

[Translation]¹

Audit Practice Standards for Internal Control Systems

Japan Corporate Auditors Association
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Enactment of Audit Practice Standards for Internal Control Systems

I Background

In response to the Companies Act of Japan and the ministerial ordinance of the Ministry of Justice thereof which came into effect in May 2006, the Code of *Kansayaku* Auditing Standards (the “Code”) was revised on January 12, 2007. The Code stipulates in Article 21 (Audit of Internal Control Systems), paragraph 7 that “Audits regarding internal control systems shall be governed by ‘the audit practice standards for internal control systems’ enacted separately, in addition to this Code,” and provides that more specific audit practice standards for internal control systems shall be established separately.

In response to such provision, the audit practice standards for internal control systems (the “Internal Control Audit Practice Standards”) described herein were enacted.

II Substance of the Enactment and Major Items

The Internal Control Audit Practice Standards corresponding to Article 21, paragraph 7 of the Code are based on the same underlying ideas as the Code and is positioned to be understood and utilized integrally with the Code.

Major items of the Internal Control Audit Practice Standards are as follows:

1. The Internal Control Audit Practice Standards provide standards and behavioral guidelines based on the Code for *kansayaku* conducting audits of the internal control systems of a company. (Article 1)
2. In the Internal Control Audit Practice Standards, “internal control systems” is defined as the systems set forth in each item of Article 21, paragraph 1 of the Code. (Article 2, paragraph 1, item 1)
3. The subjects of the audit in the Internal Control Audit Practice Standards are the “existence of events for which the board of directors’ resolutions on the internal control systems are found to be inappropriate” and the “existence of deficiencies (*fubi*) in the operating effectiveness of the internal control systems developed by the directors”. (Article 3)
4. The Internal Control Audit Practice Standards clarify that the “control environment of the company” is an especially important subject of the audits of the internal control systems by the *kansayaku*. The Internal Control Audit Practice Standards emphasize that the approaches of the internal control audits are the monitoring and verifying of “the effectiveness of the controls comprising the internal control systems as processes for adequately addressing the material risks” (so-called “process check”) with a focus on “whether the internal control systems adequately address the material risks likely to cause significant damage to the company” (so-called “risk approach”). (Article 4)
5. In addition to the above, in Chapter II of the Internal Control Audit Practice Standards, there are provisions on the methods of audits such as the audit of the board of directors’ resolution (Article 5), cooperation with the Internal Audit Division, etc. and the audit of the effectiveness of

¹ Please refer to the translation notes to the “Code of *Kansayaku* Auditing Standards”.

monitoring functions thereof (Article 6), and responses to deficiencies or material defects in the internal control systems and deliberations of the *kansayaku-kai* (Article 7).

6. Chapter III lists material risks to be emphasized during the Internal Control Audit of the compliance systems for laws and regulations, risk management system, system to retain and manage information, system to ensure efficiency and the corporate group internal control stipulated by the Companies Act of Japan. As there was strong demand for specific guidelines for audit practices, points to be examined to be kept in mind during the Internal Control Audit of each system (key control points) are also listed (provided, however, as this list is for illustrative purposes only and shall be selected without excess and deficiency in light of the characteristics, etc. of the company).
7. With respect to the internal control over financial reporting, in consideration of the status of discussions on the legal characteristics thereof and the relationship with the accounting auditors and other relevant matters, we provide a separate chapter (Chapter IV). As the system of “assessment and audit of internal control over financial reporting” in the Financial Instruments and Exchange Law (*Kinyu Shohin Torihiki Hou*) has just been introduced and the system itself has not yet come into effect, it is difficult to establish specific guidelines regarding internal control over financial reporting. However, as the *kansayaku* audit practices expressed significant interest in having such guidelines, a separate provision has been provided. Given the fact that the accounting audits to be conducted by the accounting auditors under the Companies Act of Japan and the so-called audit of financial statements to be conducted by an auditor (*kansanin*) under the Financial Instruments and Exchange Law are almost identical and have integrity even though they are different legal systems, as well as taking into consideration the roles and duties of *kansayaku* set forth in the Companies Act of Japan and Financial Instruments and Exchange Law respectively, we present one idea on the roles to be played by *kansayaku* in the development of internal control over financial reporting by the representative director, etc with their responsibilities. In the near future, when the internal control systems over financial reporting come into effect, further examination may be made as necessary.
8. With respect to the development of an environment for *kansayaku* audits, as this has a characteristic which differs from those of the other constituent factors of internal control systems, etc., we provide a separate chapter (Chapter V) and stipulate that necessary requests should be made to the representative directors, etc. and/or the board of directors with respect to the matters concerning supporting employees, a reporting system to *kansayaku* and the system of cooperation with the company’s Internal Audit Division, etc. and other relevant matters.

