

Chairman and President's Statement

April 6, 2006

The Japanese Institute of Certified Public Accountants

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Chairman and President

**Restoring Confidence in Certified Public Accountants' Audits
- Enhancement of the self-regulatory function of JICPA -**

In my statement of October 25, 2005, I mentioned the alleged fraudulent accounting at Kanebo, announced various measures including requests for the re-examination of audit partners' rotation within Big 4 firms, and announced responses to the recently established Standards on Quality Control for Audits. While implementing the measures, which are aimed at restoring confidence in audits performed by Certified Public Accountants (CPAs), the Livedoor scandal took place, resulting in the indictment of Livedoor's external auditors, the trial of Kanebo's former auditors started, and the punishments of auditors involved in several other cases of fraudulent accounting were announced.

The principal goal of financial policy set out by the Financial Services Agency in Japan is substantial change of the financial system "from savings to investment." This change is proceeding gradually and has given rise to growing demand for confidence in securities markets.

In my statement, I mentioned our request for comprehensive measures which included the amendment of the entire system related to corporate disclosures to prevent fraudulent accounting. Bills for legislating the Financial Instruments and Exchange Law were presented to the Diet in March 2006. This law mandates the certification of management for the fair presentation of securities reports, management's assessment and auditor's audits for the effectiveness of internal control over financial reporting, and raises the penalties which may be imposed on management. With this reinforcing of the responsibility of the management, who prepare the financial statements, we must introduce stricter measures for self-regulation.

I believe that Japanese Institute of Certified Public Accountants (JICPA) must deal sincerely with public criticism and the expectations of audits and, as a way forward, fulfill the public mandate through stricter self-regulation as an accountancy profession. Therefore the JICPA is determined to take the following actions to accomplish the social mission imposed on auditors and to ensure the

restoration of confidence in audits by CPAs.

1. Stricter JICPA self-regulation and a comprehensive Code of Ethics

1-1 Creation of the Center for Listed Company Audit Firms and introduction of registration

To ensure confidence in audits by CPAs in capital markets, we will set up the Center for Listed Company Audit Firms ("the Center") under Quality Control Committee and request audit firms which conduct audits of listed companies to register with this Center, with the aim of improving the quality of listed company audits by taking actions such as removing from the register those audit firms that are unable to maintain the required level of audits.

Audit firms registered with the Center are obliged to cooperate with our quality control reviews, to take appropriate actions in response to recommendations based on the results of the reviews, and to submit by predetermined dates annual reports on the implementation of their quality controls. Further to these current requirements, registered audit firms will also be required to:

- submit documents to the Center describing the quality control policies and procedures they have established to reach the required level of auditing
- implement their policies and procedures in good faith
- accept any disciplinary actions, including expulsion, in case of misconduct
- submit a declaration to the Chairman and President upon registration agreeing to the disclosure of their names in the register and agreeing to fulfill the above obligations

This registration system will operate under the instruction and supervision of the Quality Control Committee. JICPA will examine the authority of the Quality Control Board and seek sound operation with objectivity, transparency and expertise through the deliberations of the reorganized board. We believe that the effectiveness, objectivity and transparency of our quality control, as a self-regulatory function, is best ensured through monitoring of the overall operation of this registration system by the Certified Public Accountants and Auditing Oversight Board (CPA AOB).

The Quality Control Board will be authorized to take disciplinary actions against registered audit firms which fail to respond to notified material recommendations based on the results of quality control reviews performed by the Quality Control Committee. Pursuant to the deliberations of the board, the Chairman and President may impose the following actions to demonstrate the enhancement of the self-regulatory function and to ensure confidence in capital markets:

- admonish the firm and require additional CPE credits
- publish the review reports and reports of recommendations, and
- take disciplinary actions including deregistration

Based on the above, JICPA will begin specifying details of the registration system, aiming at implementing the system commencing April 2007.

Certain audit firms who do not audit listed entities remain subject to quality control reviews conducted under the supervision of the Quality Control Committee.

1-2. Establishment and enhancement of a comprehensive Code of Ethics

The revised CPA Law, effective April 1, 2004, stipulates strict independence requirements similar to those set out in the Sarbanes-Oxley Act. JICPA created an Ethics Committee by reorganizing the former Special Committee for Independence and we improved the Code of Ethics to achieve appropriately the objectives of the revised CPA Law. From an international perspective, the International Federation of Accountants (IFAC) has undertaken the improvement of the comprehensive Code of Ethics to become global standards which provide common requirements for all CPAs, professional accountants in public practice and in business.

JICPA has reaffirmed the significance of the Code of Ethics on independence as the starting point for ensuring confidence in audits through the experience of accounting scandals in the past few months.

2. Matters requiring special consideration for audits of financial statements ending March 31, 2006

Implementation of more in-depth audits of investment funds and similar vehicles

According to the media reports, investigation into Livedoor has revealed manipulation of accounts by making use of several investment funds. Interested parties are doubtful as to whether audits were properly conducted of these investment funds. These doubts should be addressed. JICPA published "Matters that require consideration for the audits of investment funds and deferred tax assets in relation to the revaluation of real estate property," on February 22, 2006, in a call for members engaged in audits to obtain the full understanding of investment funds by performing more rigorous audits for the fiscal year ending March 31, 2006. Investment activities using vehicles such as special purpose entities and investment funds have been expanding recently, and the businesses of these vehicles has diversified enormously. The existence of control or influence over the investment funds should be the criteria for the judgment as to whether these funds should be included in the consolidation. However, the actual investment activities have been more complex, especially when involving cash transfers overseas. Members are requested to acknowledge social criticism and expectations, and to take appropriate actions.

With respect to practical guidance for the consolidation of special purpose entities and investment funds, the Accounting Standards Board of Japan has already started to address the establishment of accounting guidelines. We are also determined to develop practical guidance from an auditing perspective.

Acknowledging the recent changes in the environment surrounding CPA audits, we released a draft of the reforms of our organization and governance at the end of 2005 in order to protect the public interest as a self-regulated body. After deliberating the comments received on the draft, the proposed amendments to the Constitution of JICPA will be put before the General Assembly which is due to convene in July 2006. The JICPA also commits itself to making further revisions of our Constitution and of relevant rules and regulations concerning the establishment of the Center for Listed Company Audit Firms and the comprehensive amendment of the Code of Ethics, in order to submit them to the Special Assembly, due to convene in the autumn of this year.