

# **Corporate Disclosure in Japan Auditing**

The Japanese Institute of Certified Public Accountants  
July 2009  
(Fourth Edition)



## FOREWORD

The globalization of business and capital markets has transformed the auditing regime, including auditing standards in Japan. The Japanese Institute of Certified Public Accountants (JICPA) has taken various measures, as a self-regulating body, in response to an upheaval in the audit environment, with the aim of restoring public confidence in audits and improving audit quality. Those measures include strengthening the quality control review conducted by the JICPA, introduction of the registration system of listed company audit firms, and the comprehensive revision of the Code of Ethics ("JICPA Code").

As a part of the drive to international convergence of auditing standards, JICPA participates in the activities of the International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants (IFAC), in order to contribute to the development of robust auditing standards. In addition, in order to respond to the clarity project of the IAASB, JICPA is carrying out the project of rewriting its Implementation Guidance by our Auditing Standards Committee.

As for the JICPA Code, convergence has progressed based on the Code of Ethics of IFA. JICPA also continues to improve the JICPA Code, and participates in the International Ethics Standards Board for Accountants of IFAC in order to develop a high-quality Code.

This booklet is the fourth edition of "Corporate Disclosure in Japan – Auditing," published by the International Relations Committee of the JICPA, in order to provide an updated edition of the development and current status of auditing in Japan. I am confident that this booklet will help you better understand and appreciate the auditing profession and its environment in Japan.

Koichi Masuda  
Chairman and President  
The Japanese Institute of Certified Public Accountants

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## **Chapter I Overview**

### **1. Globalization of the Auditing Regime**

The globalization of business and capital markets has completely transformed the auditing regime, including auditing standards in Japan.

The amendment of the Certified Public Accountants Act ("CPA Act") in 2003, the biggest change since the 1970s, was strongly influenced by the U.S. Sarbanes-Oxley Act of 2002. Some of the major amendments included strengthening of the auditor independence rules and auditor oversight, reform of the Certified Public Accountants (CPA) examination, and limited liabilities of partners for audited entities. Nevertheless, corporate scandals involving listed companies relating to financial reporting have emerged in succession since 2004. As a means to prevent such fraudulent accounting, the CPA Act was revised again in 2007. In this most recent amendment, the focus was placed on further strengthening of oversight on auditors, revision of auditor liability, enhancing the quality control, governance, and disclosure of audit corporations, and reinforcing the independence of auditors.

Moreover, the Securities and Exchange Law (SEL) and other related laws, which regulate capital markets, were amended and reorganized into the Financial Instruments and Exchange Act (FIEA) in 2006. Under the FIEA, the following measures related to financial reporting became effective in the fiscal year beginning April 1, 2008:

- Management's assessment of internal control over financial reporting and a CPA audit of the assessment;
- Introduction of quarterly financial reporting and CPA reviews.

The Japanese Institute of Certified Public Accountants (JICPA) has executed various measures as a self-regulating body, in response to an upheaval in the audit environment, with the aims of restoring the public confidence in audits and improving the audit quality. Those measures include strengthening the quality control review conducted by the JICPA, introducing the registration system of listed company audit firms, and the comprehensive revision of JICPA Code of Ethics ("JICPA Code").

With respect to auditing standards, convergence has been accelerated on a global basis with the International Standards on Auditing (ISA) developed by the International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants (IFAC). In order to respond to the clarity project of the IAASB, in 2008, JICPA began the task of rewriting its Implementation Guidance issued by the Auditing Standards Committee under the clarity convention.

The sections below provide an overall description including legal and regulatory framework of the auditing system and process of standard setting in Japan.

### **2. Auditing Standards and Standard-Setting Bodies**

In Japan, the Business Accounting Council (BAC), an advisory body established within the Financial Services Agency (FSA), determines the Auditing Standards, the basic framework for auditing standards, and the JICPA determines the Implementation Guidance, the guidelines for applying the

Auditing Standards. The Auditing Standards and Implementation Guidance, as a combined set, constitute Generally Accepted Auditing Standards (GAAS) in Japan.

**(i) The BAC and auditing standards**

The Auditing Committee, a sub-committee of the BAC, consisting of members drawn from universities, businesses and audit corporations, develops the framework for auditing standards through a consensus among the members. This framework underlies the basic concepts for audits of financial statements. In 2005, the Auditing Standards were greatly revised, among other things, to introduce a risk-based approach that focuses on business risks. Moreover, the following standards were newly set by the BAC:

- (a) Standards on Quality Control for Audits (October 2005)
- (b) Standards and Practice Standards for Management Assessment and Audit concerning Internal Control Over Financial Reporting (February 2007).
- (c) Review Standards for Quarterly Financial Reporting (March 2007)

The Standards on Quality Control for Audits, in consideration of the situation about the quality control of the recent auditing in Japan and an international trend, were established by the BAC as an independent standard to further improve the quality of financial statements audits. It is necessary for these standards to be applied together with the Auditing Standards.

The Standards for Management Assessment and Audit concerning Internal Control Over Financial Reporting, and the Review Standards for Quarterly Financial Reporting uphold internal control in a financial reporting system and quarterly financial reporting system required under the FIEA established in June 2006.

**(ii) JICPA and auditing standards**

For more than a decade, the BAC and JICPA have shared the process of standard setting. The JICPA Auditing Standards Committee has issued more than 35 statements, most of which are largely modeled after ISAs. As described above, the Auditing Standards Committee has launched a project to redraft all statements under the clarity convention.

In addition to the Auditing Standards Committee, the JICPA Auditing and Assurance Practice Committee has issued various statements and guidelines regarding practical issues that have emerged during audits. These statements and guidelines are an integral part of GAAS in Japan. JICPA members must follow these committee statements and guidelines, as required by Article 41 of the JICPA Constitution.

**3. Auditing System (Summary)**

Audits are of two types, based on who conducts the audit: internal audits conducted by personnel in the organization, and external audits conducted by outside parties independent of the organization (e.g. audits by CPAs). The aim of external audits is to provide reasonable assurance to various stakeholders as to whether the financial statements prepared by companies are fairly presented, based on their audits as an independent third party. CPA audits are required under many laws including the Companies Act and the FIEA, and contribute to ensuring the credibility of the financial information that entities provide.

Audits are performed by individual CPAs or audit corporations (special corporations established pursuant to CPA Act provisions). References to CPAs hereinafter may include audit corporations, depending on the context.

#### **(i) Statutory audits**

Statutory audits consist mainly of those performed as required under the FIEA and the Companies Act.

Companies that must be audited by independent CPAs under the FIEA are as follows:

- Companies that issue shares listed on a financial instruments exchange or are in the process of listing;
- Companies that filed a registration statement; and
- Companies with a specified number of shareholders.

Companies that must be audited by independent CPAs under the Companies Act are as follows:

- Large companies: Capital stock of ¥500 million or more, or total liabilities of ¥20 billion or more, as of the latest fiscal year-end;
- Companies which adopt a "Company with Committees" corporate governance system; and
- Other companies which appoint an accounting auditor (*kaikeikansanin*) on a voluntary basis.

The auditor's report on the financial statements is presented at the annual general shareholders meeting. The Companies Act also provides that the company auditor (*kansayaku*) or the auditing committee (*iinkai*), that is, one component of a company's organization, has a duty to examine the financial statements prior to the annual general shareholders meeting. This company auditor or its equivalent is also responsible for monitoring the activities of the directors (*torishimariyaku*).

#### **(ii) Voluntary audits**

In addition to statutory audits, companies may have voluntary audits to obtain independent assurance regarding the accuracy and reliability of their financial statements.