III Matters to be Noted

The Internal Control Audit Practice Standards apply to large-scale companies under the Companies Act of Japan, and were formulated mainly in consideration of listed companies.

Provisions set forth in the Internal Control Audit Practice Standards present behavioral guidelines for *kansayaku* performing duties imposed under the Companies Act of Japan. *Kansayaku* are required to act taking into consideration the company’s size, the nature of its business, business category, various risks surrounding the company’s management, and other characteristics of the audit environment unique to the company.

Audit Practice Standards for Internal Control Systems

Chapter I

Purposes of the Audit Practice Standards for Internal Control Systems

Article 1 (Purpose)

These audit practice standards (the “Internal Control Audit Practice Standards”) provide standards and behavioral guidelines for *kansayaku* conducting audits of the internal control systems of a company, hereinafter referred to as “Internal Control Audit”, pursuant to Article 21, paragraph 7 of the Code of *Kansayaku* Auditing Standards (the “Code”) (enacted on March 25, 1975, final revision on January 12, 2007).

Article 2 (Definitions)

1. In the Internal Control Audit Practice Standards, the meanings of the terms listed in the following items shall be as follows:
 - (1) “internal control systems” means systems set forth in each item of Article 21, paragraph 1 of the Code;
 - (2) “compliance system for laws and regulations, etc.” means a system to ensure that the directors’ and employees’ performance of their duties comply with all laws, regulations and the articles of incorporation;
 - (3) “risk management system” means company rules and other systems relating to the risk management of the company;
 - (4) “system to retain and manage information” means a system to retain and manage information related to the directors’ performance of their duties;
 - (5) “system to ensure efficiency” means a system to ensure the efficiency of the directors’ performance of their duties;
 - (6) “corporate group internal control” means a system to ensure the appropriateness of corporate affairs in the corporate group consisting of the company, its parent companies and its subsidiaries;
 - (7) “internal control over financial reporting” means a system to ensure the appropriateness of the financial reporting of the company and the corporate group to which the company belongs;
 - (8) “directors in charge of finance” means representative directors or managing directors in charge of financial reporting;
 - (9) “system to ensure the effectiveness of *kansayaku* audits” means a system set forth in Article 14 of the Code;
 - (10) “reporting system to *kansayaku*” means systems for directors and employees to report to *kansayaku* and any other systems relating to reports to be provided to *kansayaku*;
 - (11) “Internal Audit Division, etc.” means the internal audit division, etc. set forth in Article 32, paragraph 1 of the Code;
 - (12) “supporting employees” means supporting employees set forth in Article 14, paragraph 2, item 1 of the Code;

- (13) “Internal Control Division” means the company’s internal control division set forth in Article 32, paragraph 3 of the Code;
 - (14) “Meetings, etc.” means the meetings, etc. set forth in Article 6, paragraph 3 hereof; and
 - (15) “Representative Directors, etc.” means the representative directors, etc. set forth in Article 6, paragraph 3.
2. The terms “Chapter” and “Article” when used in the Internal Control Audit Practice Standards shall mean chapters and articles in the Internal Control Audit Practice Standards unless otherwise specified.

Chapter II

Basic Policies and Methods, etc. of Internal Control Audit

Article 3 (Subject of Internal Control Audit)

Kansayaku shall audit the following matters concerning the internal control systems as part of their audit of the directors’ performance of their duties:

- (1) Existence of events for which the board of directors’ resolutions on the internal control systems are found to be inappropriate; and
- (2) Existence of deficiencies (*fubi*) in the status of establishment and operation of the internal control systems (hereinafter collectively referred to as the “operating effectiveness of the internal control systems”) developed by the directors.

Article 4 (Basic Policies of Internal Control Audit)

1. *Kansayaku* shall keep in mind that the proper development of the internal control system is indispensable for the establishment of a good corporate governance system and shall, as their own duties, monitor and verify the contents of the board of directors’ resolutions on the internal control systems and the operating effectiveness of internal control systems.
2. *Kansayaku* shall conduct the internal control audit with emphasis on the control environment (*tousei-kankyō*) of the company (such as the representative directors’ and other directors’ awareness of the importance of internal control systems and the status of their undertakings for the development thereof and the status of the board of directors’ supervision).
3. *Kansayaku* shall conduct the Internal Control Audit with emphasis on whether the internal control systems adequately address the material risks likely to cause significant damage to the company, among the risks expected for the company and the corporate group to which the company belongs. If the internal control systems are found to be not adequately addressing such risks, *kansayaku* shall provide a timely indication of the deficiency (*fubi*) of the internal control systems to the Representative Directors, etc., Internal Audit Division, etc. or Internal Control Division, and suggest or recommend, or take other appropriate measures as necessary to the Representative Directors, etc. or the board of directors.
4. *Kansayaku* shall monitor and verify whether a set of controls comprising the internal control systems (such as the company rules and organizational systems, systems to retain and transmit information and monitoring systems for the implementation of internal control systems) function effectively as processes adequately addressing the risks mentioned in the preceding paragraph.

