

Oversight Policy and Plan

“Ensuring Reliable Auditing”

The Certified Public Accountant Law stipulates that Certified Public Accountants (hereinafter referred to as “CPAs”), as professionals in the auditing and accounting field, have a mission that they should promote fair corporate activities and protect investors and creditors by assuring the reliability of, from an independent standpoint, financial statements and related financial information, so that CPAs may contribute to the sound progress of the national economy. The Japanese Institute of Certified Public Accountants (hereinafter referred to as the “JICPA”) has promoted the enhancement and advancement of audits of financial statements by CPAs and audit firms (hereinafter referred to as “audit firms”). With the amended Certified Public Accountant Law taking effect, the JICPA’s quality control review for improving the quality of audits by audit firms is now legally stipulated, and it becomes mandatory that the JICPA reports the results of the quality control review to the oversight authority. To further improve the reliability of the JICPA’s quality control review, the Certified Public Accountants and Auditing Oversight Board (hereinafter referred to as the “CPAAOB”) was given the legal authority to oversee the JICPA’s quality control review and, if deemed necessary, inspects the JICPA, audit firms and audit clients, from a public interest perspective (hereinafter referred to as “oversight”).

Through oversight, the CPAAOB shall review reports from the JICPA, to determine, from an independent and public interest perspective, whether the JICPA appropriately operates the quality control review of audits and whether audits are being appropriately performed by audit firms, and, if deemed necessary, the CPAAOB shall conduct on-site inspections of audit firms and related places. Based on the result of oversight, the CPAAOB may, if deemed necessary, issue recommendations to the Commissioner of the Financial Services Agency (hereinafter referred to as the “FSA”). In this way, oversight of the CPAAOB, in conjunction with the oversight function of the FSA on audit firms and the self-regulation function of the JICPA, constitutes one of the important core functions in a system for ensuring the quality and more effectiveness of audits in Japan.

The CPAAOB, in response to public expectations for ensuring the quality and more

effectiveness of audits; in accordance with the purpose of the amended Certified Public Accountant Law; in consideration of international trends, including “Principles for Auditor’s Oversight” published by the International Organization of Securities Commissions (IOSCO); and in preparation for constructing a close relationship with relevant oversight authorities overseas, shall implement oversight, based on the following Perspectives and Objective;

Perspectives

The CPAAOB, from a citizen’s perspective in the public interest, using its competence and authority to the fullest extent possible, shall aggressively seek to ensure the quality and more effectiveness of audits, by not limiting oversight to the existing framework of the quality control review performed by the JICPA. And the CPAAOB shall actively respond to international trends and disseminate appropriate information to the domestic and overseas public.

Objective

Through oversight, the CPAAOB shall not focus on judging the appropriateness of individual audit opinions, but mainly promote further enhancement of the quality control review function of the JICPA from a public interest point of view. By doing so, the CPAAOB shall aim to enhance audit practices of audit firms through the effective self-regulation function of the JICPA.

The CPAAOB has decided, as stated below, “Monitoring and Review Policy and Plan” and “Inspection Policy”, based on the above-mentioned Perspectives and Objective. And taking into account changes in socio-economic situations and improvement of monitoring, review and inspection methods, these policies and plans are expected to be reviewed every administrative year.

I. Monitoring and Review Policy and Plan

1. Monitoring and Review Policy

(1) Basic concepts

Considering the purpose of introducing the CPAAOB's oversight system and taking into account that it has just been implemented, the CPAAOB shall, for the time being, basically focus on the following concepts in order to perform this function effectively in the context of limited administrative resources.

- i. To respond proactively to expectations for ensuring the quality and more effectiveness of audits

In order to respond proactively to expectations for ensuring the quality and more effectiveness of audits, the CPAAOB shall seek to establish an approach where key issues may be adequately understood and effective improvements may be ensured by not only reviewing the reports and information from the JICPA, but also utilizing information from various sources. In particular, the CPAAOB shall seek to establish an approach that enables timely and sufficient understanding of audit quality control issues especially on listed companies and specific entities that may have great influence on the Japanese economy.

- ii. To continue oversight of audits and seek to further enhance the quality control review function of the JICPA

In addition to continued monitoring and review based on reports and information from the JICPA, the CPAAOB shall seek to ensure the establishment of a mechanism that may enhance reliability and effectiveness of the quality control review by the JICPA and may make the results of monitoring and review adequately reflected in the quality control review, so that reliable quality control may be implemented pervasively in audits.

(2) Monitoring and Review Framework

- i. The CPAAOB shall receive reports on the quality control review, seek relevant

information and materials from the JICPA, and utilize other various pieces of information to examine the following issues;

- a. Whether the quality control review system is being appropriately operated by the JICPA.
 - b. Whether the audits of audit firms are being properly performed and whether the issues pointed out by the JICPA in the quality control review are appropriately reflected in their audits.
- ii. Based on the results of the above-mentioned examination, depending on the circumstance of each situation, the CPAAOB shall take appropriate action by expressing its evaluations or proposals, etc and, if deemed necessary, issuing recommendations to the Commissioner of the FSA on administrative dispositions or other measures.
- iii. When it is deemed necessary, based on the mission of the CPAAOB, the CPAAOB may give its advice or suggestions to relevant parties if certain measures are recognized as a contribution to ensuring the quality and more effectiveness of audits.