## **4. Financial Statements Subject to Audit**

### **(i) FIEA**

Audited consolidated financial statements, which are considered the primary financial statements, along with audited non-consolidated financial statements must be included in registration statements and securities reports filed with the FSA. The financial statements subject to an audit by independent CPAs consist of the balance sheet, income statement, statement of changes in net assets, statement of cash flows, and supporting schedules. Listed companies are also required to file quarterly reports that include financial statements reviewed by CPAs.

### **(ii) The Companies Act**

The financial documents consist of the business report and financial statements, namely, balance sheet, income statement, statement of changes in net assets, notes to non-consolidated financial statements and accounting figures included in supplementary schedules. The financial statements are subject to an audit. These financial documents are to be prepared in conformity with the "Ordinance for Companies Accounting." Companies are not required under the Companies Act to

prepare interim financial statements for distribution to shareholders.

From the fiscal years ending after March 31, 2004, the consolidated financial statements of large companies whose financial statements are filed with the FSA are also subject to audit under the Companies Act.

## **5. Legal and Regulatory Framework of the CPA Profession in Japan**

### **(i) The CPA Act**

The CPA Act provides the basic framework for the audit profession in Japan. It includes the scope of services to be provided by CPAs, establishment of the national CPA examination, requirements for CPA qualification, establishment of audit corporations, duties and responsibilities of CPAs, roles and organization of the Certified Public Accountants and Auditing Oversight Board (CPAAOB), roles and organization of the JICPA, roles of the regulatory authority, and the disciplinary and criminal sanctions applicable to CPAs. The CPA Act grants the FSA the authority to oversee CPAs and the JICPA.

### **(ii) FSA**

As noted above, the FSA has oversight responsibilities over the audit profession in Japan. The CPA examination is conducted by the CPAAOB, an arm of the FSA (Article 35 of the CPA Act). Amendments to the CPA Act in 2003 changed the legal procedures for incorporation, dissolution, mergers and amendments to the articles of incorporation of an audit corporation from an approval basis to a filing basis with the FSA (Articles 34-9-2, 34-10, 34-18, and 34-19). CPAs are subject to the FSA's requirements as to reporting and submission of certain materials (Article 49-3), and are subject to disciplinary sanctions including suspension of practice or revocation of qualification registrations (Articles 29 through 31, and 34-21). CPAs are subject to examinations and inspections by the FSA (Articles 32, 33, and 34-21). The FSA also oversees the JICPA, as described below.

### **(iii) CPAAOB**

The amended CPA Act in 2003 stipulates the establishment of the CPAAOB as a public oversight body to monitor and oversee CPAs and the JICPA quality control review by reorganizing the CPA Investigation and Examination Board, which formerly oversaw CPA examinations and disciplinary actions for CPAs. Further details of the CPAAOB regarding the monitoring function are described in Chapter IV "Oversight of Statutory Audits in Japan."

### **(iv) The JICPA**

The JICPA is a distinctive corporate professional body in Japan, and the only organization permitted to be established under the CPA Act. All CPAs are required to register with the JICPA (Article 17) so that the Institute may effectively guide and supervise its members and maintain close contact with them for the maintenance of a strong and independent organization.

The JICPA has stipulated a Code of Ethics in order to establish the foundation underlying the integrity of the profession as CPAs and requires their strict adherence to this Code.

In addition, the JICPA, through its various committees and project teams, carries out a wide range of activities from self-regulation to the provision of services to its members. Some examples of

such key activities include the following:

- (a) conducting research on and investigation into practices and systems of accounting, auditing and other related professional services in Japan and overseas;
- (b) providing guidance on auditing, accounting and other related professional services, and submitting comments on various exposure drafts published by other organizations;
- (c) providing pre-qualification training courses and programs for continuing professional education ("CPE");
- (d) performing quality control reviews; and
- (e) conducting investigative and disciplinary proceedings.

As a part of its international activities, the JICPA has been cooperating as a member of the IFAC and the Confederation of Asian and Pacific Accountants (CAPA), and has contributed significantly to international cooperation in the promotion of high quality accounting and auditing practices. The JICPA dispatches its members to several boards or committees of IFAC and contributes to IFAC boards or committees engaged in standard setting processes by responding to invitations to comment on proposed standards and guidelines. In order to ensure compliance with the Statements of Membership Obligations set forth by IFAC and promote further convergence around the globe, the JICPA has reflected pronouncements such as the Code of Ethics and the ISAs in its own standard setting.

## **Chapter II    Audit Requirements**

### **1. Requirements under the FIEA**

#### **(i) Disclosure requirements under the FIEA**

Under the FIEA, companies that offer securities to the public or whose outstanding securities are traded publicly (i.e. listed companies) must file financial statements with the FSA, as part of their security registration statement, annual securities report or quarterly report. Certain companies whose securities are not publicly traded (i.e. unlisted public companies) are also required to file their financial statements.

Financial statements are prepared on both consolidated and non-consolidated bases and consist of the following:

- Balance sheet;
- Income statement;
- Statement of changes in net assets;
- Statement of cash flows (non-consolidated basis is not required if a consolidated statement is prepared); and
- Supporting schedules.

The main objectives of the accounting and disclosure system under the FIEA are:

- (a) To provide information to investors for decision-making; and
- (b) To facilitate fair and smooth securities transactions.

#### **(ii) Audit requirements under the FIEA**

Filed financial statements must be audited by an independent CPA in accordance with Japanese GAAS. An independent auditor's report expresses an opinion as to the fairness of the presentation of the company's results of operations, financial position, and its cash flow, in accordance with the generally accepted accounting principles (GAAP) in Japan. The independence of auditors, together with the independent auditor's report requirements, are established under the Cabinet Office Ordinance entitled "Ordinance Concerning Audit Certification of Financial Statements."

#### **(iii) Review of quarterly financial statements**

The FIEA, enacted in June 2006, requires listed companies to submit quarterly reports from periods beginning on or after April 1, 2008. Additionally, quarterly financial statements included in the quarterly reports need to be reviewed by a CPA or an audit corporation.

The BAC issued Review Standards for Quarterly Financial Reporting in March 2007; in October of the same year, the JICPA Auditing and Assurance Practice Committee then issued, as implementation guidance, the Practical Guidelines for a Review of Quarterly Financial Statements.

#### **(iv) Audit on internal control over financial reporting**

The FIEA also requires listed companies to prepare an Internal Control Report and to have it audited. This requirement is modeled after the one provided by Section 404 of the Sarbanes-Oxley Act, though with modifications in consideration of the experiences in the U.S.

Under the Japanese requirements, management-conducted assessments on the effectiveness of internal control over financial reporting are required to be audited by CPAs in accordance with the Standards and Practice Standards for Management Assessment and Audit concerning Internal Control Over Financial Reporting. Internal control audits are to be performed by the same auditors who audit the companies' financial statements. (Not only the audit corporation, but the engagement partners are identical as well.)

Auditors are then to prepare an "Internal Control Audit Report" and express their opinion on the management's assessment on the effectiveness of internal controls over financial reporting. This report is, in principle, to be combined with the auditors' report on the financial statements. Direct reporting on the effectiveness of internal control has not been adopted.

The BAC published the Standards and Practice Standards for Management Assessment and Audit concerning Internal Control Over Financial Reporting in February 2007. Based on these Standards and Practice Standards, the JICPA Auditing and Assurance Practice Committee established Practical Treatment for Audits concerning Internal Control Over Financial Reporting in October 2007 to help members perform audits of internal control over financial reporting.