5. *Kansayaku* shall monitor and verify whether the board of directors and the Representative Directors, etc. are developing the internal control systems through a proper decision-making process and other appropriate procedures.

Article 5 (Audit of the Board of Directors' Resolutions on the Internal Control Systems)

1. *Kansayaku* shall monitor and verify the board of directors' resolutions on the internal control systems from the following perspectives:
 - (1) whether the contents of the board of directors' resolutions cover the matters set forth in Article 362, paragraph 4, item 6 of the Companies Act of Japan and Article 100, paragraphs 1 and 3 of the Ordinance for Enforcement of the Companies Act of Japan;
 - (2) whether the board of directors have passed resolutions regarding the development of the internal control systems after appropriate discussion on the internal control systems adequately addressing the risks likely to cause significant damage to the company;
 - (3) whether the necessary re-examinations of the contents of the board of directors' resolutions have been made in a timely and appropriate manner; and
 - (4) whether the contents of the indication suggested or recommended by *kansayaku* in connection with the board of directors' resolutions on the internal control systems (including indications concerning the system to ensure the effectiveness of *kansayaku* audits set forth in Chapter V) are appropriately reflected in the board of directors' resolutions, and if not reflected, whether there are any justifiable grounds therefor.
2. *Kansayaku* shall verify whether the contents of the board of directors' resolutions are accurately and appropriately summarized in the business report.
3. If a *kansayaku* finds that the contents of the board of directors' resolutions on the internal control systems are inadequate, the *kansayaku* shall suggest or recommend, or take other appropriate measures to the board of directors through deliberations of the *kansayaku-kai* as necessary. Notwithstanding the suggestions or recommendations, etc., if the board of directors without justifiable grounds fail to address appropriately the inadequacy of the contents of the board of directors' resolutions on the internal control systems and if the contents of the board of directors' resolutions on the internal control systems are found to be inappropriate as a result thereof, *kansayaku* shall indicate such fact in the audit report through deliberations of the *kansayaku-kai* as necessary.

Article 6 (Methods of Audits on Operating Effectiveness of Internal Control Systems)

1. *Kansayaku* shall monitor and verify whether each internal control system set forth in each Article of Chapter III (in this Article and following Article 7, referred to as "Each System") adequately addresses material risks listed in paragraph 1 of each Article of Chapter III hereof through audit activities set forth in this Article and other daily audit activities. *Kansayaku* shall audit and take appropriate measures for the internal control over financial reporting pursuant to the provisions of Chapter IV and for the system to ensure the effectiveness of *kansayaku* audits pursuant to the provisions of Chapter V.
2. *Kansayaku* shall, upon commencement of the Internal Control Audit for each business year, understand the contents of the board of directors' resolutions on the internal control systems and the operating effectiveness thereof as of such commencement and formulate the audit plan for the Internal Control Audit. In cases of amendment to the contents of the board of directors' resolutions during the business year, necessary re-examinations shall be made to the audit plan, etc. in response thereto.
3. *Kansayaku* shall, through attendance at the board of directors' meeting, compliance committee, risk management committee and other relevant meetings or committees, etc. (the "Meetings, etc.")

and regular meetings, etc. with the managing directors including the representative directors (the “Representative Directors, etc.”), ascertain the operating effectiveness of Each System and the awareness and knowledge by the directors (including outside directors) thereof and request as necessary that the Representative Directors, etc. report on the operating effectiveness, etc. of Each System.

4. *Kansayaku* shall request from the Internal Audit Division, etc. a timely and appropriate report on the internal audit plan, other monitoring implementation plans and the status of the implementation thereof. *Kansayaku* shall, on a regular basis, receive reports from the Internal Audit Division, etc. on matters concerning the status of addressing material risks in Each System and the operating effectiveness of Each System, and request the attendance or presence of *kansayaku* or supporting employees to investigations, etc. to be conducted by Internal Audit Divisions, etc. as necessary, or request to the Internal Audit Division, etc. the additional investigations, etc. and reports to *kansayaku* of the results thereof.
5. *Kansayaku* shall, through cooperation with the Internal Audit Division, etc. set forth in the preceding paragraph, monitor and verify the effectiveness of monitoring functions of internal control systems such as whether the Representative Directors, etc. implement necessary improvements taking into consideration continuous examination and assessment by the Internal Audit Division, etc. regarding the operating effectiveness of Each System.
6. *Kansayaku* shall, in addition to cooperation with the Internal Audit Division, etc. set forth in paragraph 4, receive on a regular basis and an as needed basis reports on the operating effectiveness of Each System and important events affecting the effectiveness of Each System, including the status of addressing to effectiveness issues, and request explanations thereon as necessary, from the Internal Control Division.
7. *Kansayaku* shall, through regular meetings, etc. with an accounting auditor, grasp the opinions, etc. of the accounting auditor on the operating effectiveness of internal control systems and request reports thereon as necessary.