2. Monitoring and Review Plan

(1) Continuous monitoring and review, and priority areas for monitoring and review

Based on the above-mentioned policies, *the CPAAOB shall continuously examine reports received from the JICPA*, particularly on the following areas. In this course of examination, along with evaluating the JICPA's self-regulation function, the CPAAOB shall study possible new approaches utilizing cross-sectional examination for compliance with certain laws and standards.

- i. The state of the auditors' independence, including compliance with the prohibition of providing certain non-audit services to audit clients.
- ii. The issues pointed out in the JICPA's quality control review and follow-up status, including a risk-based approach and an engagement quality control review by other partners at audit firms.

(2) Action plan for future administrative years

In addition to the above-mentioned continuous monitoring and review, the following actions shall be taken in respective administrative years in view of *further enhancing the function of the quality control review by the JICPA*.

Administrative year 2004 (year ending June 2005)

The CPAAOB shall seek *an in depth understanding of the actual situation* and comprehensively study and evaluate the results and effectiveness of the quality control review by the JICPA to date (basic stance, implementation framework and methods, etc). The CPAAOB *shall, from a public interest perspective, advice on and suggest to the related parties and, if necessary, issue recommendations to the Commissioner of the FSA*, at the earliest possible time in this administrative year, in order for the JICPA to improve its conditions and methods for greater reliability and effective performance in the quality control review, so that the result of the CPAAOB's study and evaluation may be reflected appropriately by the JICPA in the planning of the quality control review in the following year.

Administrative year 2005 (year ending June 2006)

The CPAAOB shall perform monitoring and review in accordance with the enhanced quality control review by the JICPA, which is based on the activity in the previous year. At the same time, the CPAAOB shall evaluate the activity of the previous year, study possible methods to improve its performance further, including *clarifying the practical roles and relationship between the JICPA and the CPAAOB, and reinforce the monitoring and review framework*.

In and after administrative year 2006 (year ending June 2007)

On the premise that the function of the JICPA's quality control review has considerably improved, the CPAAOB shall seek to *further ensure the quality and more effectiveness of audits* by the synergistic effect of the JICPA's quality control review and the CPAAOB's monitoring and review activity.

II. Inspection Policy

Based on the monitoring and review results in accordance with the Monitoring and Review Policy and Plan, the CPAAOB shall, if deemed necessary, perform inspections as stated below.

1. Inspection framework

The basic framework of inspections by the CPAAOB is as follows.

- (1) Based on the monitoring and review results as to whether the JICPA's quality control review system is being appropriately performed, the CPAAOB, if deemed necessary, shall conduct on-site inspections of the JICPA, etc.
- (2) Based on the monitoring and review results as to whether audits are performed appropriately by audit firms or whether issues pointed out in the quality control review by the JICPA are adequately reflected in audits, the CPAAOB shall, if deemed appropriate and necessary, conduct on-site inspections of audit firms concerning audits.
- (3) In the process of the inspection stated in the preceding paragraph, the CPAAOB shall conduct on-site inspections of audit clients and related places, when deemed necessary to comprehend in depth the substance of audits performed by the audit firms.

Based on the inspection result, the CPAAOB shall take appropriate measures by expressing its evaluation and recommendations, in accordance with the specifics of each situation. Furthermore, the CPAAOB shall take appropriate measures by making recommendations to the Commissioner of the FSA on administrative dispositions and other actions, when deemed necessary.

2. Implementation of the inspection

The inspection shall be conducted in the following cases;

- (1) In the case that the CPAAOB needs to confirm whether the quality control review by

the JICPA is sufficiently conducted such as whether every important review procedure has been performed or whether the implementation has been sufficient (mainly against the JICPA).

- (2) In the case that the CPAAOB needs to confirm whether audits are performed appropriately by audit firms, or whether issues pointed out in the quality control review by the JICPA are adequately reflected in the audits or whether the practice control system of the audit firms is effectively working (mainly against audit firms).
- (3) In the case that the CPAAOB needs to confirm the internal control system of the audit clients that corresponds to the audits of the audit firms, or confirm the performance of audits by audit firms at audit clients, etc (mainly against audit clients).
- (4) In the case that the CPAAOB needs a cross-sectional examination on compliance with applicable laws and standards.
- (5) Besides the above-mentioned cases, in consideration of the results of individual monitoring and review, and the specifics of each situation, where deemed necessary and appropriate for protecting the public interest or investors.

3. Inspection procedures

Based on the results of monitoring and review, in accordance with the rules of the CPAAOB, the CPAAOB shall take actions such as preparing an inspection plan including the scope, purposes, objectives and items of inspection, and other appropriate measures, and giving notice of the inspection results to the inspected audit firms and related parties after completion of the inspection.