**(v) Timetable for disclosure of financial statements**

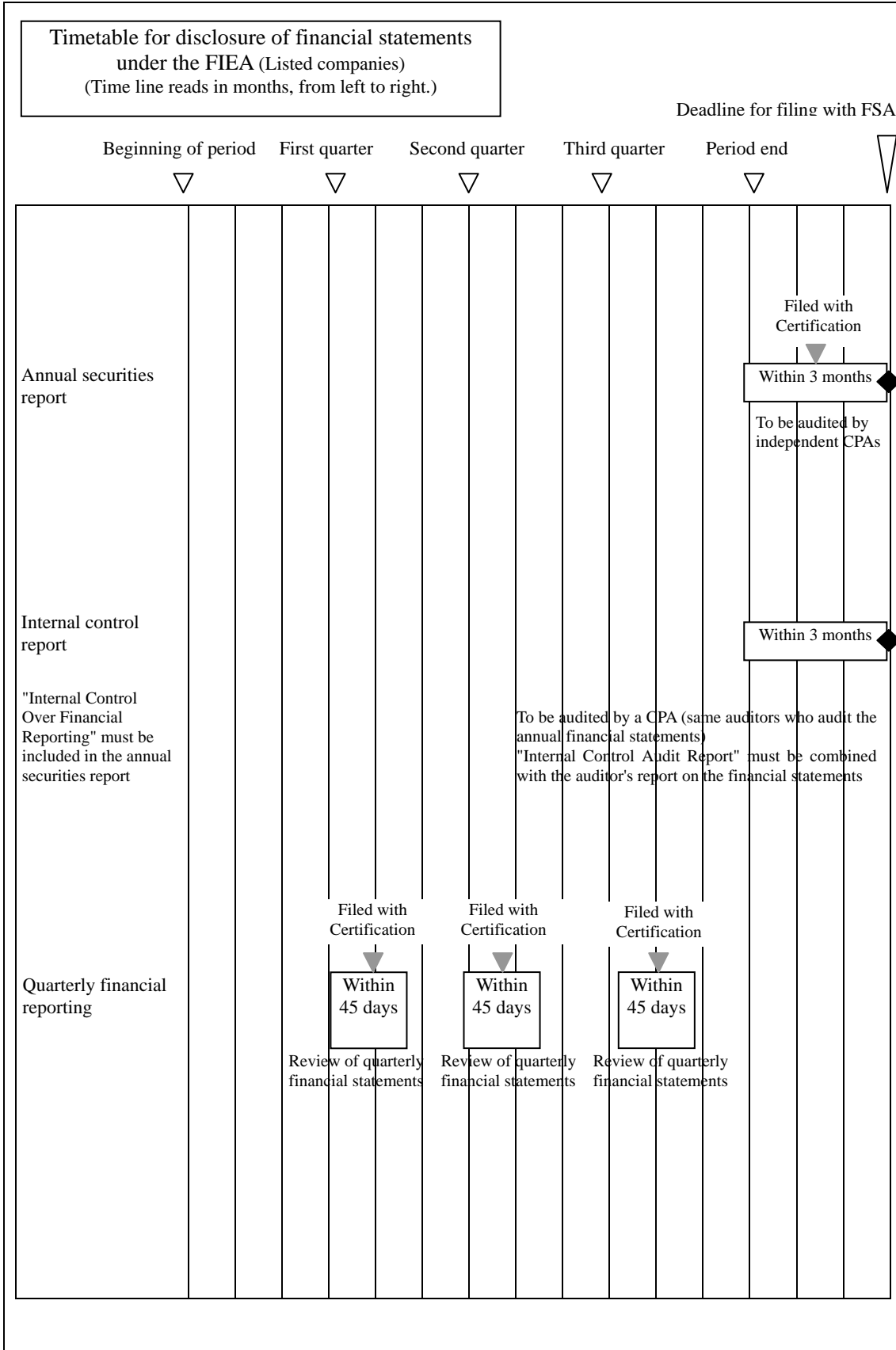
Public companies are required to submit annual securities reports, including financial statements audited by CPAs, to the FSA (actually with local finance bureaus of the Ministry of Finance (MOF)) within three months after the end of the fiscal year (Article 24 of the FIEA).

Listed companies must include an internal control report audited by CPAs as well (Article 24-4-4).

Listed companies are also required to submit quarterly reports, including financial statements reviewed by CPAs, to the FSA within 45 days after the end of the period (Article 24-4-7).

The Certification is a document that describes the management's (officer's) confirmation that the financial statements and other financial information included in the report fairly present in all material respects under the FIEA. The management (officer) certification must be included in the annual securities report or quarterly reports (Articles 24-4-2 and 24-4-8).

The above timetable can be summarized as follows:



**(vi) Filing**

All Japanese public companies must use the Electronic Disclosure for Investor's NETWORK (EDINET) to file annual securities reports and other regulatory reports with the FSA. All disclosure documents submitted through the EDINET system can be browsed via the Internet.

Companies are required to submit financial statements in the eXtensible Business Reporting language (XBRL) format to EDINET from fiscal years beginning on or after April 1, 2008.

**2. Requirements under the Companies Act**

**(i) Comprehensive amendment of the Companies Act**

Substantial revisions were made to the Companies Act in July 2005 in order to modernize the former Commercial Code. These revisions have a significant impact on many companies' activities including financial reporting under Companies Act. In particular, the revision provides more flexibility for companies in terms of the design of corporate governance structure. Disclosure requirements were revised to more closely mirror those of the FIEA, to reduce the burden for companies that are required to provide financial reporting under both Acts. Other revisions include the following:

- Requirement of establishment of internal control over financial reporting;
- Creation of accounting advisor (*kaikeisanyo*) system; and
- Expansion of companies that can voluntarily establish accounting auditor (with the exception of large companies, accounting auditors can be set up under the articles of incorporation).

**(ii) Disclosure requirements under the Companies Act**

All stock companies (*kabushikikaisha*) are regulated under the Companies Act, and are required to provide a business report and the following financial statements (Article 435(2) of the Companies Act):

- Balance sheet;
- Income statement;
- Statement of changes in net assets;
- Notes to non-consolidated financial statements; and
- Supplementary schedules.

Large companies whose financial statements are filed with the FSA should prepare consolidated financial statements from the fiscal years ending after March 31, 2004 (Article 444 (3)).

The main objectives of the accounting and disclosure system under the Companies Act are:

- (a) To protect creditors and current shareholders;
- (b) To compute the distributable earnings of the company; and
- (c) To evaluate management's performance of its stewardship function.

**(iii) Companies subject to an audit of financial statement**

In order to meet the objectives and maintain discipline in the business activities of companies, the Companies Act provides for an audit regime that varies with the size and corporate governance structure adopted by companies. Companies falling under any of the following categories are

required to have an accounting audit:

- Large companies: Capital stock of ¥500 million or more, or total liabilities of ¥20 billion or more, as of the latest fiscal year-end;
- Companies which adopt a "Company with Committees" corporate governance system; and
- Other companies which appoint an accounting auditor on a voluntary basis

An accounting auditor is also engaged to audit financial statements prepared under the FIEA when required. Auditing standards and practices applied to audits under the Company Act are also applied to audits under the FIEA.

**(iv) Corporate governance structure**

In terms of two aspects—whether transfer of company shares is restricted, and whether a company is a large company as stipulated by the Company Act—stock companies are classified into four categories. Whether transfer of company shares is restricted may be determined in the articles of incorporation (Article 107 (2)). Companies that are large and whose share transfer is not restricted are required to establish a board of company auditors and an accounting auditor (excluding companies with committees) in order to ensure more rigorous governance, as such companies generally have broader stakeholders in terms of number and nature (Article 328 (1)).