Article 7 (Responses to Deficiencies of the Internal Control Systems)

1. *Kansayaku* shall report to the *kansayaku-kai* the contents of the audit procedures conducted and any deficiencies found in the internal control audit and the grounds and the conclusions, etc. where the suggestions or the recommendations were determined to be necessary.
2. After receiving the reports from each *kansayaku* mentioned in the preceding paragraph, the *kansayaku-kai* shall examine the contents of such reports and deliberate on the matters to be suggested or recommended to the Representative Directors, etc. or the board of directors.
3. Notwithstanding the suggestions or the recommendations mentioned in the preceding paragraph, in cases where the Representative Directors, etc. or the board of directors without justifiable grounds fail to appropriately address deficiencies, and material defects (*juudaina-kekkan*) are found in the operating effectiveness of Each System as a result thereof, *kansayaku* shall indicate such fact in the audit report through deliberations of the *kansayaku-kai* as necessary.
4. The deliberations and the determinations of the *kansayaku-kai* set forth in this Article may not prevent any *kansayaku* from exercising his/her own powers.

Chapter III

Audit of Compliance System for Laws and Regulations, etc. and the Risk Management Systems, etc.

Article 8 (Audit of Compliance System for Laws and Regulations, etc.)

1. *Kansayaku* shall monitor and verify the compliance system for laws and regulations, etc. with emphasis on whether it adequately addresses the following material risks:
 - (1) risk in which the acts in violation of laws and regulations, etc. are conducted with the leadership or the involvement of the Representative Directors, etc.;
 - (2) risk in which the acts in violation of laws and regulations, etc. are conducted systematically or repeatedly and continuously as a result of the failure of the Representative Directors, etc. to ascertain the status of compliance with laws and regulations, etc. in a timely and appropriate manner; and
 - (3) risk in which the acts in violation of laws and regulations, etc. likely to cause the company significant damage that have become known to the Representative Directors, etc. are concealed in spite of the necessity to report or disclose publicly such acts.

2. *Kansayaku* shall identify the key control points including the following matters and determine whether the compliance system for laws and regulations, etc. adequately addresses the risks set forth in the preceding paragraph; provided, however, that the following matters are for illustrative purposes only and *kansayaku* shall examine the important points without excess or deficiency in light of the business and the scale of the company and other characteristics of the company; hereinafter the same shall apply in paragraphs 2 of each Article up to Article 13:
 - (1) whether the Representative Directors, etc. are fully aware that compliance with laws and regulations, etc. and the development of an effective system thereof is indispensable to the company's management;
 - (2) (i) whether a system to ensure the decision-making and management of corporate affairs in compliance with the laws and regulations, etc. has been developed, such as a system to consult in a timely and appropriate manner on the compliance with laws and regulations, etc. with the legal department and outside professionals in the decision-making and individual management of corporate affairs at the board of directors' meetings or other important Meetings, etc.; (ii) whether the decision has been made at the board of directors' meetings and other important Meetings, etc. to give priority to securing profits, etc. over compliance with laws and regulations, etc.;
 - (3) whether (i) the basic policies and standards of conduct, etc. related to compliance with laws and regulations, etc. have been established, and (ii) the officers and/or employees, etc. have been thoroughly informed of the contents of important laws and regulations related to the business activities, etc.;
 - (4) (i) whether (a) there are any monitoring divisions to monitor the status of compliance with laws and regulations, etc., (b) the issues regarding compliance with laws and regulations, etc. of the company have been found and (c) the measures for the improvement thereof have been taken; (ii) whether (a) the rules of disposition related to the violation of laws and regulations, etc. have been developed and (b) any appropriate measures in accordance thereof have been taken; and
 - (5) (i) whether the system under which reports are made on a regular basis to the board of directors and *kansayaku* on the matters likely to significantly influence the effectiveness of the compliance system for laws and regulations, etc. have been developed; (ii) whether the system to report in a timely and appropriate manner to the Internal Audit Division, etc. or *kansayaku* on the transactions or activities on which the Internal Control Division have doubts have been developed; and (iii) whether the systems, such as the internal communication system, have been developed, in which the status of compliance with laws and regulations, etc. could be grasped independently from the lines of the management of corporate affairs.

