioner reviewed the results of the member's review; other members did not take part in the review process at all.

32. The firm had no policies or procedures for the review of an audit plan or the one materially changed after its establishment.

33. The firm reviewed neither the audit plan of the client's financial statements nor the audit plan of the client's internal control.

34. The firm's internal rules required an audit team to have an engagement quality control reviewer review any matter related to the change of audit principle or going concern; however, a team issued an audit report, when the reviewer was yet to review the description relating to a change of software sales recognition or going concern conditions.

35. An engagement partner issued an audit report without having the engagement quality control reviewer review the same in a situation where, as the partner claimed, there was little time left before the deadline of the report and the partner was unable to contact the reviewer.

36. The firm did not keep the documents evidencing that the review procedure

had been completed before issuance of an audit report.

37. An engagement quality control reviewer failed to fill in the section titled “Results of Review” in the review records.

38. The drafts of a financial statement and an audit report that the engagement quality control reviewer claimed to have reviewed were not appropriately saved and thus were unidentifiable.

Monitoring the Firm’s Quality Control System

39. In the firm’s monitoring process it was discovered that some confirmations had not been timely collected from the audit staff; however, the monitoring partner only orally urged the relevant parties to collect those confirmations without taking any other follow-up procedures.

40. While the partner in charge of the firm’s quality control claimed to have appropriately conducted ongoing monitoring procedures, no documents were kept in this relation and certain deficiencies were indentified in relation to monitoring the collection status of written confirmations.

41. In the process of monitoring the firm’s audit process, the firm did not review whether or not the audit was conducted in accordance with the relevant audit standards and accounting standards. The firm did not review whether or not appropriate actions were taken in relation to remedy the deficiencies identified in the course of JICPA’s review, either.

42. In the course of monitoring the firm’s audit practice, the person in charge only orally confirmed what procedures the audit team had conducted without reviewing any relevant audit files.

Part II Audit Engagement Performance

Audit Planning

1. The firm had a policy requiring that when the audit team determined the audit materiality regarding the financial statement level they should consider how effective the internal control of the audited company was. Although it was an initial audit engagement, the team did not assess the effectiveness of the company's internal control at the audit planning stage until March 2009, even though the company's fiscal year end was March 31, 2009. Without performing any procedures the team assumed that the internal controls of the company were effective.

2. The audit team assessed audit materiality based on the prior year's financial figures of the audit client. Although there was a significant change with regard to current financial figures from last year, the audit team failed to consider the necessity of reassessing the audit materiality.

3. The audit team changed the audit materiality but did not consider the necessity of an audit plan including the extent of procedures subject to audit sampling.

4. Audit procedures related to understanding the audit client's internal control were limited to inquiries with client management and statutory auditors and the audit team did not perform procedures, such as observation, or review covering the assessment of internal control design.

5. Risks identified in the audit working paper for understanding the entity and its environment were not listed in the working paper which should summarize significant fraud risks. However, the latter working paper included certain risks which were not identified in the former working paper. The documentations of these key working papers were inconsistent, which showed that the audit team failed to document the process of identifying significant fraud risks sufficiently.

6. The audit team failed to identify significant fraud risks at the entity level, significant fraud risks at the financial statement level and risks that require special audit consideration. From this perspective the team failed to plan the

audit procedures corresponding to those risks.

7. Although the audit team could not use the results of their assessment of internal control designs, they did not consider the effect of the new accounting system that the client had implemented at the beginning of its financial year. They did not ascertain whether the account balances were appropriately carried forward to the beginning balances, either.

8. In relation to an assessment of the client's IT general control, the audit team concluded that there was no change and that the control level was good as a result of only inquiry procedures by relying upon the prior year's control assessment; they did not perform other procedures in addition to observation and review of related documentation

9. The audit client outsources maintenance services of their IT system. However, the audit team did not obtain a copy of the service contract or a detailed arrangement letter. The team also failed to ascertain the effectiveness of the internal control of this outsourced service.

10. In relation to the sales process IT system of the initial audit client, although the audit team recognized that, rather than a simple package system, it was a third-party-developed sophisticated system which supported electrical trade and enabled the customers to place purchase orders and to make payments on the client web site, they assessed that the client's IT utilization was limited, and failed to perform procedures for understanding and assessing the IT-related internal control of that process.

11. In relation to the valuation of delinquent accounts receivable and inventories, although the audit team insisted that they considered the accuracy and completeness of the information generated from the client's IT system, they failed to document the consideration process and conclusion in their working papers.

12. The audit team had an audit planning meeting of the initial audit client. However, the only participants were the engagement manager, senior accountants and staff accountants; the engagement partner did not attend the meeting, stating that the engagement manager and he had enough

communication when they had meetings with the client. There was no documentation of his instructions to the audit team in their audit working papers.

13. The audit team did not perform the audit procedures to identify and understand the significant risk of misstatements due to fraud, failing to inquire of the client management and statutory auditors regarding their understanding about those risks and their identification of actual fraud.

Risk-related Audit Procedures

14. As procedures for assessing the control effectiveness of daily and multiple controls relating to the purchase process, the audit team selected all sample items from transactions in December 2008 as they thought it preferable since they selected December 2008 and January 2009 for samples when they performed other related monthly control assessment procedures. In order to assess the effectiveness of daily and multiple controls, samples should be selected throughout the year, but they were not. Thus the audit team failed to obtain audit evidence.