The following table indicates the possible combination of components for a company with board of directors and accounting auditors based on the Companies Act.

Company with board of directors and accounting auditor				
Categories		Components		
1	A company that is a large company and whose share transfer is not restricted	Board of directors	Board of company auditors, or Committees	Accounting auditor
2	A company that is a large company and whose share transfer is restricted	Board of directors	Company auditor, Board of company auditors, or Committees	Accounting auditor
3	A company that is not a large company and whose share transfer is not restricted			
4	A company that is not a large company and whose share transfer is restricted			

(a) Components of corporate governance structure

The amended Company Act provides companies with more flexibility for the design of corporate governance structure. The following components are available to stock companies under the Company Act:

- Director(s) (*torishimariyaku*);
- Board of directors (*torishimariyakukai*);
- Board of company auditors (*kansayakukai*);
- Company auditor(s) (*kansayaku*);
- Committees (*iinkai*);
- Accounting auditor(s) (*kaikeikansanin*); and
- Accounting advisor(s) (*kaikeisanyo*).

As a minimum requirement, stock companies must have one or more directors in addition to a general assembly meeting of shareholders (Article 326 (1)). Other components are determined by the company's articles of incorporation (Article 326 (2)). Nevertheless, depending on their circumstances, certain companies are required to establish one or more components.

Details of some company components that relate to audit requirements under the Company Act are described below.

#### (b) Company auditor

Company auditors fulfill an indispensable role in the corporate governance of a Japanese company. The Companies Act protects their positions and carefully designates their duties and responsibilities.

##### i) Qualifications

A stock company may have a company auditor as prescribed by the articles of incorporation (Article 326 (2)). Although no professional qualifications are required for a company auditor, no current director or employee of a company or its subsidiary may be the company auditor of that company (Article 335 (2)).

##### ii) Appointment and dismissal of company auditors

A company auditor is elected at the general shareholders meeting (Article 329 (1)). The term of company auditors is four years (Article 336 (1)).

Shareholders may resolve to dismiss a company auditor (Article 339 (1)) before expiration of his or her term. However, a company auditor has the right to claim to the company compensation for damages due to dismissal without justifiable cause (Article 339 (2)). A company auditor may state an opinion at the shareholders meeting about the proposal for appointing or dismissing the company auditor (Article 345 (4)).

A company auditor may resign at any time. The Companies Act empowers a resigning company auditor to state his or her reason for the resignation at a shareholders meeting (Article 345 (4)). A company must send a notice of a shareholders meeting to the resigning company auditor.

##### iii) Remuneration

Remuneration for a company auditor must be set in the articles of incorporation or by a resolution at the shareholders meeting, separately from the compensation for directors (Article 387 (1)).

##### iv) Power and responsibility

The company auditor's major role is to oversee the activity of the directors, as well as the accounting records of the company (Article 381 (1)). In order to perform that role, the company auditors are granted various powers, such as being able to require directors or employees of the company to report on the status of operations; investigate the financial position of the company (Article 381(2)); and to require a subsidiary to report on the status of its operations, are entitled to examine the underlying documents of the subsidiary (Article 381(3)), if necessary..

If the company auditor finds that directors engage in misconduct, or are likely to engage in such conduct, or that there are facts in violation of laws and regulations or the articles of incorporation or grossly improper facts, the company auditor must report the same to the directors (or the board of directors) without delay (Article 382). And the company auditor is entitled to prohibit a director from proceeding with any action that would cause substantial damage to the company (Article 385 (1)).

If company auditors fail to fulfill their duties, they are liable to pay compensation for damages. If they have neglected any of their duties, they are jointly and severally liable in damages to the company (Article 423).

v) Independence

- Each company auditor has autonomous power and responsibility

Each company auditor is independently required to examine directors' behavior and activities, and accounting auditors' audit results, and to report to the other company auditors (Article 390). The board of auditors is not expected to make a resolution on audit results as a board. Instead, each auditor's conclusion on audit results must be independently reported to the shareholders meeting because there may be differing opinions between or among company auditors. This is because each company auditor is independent, and each has his or her own blend of skills and experience, such as those of an outside company auditor (*shagaikansayaku*) or an internal company auditor, a full-time company auditor or a part-time company auditor.

- Outside company auditors

As a requirement added in its 1993 revision, the former Commercial Code stipulated that out of the three or more company auditors, at least one must be an outside company auditor. This number of outside company auditors was increased to at least half the total number of auditors in 2005 pursuant to the recent revision of the then Commercial Code. Since the outside company auditor system was introduced to provide more objective oversight over the directors' activities, the Companies Act stipulates an independence rule.

It is noted that a director, executive, or employee of the parent company can be an outside company auditor of its subsidiary.

vi) Oversight of external audits by company auditors

Company auditors assume the responsibility for monitoring accounting auditors in Japan. The Companies Act requires accounting auditors and company auditors to maintain a close relationship in the conduct of an audit. At year-end, accounting auditors issue their report on the results of their annual audit of the company's financial statements (Article 396). Each company auditor is required to examine the accounting auditors' audit results and to report to the (board of) company auditors, and report each auditor's audit result to the board of directors (Article 436). Company auditors are also required to report their audit results at the shareholders meetings (Article 381). Company auditors can also require accounting auditors to report on particular issues at any time (Article 397 (2)).

vii) The board of company auditors

For a large company, three or more company auditors are required, all of whom are members of the board of company auditors (Article 328 (1)).

It is acceptable for the company auditors to rely on the accounting auditor to audit the accounting records. Nevertheless, the company auditors continue to hold ultimate responsibility for auditing both the managerial behavior of directors and the accounting records. Therefore, the company auditors are entitled to require the accounting auditor to report on all matters detected in the course of the independent audit. If the company auditors determine that the methods and results of the audit conducted by the accounting auditor are not appropriate, the company auditors must then audit the accounting records themselves.

(c) Audit Committee

The Companies Act makes it possible for a company to choose to establish an audit committee instead of (the board of) company auditors by adopting the committee system.

If a company establishes an audit committee, the Companies Act requires the audit committee to include at least three directors—the majority of whom must be independent. If the committee consists of three directors, then two of them must be independent directors. (Article 400)

The audit committee system is linked to the executive officer system, where the board of directors is designed to strictly supervise the CEO and his or her subordinates. Under this system, the authority and responsibility of the position is clearly distinguished by a complete separation of officers such as the CEO and the directors who are often outsiders. Under this system, officers are responsible for the management of the company, but they are also accountable to the management-supervisory organization consisting of the directors. If a company adopts the committee system, the company must set up (1) an audit committee, (2) a nominating committee, and (3) a compensation committee.

(d) Accounting Auditors

i) Qualifications

The accounting auditor must be a CPA or an audit corporation (Article 337 (1)).

Due to the complexity and importance of auditing, the Companies Act requires that large companies appoint independent accounting auditors to reinforce the accounting audits conducted by the board of company auditors (Article 328).

ii) Appointment and dismissal of accounting auditors

Accounting auditors are elected by the shareholders at their annual meeting, subject to the agreement of a majority of the company auditors (Articles 329 and 344 (1)). They hold this position until the next annual meeting and are considered re-elected should there be no resolution for their dismissal (Article 338 (2)).

Shareholders have the power to dismiss accounting auditors at their meeting, subject to the agreement of a majority of the company auditors (Articles 339 (1) and 344 (1)). In certain cases, accounting auditors may also be dismissed by a resolution of the board of company auditors

(Article 340 (1)). In such cases, a company auditor appointed by the board of company auditors must explain the reason for the dismissal at the next annual shareholders meeting (Article 340 (3)). The dismissed accounting auditor is entitled to attend the shareholders meeting to state his or her opinion regarding the dismissal (Article 345 (5)).