Article 9 (Audit of Risk Management System)

1. *Kansayaku* shall monitor and verify the risk management system with emphasis on whether it adequately addresses the following material risks:
 - (1) the risk of causing the company to suffer significant damage as a result of the material omission or error in the prior awareness, analysis, assessment or control of causes of material risk necessary for proper risk management;
 - (2) the risk that business activities likely to cause the company significant damage continue without justifiable reasons; and
 - (3) the risk that the damage is increased or the business is unable to be continued as a result of the failure to develop a system in advance which appropriately addresses the occurrence of accidents or incidents likely to cause the company significant damage.

2. *Kansayaku* shall identify the key control points including the following matters and determine whether the risk management system adequately addresses the risks set forth in the preceding paragraph:
 - (1) whether the Representative Directors, etc. are fully aware that risk management and the development of an effective system thereof is indispensable to the company's management;
 - (2) whether the discussions at the board of directors' meetings or other important Meetings, etc. are made through the risk analysis based on sufficient information with respect to addressing the risks likely to cause the company significant damage;
 - (3) (i) whether the Representative Directors, etc. are aware of the risks in each area of the company's business, such as the damage to the company's goodwill and other risks concerning the continuation of the company; (ii) whether the proper assessment is made about the possibility of the occurrence of such risks and about the scale of the damage in the event of such occurrence; and (iii) whether (a) the accidents of other companies, changes in the social norm for safety and environment, and changes in the legal regulations and other management environment and risk factors have been understood in a timely manner; and (b) the systems timely and appropriately addressing thereto have been developed;
 - (4) (i) whether the plan addressing the risks that are decided to be focused on for the relevant business year is properly formulated; and (ii) whether the systems reviewing the status of implementation of such plan on a regular basis have been developed;
 - (5) (i) whether the management rules setting forth guidelines for the recognition, analysis, assessment and responses concerning various risks have been developed; (ii) whether the businesses are implemented in accordance with the provided rules and the division of duties; and (iii) whether (a) any monitoring division to monitor the status of risk management has been established; (b) the issues regarding the risk management of the company have been found; and (c) the improvement measures thereof have been taken;
 - (6) (i) whether the timely and appropriate examination regarding the continuation of business activities likely to cause the company significant damage is made; and (ii) whether such activities are continued without justifiable grounds;
 - (7) (i) whether the system under which reports are made on a regular basis to the board of directors and *kansayaku* on the matters likely to significantly influence the effectiveness of the risk management system have been developed; and (ii) whether the system, such as the internal communication system, have been developed, where the status on the risk

management could be grasped independently from the lines of the management of corporate affairs; and

- (8) in assumption of the cases where the circumstances causing the company to suffer significant damage actually occur, in order to minimize damages, whether (i) the establishment of the headquarters for damage control with the Representative Directors, etc. being the members; (ii) the emergency communication network and other information communication systems; (iii) responses to customers, media and relevant regulatory authorities, etc.; and (iv) the company policy concerning the continuation of business, etc. have been formulated in advance.

Article 10 (Audit of System to Retain and Manage Information)

1. *Kansayaku* shall monitor and verify the system to retain and manage information with emphasis on whether it adequately addresses the following material risks:
 - (1) risk of causing the company to suffer significant damage as a result of the failure to appropriately prepare, retain or manage documents necessary to ensure the proper management of corporate affairs and other information, such as important contracts, minutes and legal records;
 - (2) risk of causing the company to suffer significant damage as a result of divulging important trade secrets, know-how, confidential information, personal information and other information whose retention and management is required under the laws and regulations; and
 - (3) risk of any false statements or material omissions in the disclosure of material corporate information.
2. *Kansayaku* shall identify the key control points including the following matters and determine whether the system to retain and manage information adequately addresses the risks set forth in the preceding paragraph:
 - (1) whether the Representative Directors, etc. are fully aware that retention and management of information and the development of an effective system thereof is indispensable to the company's management;
 - (2) whether (i) the company rules, etc. on the guidelines of the preparation, retention and management of information have been established; and (ii) the internal system to effectively implement such rules has been developed;
 - (3) whether the internal system to properly record and retain the minutes of the board of directors' meeting and other statutory materials to be prepared has been developed;
 - (4) whether the management system has been developed, such as the establishment of appropriate access authority, retention period, security policies and backup in accordance with the classification by the importance of the documents and information to be retained and/or managed;
 - (5) with respect to personal information and other information required to be managed under laws and regulations, whether the officers and/or employees, etc. have been thoroughly informed of the methods of management required under such laws and regulations;
 - (6) (i) whether the departments in charge of timely disclosure of important information of the company, investor relations and other disclosure are established; and (ii) whether the system has been developed in which the information to be disclosed is collected promptly

and comprehensively and disclosed timely, accurately and sufficiently in accordance with the laws and regulations, etc.;