Estimates

15. In relation to inventory valuation procedures, the audit team tested the data that the audit client prepared for the items whose net realizable value was lower than their book value and ascertained whether those valuation losses were appropriately booked or not. They failed to check the completeness of the data or to perform a further substantive test on a sample basis.

16. In relation to audit procedures for retirement benefit allowance, which the audit client calculated using package software, the audit team failed to perform those procedures to ascertain the reliability of the software and perform a substantive test such as vouching or calculation verification on a sample basis in order to check the accuracy of the year-end allowance balance.

17. Although the leased assets balance exceeded the audit materiality, the team failed to consider the necessity of leased assets' impairment.

18. In relation to the grouping of assets so as to recognize the impairment loss of the client's fixed assets, the audit team obtained the client-prepared materials but failed to ascertain the appropriateness of them. The team did not consider whether or not the client should recognize impairment loss on a consolidated group basis.

Physical Inventory Taking

19. In relation to the audit of a client in the real estate development business, the audit team agreed with the client decision not to conduct physical counts or inspect their inventory properties and properties in the construction stage even though the team had not conducted a test of related internal control to ascertain effectiveness. The team failed to document that they did not attend physical inventory taking and the reasons therefore in their audit working papers.

Revenue Recognition

20. The audit client engaged in subleasing of the real estate properties as its main business. The audit team performed only a vouching procedure for the revenue of the client and they did not perform further substantive procedures such as inspection of leased properties or analytical procedures to ascertain the relevance between the revenue and the cost because the team did not assume fraud risk based on the client's revenue recognition.

Confirmation Procedures

21. In relation to confirmations not received until the audit reporting date, the audit team failed to perform alternative procedures for confirmations and provided no reasons therefore.

22. The audit team noted that there were problems with the collection of accounts receivable confirmations. For example a large number of confirmations were not received from customers in accordance with set conditions. The team also recognized that there was a case of fraud caused by one of the client's employees two months before the year-end. The audit team used the month-end date 3 months before the year-end as the confirmation balance date but they failed to document the rationale of setting the confirmation balance date before

the year-end, including the status of the client internal controls responding to related audit risks and the relationship with roll-forward procedures.

23. After the audit team conducted confirmation procedures by setting a confirmation date before the year-end, they recognized an occurrence of employee fraud. Although they considered the effect of this fraud on internal control audit, the necessity of amending the financial statements, including the adding of notes related to subsequent events, they failed to consider the necessity of re-performing confirmation procedures at the year-end.

24. In relation to the confirmation procedures for the client's accounts receivable as of February 28, 2009, the audit team selected the samples but they did not send the confirmation to over 10% of the selected customers as they were explained by the client that it would impair its business relationship with those customers. The audit team failed to document the reason why they did not send the confirmation to certain customers and failed to document their assessment of whether the limit of their audit procedures indicated occurrence of fraud.

Substantive Analytical Procedures

25. In relation to the significant financial statement items, the audit team performed substantive audit analysis as only substantive procedures. But they failed to develop an expectation at a sufficient level of precision or consider the amount of difference from an expectation that can be accepted without further investigation.

Group Audit

26. Although the audit team planned to visit certain subsidiaries, review their financial statements and perform confirmation procedures, they did not prepare relevant audit programs. They actually did not perform the planned confirmation procedures and failed to document the changes to the audit plan in their working papers.

Related Party Transactions

27. In relation to audit procedures of related party transactions, the audit team used

the firm-prepared checklist and considered the information related to related party transactions. However, there were only check marks on the list and no detailed documentation was made in the working papers about audit procedures regarding such matters as the scope of the party, whether there were transactions or not, and the significance and appropriateness of those transactions, if any. The team did not consider the internal controls on the client's approval or record the related party transactions, either.

Subsequent Events

28. The audit team planned to rely on other auditors' work for certain subsidiaries. However they collected the reports in respect of subsequent events from other auditors after the audit report date without performing any alternative procedures before that date.

Financial Statement Disclosures

29. In relation to notes to the financial statements in respect of leases, investment securities, retirement benefits and deferred taxes, the audit team only compared the figures in the notes to the summary sheets prepared by the client and failed to verify the appropriateness of the client-prepared sheet.

Other Auditors' Work

30. The audit team relied on other auditors' work for overseas subsidiaries; they only checked the material impairment loss recognized in their financial statements and failed to consider the necessity of additional procedures, including the request of details supporting documents from or inquiries with the auditors.

Use of Specialists

31. In relation to the calculation of allowances for retirement benefits, the audit team utilized the actuary reports issued by the trust bank which the client outsourced. However, the team failed to consider its competency as an actuary specialist.

32. The audit team obtained and checked the opinion letter issued by an independent real estate valuation specialist whom the client used for its idle land. The team used the letter as audit evidence and explained that they considered the objectivity of the specialist but failed to document the procedures and conclusion.

Final Analysis

33. The audit team did not perform a final analysis of the financial statements as a whole at the last stage of their audit. Thus they failed to obtain an overall understanding of the financial statements taken as a whole.

Assessment of Client Control over Litigation Risks

34. Although there were situations where the audit client made an apology advertisement in a newspaper, disclosed significant claims as subsequent events, and had other claims, the audit team failed to ascertain whether the client had an adequate department and whether there was a sufficient process to manage risks related to litigations and claims.

Going Concern

35. In fiscal 2009, the audit team concluded that there was no significant uncertainty related to the client's going concern assumption as a result of their analytical procedures of the management-prepared business plan. However, the plan had been prepared by the director in charge of accounting and had not been duly approved by a party with proper authority, such as the board of directors.

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