### iii) Power and responsibility

Unlike a company auditor, the scope of the audit of an accounting auditor is limited to the accounting records. An accounting auditor is required to prepare an accounting auditor's report based on his or her audit (Article 396 (1)); and as such, he or she has the power to inspect the accounting books and related documents, and to require directors or employees to provide accounting information (Article 396 (2)), and the power to require subsidiaries of the company to provide accounting information (Article 396 (3)). The accounting auditor is also required to inform (the board of) company auditors of any and all fraudulent and/or material illegal acts of directors identified in the course of an audit (Article 397).

Accounting auditors are obliged to compensate the company for any losses resulting from his or her failure to exercise the due professional care which would normally be required under generally accepted auditing standards (Article 423 (1)), and are obliged to compensate a third party for any losses resulting from any misrepresentation in the accounting auditor's report where the accounting auditor is unable to prove that he or she exercised due professional care in the performance of his or her audit procedures (Article 429 (1)).

### (e) Accounting advisor

The establishment of the accounting advisor is mainly aimed at improving for the adequacy of the financial statements of the small and medium sized companies. Accounting advisors must be a CPA, an audit corporation, a certified public tax accountant, or a tax accountant corporation. (Article 333)

Accounting advisors prepare, jointly with the directors, the financial statements and the supplementary schedules thereof as well as the consolidated financial statements. In such cases, the accounting advisor prepares an accounting advisor's report pursuant to the provisions of the applicable Ordinance of the Ministry of Justice. (Article 374-1)

### **(v) Timetable for auditing financial statements**

Timelines vary based on the corporate governance structured established by a company. Following describes a timetable for a large company whose share transfer is not restricted.

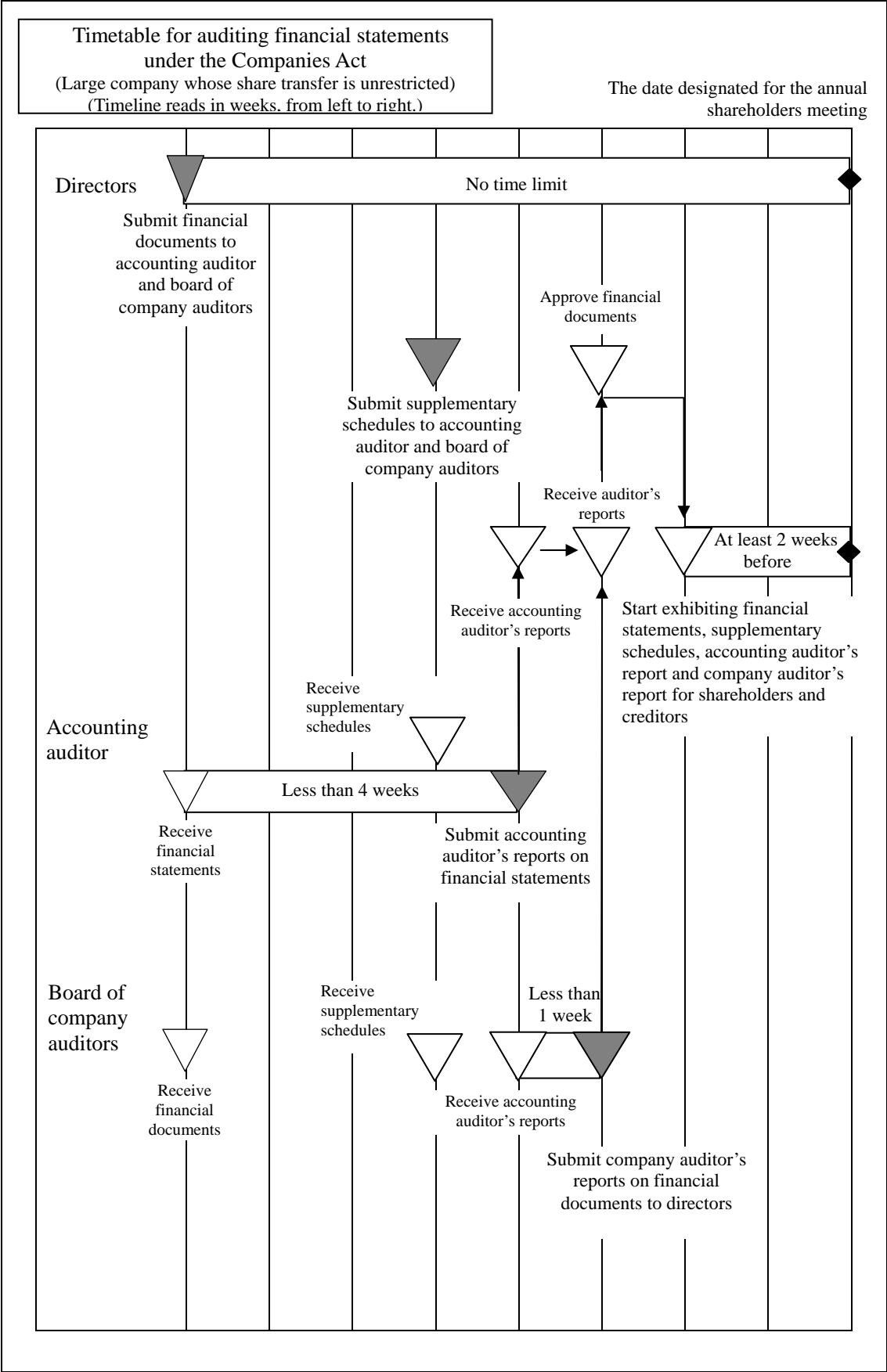
Company directors must submit the financial documents to both the company auditor(s) and accounting auditor(s). The accounting auditor is required to submit his or her accounting auditor reports to the company auditor and the directors within four weeks after the date of receiving the financial statements or within one week after the date of receiving the supplementary schedules (either later day) in principle (Article 158 (1) of the Ordinance for Companies Accounting). The company auditor must submit his or her company auditor report to the directors and the accounting auditor within one week after the date of receiving the accounting auditor's reports in principle (Article 160 (1) of the Ordinance for Companies Accounting).

The financial statements are submitted to the annual shareholders meeting. When (i) the accounting auditor expresses the opinion that the financial documents present fairly the financial position and results of operations, and are in compliance with the Companies Act, related regulations and articles of incorporation, and (ii) the board of company auditors agrees with the accounting auditor's opinion, the financial statements become definitive and the approval of the shareholders at their annual meeting is not necessary (Article 439). The financial documents are submitted to the annual shareholders meeting for the purpose of reporting them to shareholders.

When the accounting auditor disagrees with the company auditor's opinion on whether the financial documents are in compliance with the requirements of the Companies Act, related regulations and the articles of incorporation, the accounting auditor is entitled to attend the annual shareholders meeting and state his or her opinion (Article 398 (1)).

If there is a resolution for an annual shareholders meeting that requires the attendance of accounting auditors, the accounting auditors are to attend the shareholders meeting and state their opinions. (Article 398 (2)).

The above timetable can be summarized as follows:



**(vi) Public notice and public inspection of financial documents**

The Companies Act requires every stock company to publish, at a minimum, the balance sheet. Large companies must publish the balance sheet and the income statement. However, this requirement does not apply to those companies that file financial statements with the FSA, since those statements are published via EDINET (Article 440).

The directors must keep the financial documents and the auditor's report at the principal office of the company for five years and a copy of each for three years at branch offices, from two weeks prior to the date designated for the annual shareholders meeting (Articles 442 (1) and 442 (2)). Any shareholder or creditor of the company may, at any time during business hours, demand to review these documents and may demand delivery of a copy of such documents or a summary thereof (Article 442 (3)).