- (7) (i) whether the management are implemented in accordance with the company rules and the division of duties concerning the retention and management of information; and (ii) whether (a) any monitoring division to monitor the status of the retention and management of information has been established; (b) the issues on the information retention and management of the company have been found; and (c) the improvement measures thereof have been taken; and
- (8) (i) whether the system has been developed under which reports are made on a regular basis to the board of directors and *kansayaku* on the matters likely to significantly influence the effectiveness of the retention and management of information; and (ii) whether the system, such as an internal communication system, has been developed, under which the status of the retention and management of information could be grasped independently from the lines of the management of corporate affairs.

Article 11 (Audit of System to Ensure Efficiency)

1. *Kansayaku* shall monitor and verify the system to ensure efficiency with emphasis on whether it adequately addresses the following material risks:
 - (1) risk of causing the company to suffer significant damage as a result of inappropriate management strategies, allocation of corporate resources, establishment of organization, development of performance management system, etc. leading to excessive inefficiency;
 - (2) risk of causing the company to suffer significant damage as a result of damaging the soundness of the company by pursuit of excessive efficiency; and
 - (3) risk of causing the company to suffer significant damage as a result of material and avoidable errors in the recognition of facts prerequisite to the determination of important corporate decisions by the Representative Directors, etc.
2. *Kansayaku* shall identify the key control points including the following matters and determine whether the system to ensure efficiency adequately addresses the risks set forth in the preceding paragraph:
 - (1) whether the Representative Directors, etc. are fully aware that the formulation of a management plan and business objectives to ensure the continuous growth of the company, and the proper balance of ensuring the efficiency and soundness, etc. are important in the company's management;
 - (2) whether the structure have been developed in which the formulation of a management plan, allocation of management resources, establishment of an organization, guideline of the management system, and the responses to information technology, etc. could be properly determined, conducted or rectified;
 - (3) whether (i) any management plan and/or business objectives, etc. which are difficult to achieve in light of management resources and management environment, etc. of the company are established; and (ii) excessive efficiency that is damaging the soundness of the company for the achievement thereof is being pursued; and
 - (4) whether the system to ensure compliance with the business judgment rules in the important decision-making and determinations of individual corporate affairs to be conducted by the Representative Directors, etc. have been developed.

Article 12 (Audit of Corporate Group Internal Control)

1. *Kansayaku* shall monitor and verify the corporate group internal control with emphasis on whether it adequately addresses the following material risks:
 - (1) risk of causing the company to suffer significant damage as a result of the deficiencies in the compliance system for laws and regulations, etc., the risk management system, the system to retain and manage information, and the system to ensure efficiency in any of the material subsidiaries;
 - (2) risk of causing the company to suffer significant damage as a result of the failure by the company to timely and appropriately grasp the operating effectiveness of internal control systems in any of the material subsidiaries; and
 - (3) risk of the company incurring significant damage as a result of improper acts conducted using subsidiaries or due to inappropriate pressure from parent companies.

2. *Kansayaku* shall identify the key control points including the following matters and determine whether the corporate group internal control adequately address the risks set forth in the preceding paragraph:
 - (1) whether the Representative Directors, etc. are fully aware that corporate group internal control and the development of the effective system therefor are indispensable to the companies management;
 - (2) whether (i) the entire corporate group has been thoroughly informed of the management principles, standards of conduct and the issues to be dealt with which is to be shared by the entire corporate group; (ii) the standards related to compliance with laws and regulations, etc., risk management and retention and management of information, etc. in line with the above have been established; and (iii) whether the appropriate enlightenment activities and monitoring for the compliance with such standards are being implemented;
 - (3) whether the material subsidiaries in light of group business strategy and control risks as well as material overseas subsidiaries are subject to the corporate group internal controls;
 - (4) (i) whether (a) the control headquarters, etc. to grasp and monitor on a regular basis the operating effectiveness of internal control systems of the subsidiaries have been established in the company; (b) any issues on the important agenda on internal control systems of the subsidiaries are found; and (c) appropriate measures for the improvement thereof have been taken.; and (ii) whether the information communication system in which the company may timely and appropriately grasp the status thereof are developed in case of occurrence of any acts in violation of laws and regulations, etc. in the subsidiaries and other circumstances with significant damage to the subsidiaries;
 - (5) in cases where there are any *kansayaku* in the subsidiaries, (i) whether (a) such *kansayaku* properly conducts an internal control audit of such subsidiaries pursuant to the provisions of these Articles 8 through 12; and (b) there is any timely and appropriate communication and information exchange between the controlling headquarters, etc. of the company and the *kansayaku* of the company; if there are no *kansayaku* at the subsidiaries; and (ii) whether a proper system supplementing the audit functions are separately developed by the subsidiaries or the entire corporate group;
 - (6) whether the information technology and processing, etc. to be commonly equipped within the corporate group are properly systemized;
 - (7) whether (i) any business objectives or management plan which are difficult to achieve for the subsidiaries are established; and (ii) excessive efficiency damaging the soundness of such subsidiaries or the entire corporate group for the achievement thereof are being pursued;

- (8) whether the system to timely grasp the status of improper acts using the subsidiaries and to take appropriate measures for the improvement thereof have been developed; and
- (9) whether the system to prevent acts seeking inappropriate profits for the parent company at the sacrifice of the profits of minority shareholders if there are parent companies to the company has been developed.

Chapter IV **Audit of Internal Control over Financial Reporting**

Article 13 (Audit of Internal Control over Financial Reporting)

1. *Kansayaku* shall monitor and verify the internal control over financial reporting with emphasis on whether it adequately addresses the following material risks:
 - (1) risk that improper financial reporting will be conducted with the leadership or the involvement of the directors in charge of finance;
 - (2) risk that improper financial reporting will be conducted systematically or repeatedly and continuously as a result of the failure of the directors in charge of finance to timely and appropriately obtain financial information which importantly influences operating results and financial conditions of the company; and
 - (3) risk that improper financial reporting will be conducted by the involvement or the negligence of the accounting auditor.
2. *Kansayaku* shall identify the key control points including the following matters and determine whether the internal control over financial reporting adequately addresses the risks set forth in the preceding paragraph:
 - (1) (i) whether the directors in charge of finance are fully aware that the reliability of financial reporting and the development of the effective system thereof are indispensable to the company's management; and (ii) whether the directors in charge of finance fully understand the significance of the risk of the failure to discovery and prevention in a timely and appropriate manner misstatements in financial reporting;
 - (2) whether persons with sufficient expertise in accounting and finance are allocated to departments in charge of financial reporting;
 - (3) in light of the matters being grasped or confirmed by *kansayaku* through daily auditing activities, whether the systems for the directors in charge of finance to make appropriate determinations and response of the following matters as well as for the accounting auditor to properly audit the following matters are developed; provided, however, that the following matters are examples, and shall be identified without excess and deficiency in light of the characteristics of the business, etc. of the company;
 - a. existence of sales and costs, appropriateness of period allocation, existence of inventory assets, propriety of various reserves reported, propriety of tax effect accounting, propriety of asset-impairment accounting, propriety of hedge accounting, appropriateness of off-balance sheet matters and other important accounting treatments;
 - b. propriety of change in important accounting policies;
 - c. propriety of important agreements in capital transactions and profit-and-loss transactions;
 - d. propriety of acquisition and disposition, etc. of important assets;
 - e. propriety of fund management (including derivative transactions, etc.);
 - f. operating effectiveness of control systems of information technology in general and information systems which importantly influences financial reporting;

- g. responses to revisions, etc. of accounting standards and systems;
 - h. propriety of policies on appropriation of surplus;
 - i. propriety of the scope of consolidation and the scope of equity method affiliate; or
 - j. proper accounting treatments of each item listed above concerning the companies within the corporate group which importantly influence the consolidated accounts.
- (4) whether the system have been developed in which the financial information to be disclosed is collected promptly and comprehensively and such information disclosed timely, accurately and sufficiently in accordance with the laws and regulations, etc.; and
- (5) with respect to the matters found to be highly likely to importantly influence the operating results and financial conditions of the company, (i) whether information is being shared appropriately between the directors in charge of finance and accounting auditors; (ii) whether there is any special relationship in which the independence of the accounting auditor from the company is doubted; and (iii) whether other systems to ensure that the performance of the duties of the accounting auditor are properly conducted have been developed.
3. *Kansayaku* shall request the accounting auditor to report to *kansayaku* or the *kansayaku-kai* timely and appropriately whether the internal control over financial reporting adequately addresses the material risks set forth in paragraph 1, and other matters found to be likely to influence the effectiveness of the internal control over financial reporting, in order to effectively share information with the accounting auditor.
4. *Kansayaku* shall request the directors in charge of finance and the accounting auditor to report timely to *kansayaku* or the *kansayaku-kai* in cases where opinions on the methods of audit or the accounting treatment, etc. differ between the directors in charge of finance and the accounting auditor.
5. *Kansayaku* shall, in cases where it determines that the internal control over financial reporting does not adequately address the material risks set forth in paragraph 1 through the methods of audit set forth in this Article 13 or other audit activities set forth in the Companies Act of Japan, (i) indicate timely and appropriately such fact to the directors in charge of finance and request necessary improvement through deliberations of the *kansayaku-kai* as necessary, and (ii) provide necessary information to the accounting auditor. In cases where *kansayaku* finds the accounting auditor does not conduct a proper accounting audit of the contents of such information, *kansayaku* shall describe in its audit report the fact that the method or result of the audit of the accounting auditor is found to be inappropriate and the reason therefor.