**3. Audit Requirements for Foreign Companies**

Foreign companies that offer or have offered their shares, investment trusts and/or bonds publicly in Japan are not required to have their financial statements audited by a Japanese CPA, provided that the financial statements of the foreign company are audited by a professional accountant who is the equivalent of a Japanese CPA.

In addition, there are the following special reporting exceptions for foreign companies:

- If the FSA recognizes that financial statements disclosed by the foreign company in its own country are adequate to protect both the public interest and investors in Japan, the terminology, forms, and the method of preparation of financial statements followed in the company's own country are acceptable.
- Foreign companies are permitted to submit annual securities reports to the FSA up to six months after the fiscal year-end, rather than up to the three months required for Japanese companies.

However, foreign audit corporations that audit above foreign companies are required to file their registrations with the FSA (Article 34-35 of CPA Act).

The FIEA allows foreign issuers with an obligation to submit continuous disclosure documents in accordance with the FIEA Article 24 (1), etc. to provide continuous disclosure in the form of an English-language Foreign Company Report (*Gaikokugaisha-houkokusho*) instead of continuous disclosure documents, such as the annual securities report, in Japanese.

**4. Other Audit Requirements**

**(i) Audit requirements at the time of going public**

When a stock company goes public, the company must submit a securities report to the FSA in order to apply for listing on the financial instruments exchange or the Japan Securities Dealers Association. The financial statements included in the securities report must be certified by an independent CPA.

**(ii) Labor unions**

Labor unions are required to have their financial statements audited by CPAs.

**(iii) Kindergartens, schools, universities, etc.**

Where a private educational organization (legal entity) such as a kindergarten, school, or university receives a subsidy from a governmental body, an independent audit of its financial statements by a CPA is required.

**(iv) Others**

In addition to audits that are required by laws and regulations, some organizations, including private companies and public organizations (e.g. public service companies, religious juristic foundations and social welfare companies), engage independent CPAs to audit their financial statements.

## Chapter III Independence Requirements for CPAs

Independence requirements for external auditors exist in laws and the JICPA Code.

### 1. CPA Act

#### (i) Individual CPAs

In accordance with Article 24 of the CPA Act, a CPA shall not render audit services in any of the following cases:

- (a) For a company or other entity in which the CPA or his or her spouse is, or was, within the past year an officer or staff member corresponding thereto or a responsible official in charge of affairs concerning financial matters;
- (b) For a company or other entity for which the CPA is, or was an employee within the past year; and
- (c) For a company or other entity in which the CPA has substantial interests.

"Substantial interests" referred to in item (c) above include the following business, financial or other relationships between a CPA or his or her spouse and a company or other organization (audit client):

- i) The CPA or his or her spouse is or was a director and/or an officer or a person responsible for finance of the audit client during the audit-related period;
- ii) The CPA or his or her spouse is or was an employee of the audit client during the past year;
- iii) The CPA's spouse is or was a government official that had a close relationship with the audit client during the past two years;
- iv) The CPA or his or her spouse owns stock of the audit client and/or debt or credit;
- v) The CPA or his or her spouse has special economic interests such as office rent or borrowings with no or unreasonably low rent or interest;
- vi) The CPA or his or her spouse provides tax services for the audit client;
- vii) The CPA or his or her spouse has or had a special economic interest described above provided by any director of the audit client, or provides tax services for any director of the audit client within the past year or during the audit-related period;
- viii) The CPA or his or her spouse is or was a director of an affiliated company of the audit client within the past year or during the audit-related period; and
- ix) The CPA or his or her spouse is an employee of the parent company or subsidiary of the audit client.

A CPA who was once a national or local government official shall not conduct, during his or her tenure of office or during the two years following his or her termination, an audit practice with respect to the financial affairs of those business enterprises closely related to the duties of the office held during the two years preceding his retirement.

#### (ii) Audit corporations

In addition, in accordance with Article 34-11 of the CPA Act, an audit corporation shall not provide audit services to a company or other entity falling under any of the following categories:

- (a) A company or other entity whose stock the audit corporation owns or in which the audit

corporation is investing;

- (b) A company or other entity with which any member of the audit corporation has the relationship described in Article 24 (1) (i);
- (c) When a partner is involved in audit services provided by the audit corporation concerning the financial documents of a company or an entity, if he or she has become an officer for or taken an equivalent position with the company or the entity or any entities within the consolidated companies during the accounting period pertaining to said financial documents or the following accounting period, then such company or entity or entities within the consolidated companies; or
- (d) A company or other entity in which the audit corporation has other substantial interests.

"Substantial interests" in item (d) above include the following business, financial, and other such interests between the audit corporation or its partners and the company or other entity (audit client):

- i) An audit corporation is either a debtor or creditor of the audit client in any amount;
- ii) An audit corporation has special economic interests such as office rent or borrowings with no or unreasonably low rent or interest;
- iii) An audit corporation is provided special economic interests described above from a director of the audit client;
- iv) Any partner of an audit corporation is an employee of the audit client;
- v) Any partner of an audit corporation is a director, a company auditor and/or an employee of the parent company and/or its subsidiaries of the audit client;
- vi) Any partner of an audit corporation provides tax services for the audit client;
- vii) A partner of an audit corporation being engaged in the audit service of a company or his/her spouse has any of the relationships described in Article 24 (1) (ii) or (iii), or Article 7 (1) (i) through (viii) of the Cabinet Order of the CPA Act; and
- viii) The majority of partners of an audit corporation or their spouses have any of the relationships described in Article 24 (1) (ii) or (iii), or Article 7 (1) (i) through (viii) of the Cabinet Order of the CPA Act.

Further, any partner of an audit corporation who has a relationship described in Article 24 (1) or (3) with an audit client shall not be engaged in an audit of the financial statements of such audit client conducted by the audit corporation.

Audit corporations are permitted to provide financial advisory and consulting services for audit clients as long as such services do not impede the audit service (Article 34-5 of the CPA Act), but they are prohibited from providing tax services. Individual CPAs, however, are permitted to provide tax services excluding the ones for audit clients (Articles 3 and 52 of the Certified Tax Accountants Law).

In the amended CPA Act, enforced from April 2004, an individual CPA and engagement partner of audit corporations who performs audit services to a client shall not be in the management of such a client as a director or any other important position until at least one year elapses after the end of the accounting period during which this partner was involved in auditing the client (Articles 28-2 and 34-14-2). This requirement has been expanded by the amended CPA Act of 2007 to cover

certain consolidated companies.

### **(iii) Scope of Services**

As mentioned previously, the scope of audit corporation services is limited to audits and audit-related services such as compilation of financial statements, research, and advice and consultation on financial matters, so long as such services do not impede the conduct of the audit (Article 34-5). This requirement effectively prevents audit corporations from providing extensive consulting services to their audit clients.

The amended CPA Act, effective from April 2004, restricts audit corporations from providing certain non-audit services to audit clients. Prohibition of the following non-audit services, which was partially amended by the revised CPA Act of 2007, is provided in Cabinet Office Ordinance:

- (a) Services related to bookkeeping, preparing financial documents, and accounting books and records;
- (b) Design and management of financial or accounting information systems;
- (c) Services related to verification or appraisal of properties contribution-in-kind or any property equivalent;
- (d) Actuarial services;
- (e) Internal audit outsourcing services; and
- (f) Other services that are equivalent to the above listed services that may involve management decisions or lead to self-audit of the financial documents the auditor examines.