Chapter V

Audit of System to Ensure the Effectiveness of *Kansayaku* Audits

Article 14 (Matters concerning Supporting Employees)

1. If any of the following cases are found with respect to the supporting employees, *kansayaku* shall make a necessary request for remedial action to the Representative Directors, etc. or the board of directors:
- (1) in cases where the number or the expertise of supporting employees necessary for the performance of the duties of *kansayaku* are lacking in light of the auditing system of *kansayaku*;
 - (2) in cases where attendance at the Meetings, etc., information collection and other necessary acts conducted by supporting employees under the instructions of *kansayaku* are found to be restricted inappropriately;

- (3) in cases where the rights of supervision and instruction necessary for the *kansayaku* of supporting employees are found to be restricted inappropriately;
 - (4) in cases where *kansayaku* are not granted the rights of consent to the personnel transfer (including the place for transfer), personnel evaluation and disciplinary actions, etc. concerning supporting employees; or
 - (5) in other cases where there are any factors that restrict the effectiveness of *kansayaku* audits.
2. Requests of *kansayaku* set forth in the preceding paragraph shall be made through deliberations of the *kansayaku-kai* as necessary. In cases where the Representative Directors, etc. or the board of directors do not take appropriate measures and do not have justifiable grounds for such inaction, *kansayaku* shall indicate such facts in the audit reports, etc. through deliberations of the *kansayaku-kai*.

Article 15 (Reporting System to *Kansayaku*)

1. If any of the following cases are found with respect to the reporting system to *kansayaku*, *kansayaku* shall make a necessary request for remedial action to the Representative Directors, etc. or the board of directors:
 - (1) in cases where no measures to ensure the opportunity of attendance of *kansayaku* are taken with respect to important Meetings, etc. that *kansayaku* need to attend, other than the board of directors' meeting;
 - (2) in cases where no measures are taken to make a timely inspection by *kansayaku* in response to *kansayaku*'s request for the materials of the agenda and materials such as the minutes of the Meetings, etc. to which the *kansayaku* does not attend;
 - (3) in cases where no measures are taken to make a timely inspection by *kansayaku* in response to *kansayaku*'s request for the materials circulated for approval and other important documents with respect to the decision-making for management of corporate affairs;
 - (4) in cases where matters to be reported on a regular basis to *kansayaku* by Representative Directors, etc., Internal Audit Division, etc. or Internal Control Division have not been reported;
 - (5) in cases where matters, except matters mentioned in the preceding item, to be timely reported to *kansayaku* by the Representative Directors, etc., Internal Audit Division, etc. or Internal Control Division have not been reported; or
 - (6) in cases where information to be provided to *kansayaku* by an internal communication system established at the company is not timely reported.
2. Requests of *kansayaku* set forth in the preceding paragraph shall be made through deliberations of the *kansayaku-kai* as necessary. In cases where the Representative Directors, etc. or the board of directors do not take appropriate measures and do not have justifiable grounds for such inaction, *kansayaku* shall indicate such fact in the audit reports, etc. through deliberations of the *kansayaku-kai*.

Article 16 (System of Cooperation with Internal Audit Division, etc.)

1. If any of the following cases are found, *kansayaku* shall make a necessary request for remedial action to the Representative Directors, etc. or the board of directors:

- (1) in cases where the cooperation with *kansayaku* and the Internal Audit Division, etc. set forth in Article 6, paragraph 4 is found not to be conducted effectively;
 - (2) in addition to the cases set forth in the preceding item, in cases where effective cooperation with *kansayaku* and the Internal Audit Division, etc. is found to be impeded;
or
 - (3) in cases where matters requested by *kansayaku* in connection with the reports from the Internal Control Division set forth in Article 6, paragraph 6 are not being complied with.
2. Requests of *kansayaku* set forth in the preceding paragraph shall be made with deliberations of the *kansayaku-kai* as necessary. In cases where the Representative Directors, etc. or the board of directors do not take appropriate measures and do not have justifiable grounds for such inaction, *kansayaku* shall indicate such facts in the audit reports, etc. through deliberations of the *kansayaku-kai*.