These non-audit services are prohibited to any clients that are required to be audited in accordance with the FIEA and certain large companies that are required audits by the Companies Act (Article 34-11-2). Individual CPAs are required to follow the similar rule (Article 24-2)

### **(iv) Individual CPA and Audit Partner Rotations**

The JICPA Application Guidance for Conceptual Framework of Independence provides that each individual CPA and engagement partner of audit corporations must rotate for particular audit engagements of listed companies and certain large companies at least every seven years with cooling-off periods of two years. Partner rotation is required for the FIEA audits and certain large company audits pursuant to the Companies Act (Articles 24-3 and 34-11-3).

JICPA established a self-regulatory rotation rule for audit corporations auditing 100 or more listed companies to follow a five-year rotation rule with a five-year cooling-off period for the lead engagement partners and engagement quality control review partners. JICPA had made this rule effective in April 2006, prior to its incorporation into the CPA Act amended in 2007.

## **2. Independence Requirements under the FIEA and Companies Act**

Similar independence requirements are provided in these Acts as follows:

All provisions required in Article 24 (for individual CPAs) and Article 34-11 (for audit corporations) of the CPA Act are applicable to CPAs performing audits required by the FIEA. In addition, independence rules are stricter in the FIEA than in the CPA Act, and auditors are required to comply with these more rigorous rules for the FIEA audits. For instance, under the FIEA, the independent

rules apply to assistants in engagement teams. The coverage of related persons described as "CPA and his or her spouse" is expanded to "CPA, his or her spouse and relatives within the second degree of kinship (parents, siblings, grandparents and grandchildren in addition to spouse and children)". Economic relationships with the client "company" are expanded to the client "company and any of its affiliates included in the consolidated financial statements" (Article 2 of the Cabinet Office Ordinance relating to the Audit of Financial Statements).

All CPA Act provisions are applicable to CPAs performing Companies Act audits (Article 337 of the Companies Act).

### **3. JICPA Code of Ethics**

Article 16 of the JICPA Code requires independence of auditors as follows:

- (a) When accepting or continuing an assurance engagement, a member should maintain independence from clients.
- (b) A member should ensure prevention of circumstances or relationships which might compromise the independence of members of an assurance services team, employees, companies that control, or are controlled by, the member, or a network firm from a client.
- (c) Independence requires:

- Independence of Mind

The state of mind that permits the expression of a conclusion without being affected by influences or pressure that compromises professional judgment, allowing an individual to act with integrity, and exercise objectivity and professional skepticism.

- Independence in Appearance

The avoidance of facts and circumstances that are so significant that a reasonable and informed third party, having knowledge of all relevant information, including applicable laws and regulations, would reasonably conclude a member's, or a member of the assurance team's, integrity, objectivity or professional skepticism had been compromised.

According to Article 3 of the Code of Ethics, JICPA members should evaluate the significance of threats when they know of circumstances or a client relationship that may cause a threat to independence. Furthermore, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate the threat or reduce it to an acceptable level.

In situations when no safeguards are available to reduce the threat to an acceptable level, the only possible recourse is to eliminate the activities or interest creating the threat, or to refuse to accept or continue the assurance engagement.

## Chapter IV Oversight of Statutory Audits in Japan

### 1. FSA

#### (i) Regulator function of statutory audits by the FSA

The FSA is responsible for ensuring the stability of the financial system in Japan and the protection of depositors, insurance policy holders, and securities investors by inspecting financial institutions and conducting surveillance of securities transactions.

Pursuant to these responsibilities, the FSA inspects and supervises banks, securities houses, insurance companies, and other financial institutions, and the FSA also performs activities related to corporate disclosure and securities markets, such as the supervision of CPAs, surveillance of rules governing securities markets, and the establishment of rules for trading in securities markets.

The Office of the Director for Corporate Accounting and Disclosure in the FSA Planning and Coordination Bureau monitors the auditing activities of CPAs and reviews financial statements of certain public companies that are filed pursuant to the FIEA.

#### (a) Monitoring of audit activities

##### i) Approval of the establishment of audit corporations

The FSA has various oversight responsibilities over the accounting profession in Japan.

Before the amendment to the CPA Act in 2003, audit corporations could not be legally established unless they obtained FSA approval. When an audit corporation planned a merger with another audit corporation, they were also required to obtain FSA approval.

However, the FSA's authority to approve or disapprove the establishment of audit corporations was changed to a much simpler process wherein audit corporations would file certain information with the FSA. In this amendment, the procedures for establishing or dissolving an audit corporation, merging one audit corporation with another, and modifying the articles of incorporation of audit corporation, were changed from requiring FSA approval to simply filing with the FSA (Articles 34-9-2 and 34-10 of the CPA Act).

The limited liability audit corporation system is permitted by the CPA Act that was revised in June 2007. This new system requires an audit corporation with limited liability to register with the FSA (Article 34-24).

##### ii) Review of the audit corporations' annual reports and summaries of individual audit engagements

The FSA conducts annual reviews of audit corporations' annual business reports, including financial statements, which these corporations are required to file with the FSA (Article 34-16(2)). The FSA also reviews the summary reports of individual audit engagements, described below, prepared by CPAs and audit corporations. CPAs and audit corporations are required to file with the FSA summary reports of all individual audit engagements required under the FIEA. CPAs and audit corporations are also required to file with the JICPA a copy of the above summaries and other similar summaries for audits required under the Companies Act and other audits. These summaries may serve as a basic measure to evaluate whether adequate engagement hours were

spent, and determine whether key audit procedures were conducted. They are not disclosed to the public.

The summary to be submitted to the FSA must include the following information:

- The qualifications (such as "lead auditor or engagement partner," "CPA," and "audit staff") and names of lead auditor or engagement partner;
- Any changes in the lead engagement partner, audit corporation, or responsible CPA for sole practitioner engagements;
- Total engagement hours spent on the audit work (separately described according to the auditors' qualifications);
- Audit and assurance fee amount and other services fee amount for the year and previous year, respectively;
- Information on quality control; the name or the section of the audit corporation, who/which is responsible for quality control and the names of engagement quality control review partners;
- The following matters particularly considered in the course of audit work:
  - Communication with predecessor auditors;
  - Significant matters particularly considered in audit planning and audit procedures;
  - Reporting to management concerning material weakness in internal control;
  - Response to identified significant fraud and illegal acts;
  - Discussion with management;
- Information as to reliance on other auditors' audit results, if any;
- Additional explanations of an auditor's opinion when an unqualified opinion is not expressed;
- Information on the independent review; and
- Information on explanatory paragraphs, if any.

Furthermore, if the FSA finds it necessary to obtain additional reports from CPAs or audit corporations, it is entitled to collect such reports (Article 49-3).

### iii) Enhancement of the FSA oversight function

The CPA Act enhances FSA authority by introducing the general authority of on-site inspections of audit corporations. FSA on-site inspections were previously conducted for the purpose of taking disciplinary action (Article 49-3).

The amendment of CPA Act in 2003 also introduced the authority of the FSA to effect administrative directions against audit corporations. Although the FSA had not previously been empowered in such a way, it had been authorized only to take such disciplinary actions as business suspension orders and revocation of approvals of establishment (Articles 34-2 and 34-21). Under the amendment of CPA Act in 2007, the FSA has the authority to order for payment of surcharge to audit firms upon an audit failure. The amount may be equal to the audit fee when a partner of an audit corporation is found to have been negligent, or equal to the audit fee plus 50 percent when an audit corporation partner's misconduct is found to be willful (i.e. 1.5 times the audit fee). The surcharges are administrative actions and not a criminal penalty (Article 34-21-2).

The CPA Act, amended in 2003, also grants the FSA the authority to issue business improvement orders against the JICPA, an authority which it did not previously have (Article 46-12-2).

iv) Review of financial statements of certain companies

All Japanese public companies file annual securities reports, including financial statements audited by CPAs, with the FSA (actually with local finance bureaus of the MOF within three months after the close of the fiscal year)(Article 24 of the FIEA). There are 11 regional finance bureaus throughout Japan. The Kanto Local Finance Bureau received and reviewed 3,341 securities reports in fiscal 2007, accounting for approximately 70% of the total 4,807 securities reports received by all local bureaus that year.

(b) CPAAOB

The CPA Act of 2003 stipulates the establishment of a CPAAOB to monitor and oversee CPAs and audit corporations, and the JICPA quality control review. The CPAAOB has ten members who are nominated by the Prime Minister, with Diet consent. At least one chairperson and one member of the Board will serve full-time. The roles of CPAAOB are to review quality control review, carry out a CPA examination, and investigate and deliberate matters such as disciplinary actions for CPAs.

From 2007, the CPAAOB performs the review that ensures whether audit firms comply with the Standards on Quality Control for Audits, which was issued in 2005, and it also reviews whether JICPA's registration system for listed company audit firms functions well. When the CPAAOB deems it so necessary as a result of review, they carry out an on-site inspection at JICPA, audit firms, or audited companies.

## **2. JICPA**

The JICPA has three different oversight systems. First, the quality control review oversees the quality control of members' audit engagements and firm-wide system. Second, JICPA requires all audit firms that audit listed companies to register with the Center of Listed Company Audit Firms. Third, the Audit Practice and Review Committee oversees individual audit engagements.

JICPA introduced a system to register audit firms which audit listed companies in April 2007. The aims of this system are to enhance the quality control of audit firms which audit listed companies—these tend to have wider public influence, and to ensure confidence in audits by CPAs in capital markets.

The system requires all firms which audit listed companies to register with the Center of Listed Company Audit Firms and to publish an outline which includes a description of its audit quality control systems. This allows market participants including investors to understand the level of quality control of audits by the registered audit firms. In addition, when a deficiency is identified in the quality control of a registered audit firm as a result of a quality control review, measures such as recommendations or striking the firm off the register are taken. These measures enhance the effectiveness of the improvements made to the quality control of registered audit firms.

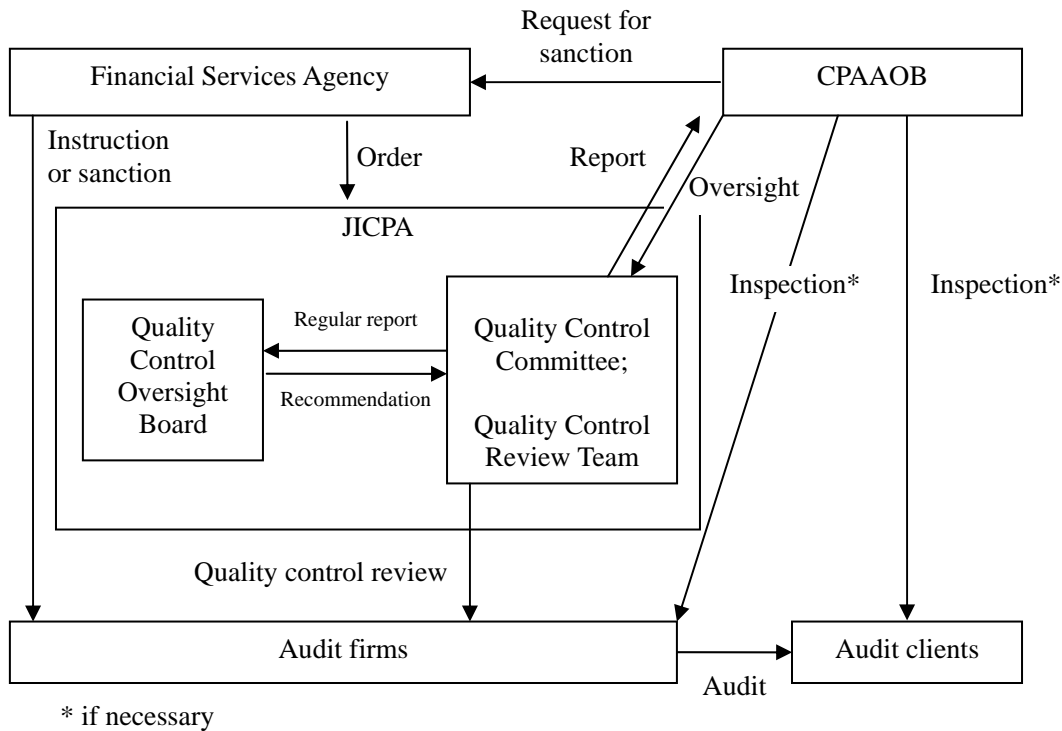
### **(i) Quality control review**

#### **(a) Overview**

Under the CPA Act, as amended in 2003, the JICPA has the legal authority to conduct quality control reviews. Since 1999, quality control reviews have been carried out as a self-regulatory

activity of the JICPA. The amended CPA Act also requires the establishment of a public oversight body, the CPAAOB, to ensure a fair, neutral, and effective auditor oversight system in Japan. One of the most significant roles of the CPAAOB is to monitor the quality control reviews performed by the JICPA.

The following chart illustrates the structure of quality control review and the monitoring by the CPAAOB:



(b) History

During the economic recession of the 1990s, the Japanese accounting and auditing system was under scrutiny, and improvement of the system was considered necessary. Faced with increasing public attention to external auditing, the JICPA introduced a post-audit review system. In March 1997, the JICPA established a project team for quality control. In April 1997, the CPA Investigation and Examination Board, then an advisory body to the Finance Minister, recommended a post-audit review system. Meanwhile, the JICPA Auditing Standards Committee issued Auditing Standards Committee Statement No. 12, "Quality Control of Audits," that requires all audit corporations and CPAs to perform quality control of audit practices. In March 1998, the Quality Control Project Team issued an important statement regarding the implementation of quality control reviews in Japan, proposing that full-time professionals from the JICPA conduct quality control reviews of all audit corporations and CPAs who are engaged in audits of listed companies. All such audit corporations and CPAs shall be reviewed once every three years to assess whether they conduct audit practices in compliance with then Auditing Standards Committee Statement No. 12, which was modeled after ISA 220 and other related requirements. In view of practical considerations, especially related to smaller firms, the JICPA did not employ the firm-to-firm peer review system. At the JICPA General Assembly in July 1998,

members approved a proposal to require quality control reviews. The quality control review teams began conducting their reviews in April 1999.

The CPA Act, as amended in 2003, provides the JICPA with the legal authority to conduct quality control review.

The JICPA quality control review is performed for audits of financial statements only, not management consulting services. Under the amended JICPA Constitution, the scope of quality control review was extended from only listed companies to include certain large companies and other entities which are required by relevant laws and regulations to have their financial statements audited by CPAs. This amendment became effective on April 1, 2004.

#### (c) Review organization and procedures

In order to implement the quality control review system, the JICPA created a Quality Control Committee consisting of predominantly JICPA council members, and other highly experienced members that plan quality control reviews and direct the Quality Control Review Team that executes reviews. The Quality Control Review Team is independent of other JICPA organizations and reports directly to the Quality Control Committee. The team consists of full-time reviewers including one chief executive reviewer, four deputy chief reviewers, 15 senior reviewers and eight staff reviewers as of March 31, 2009. Each reviewer must be independent of the firm under review and is required to have sufficient knowledge and experience of audit practices. Also, the reviewers are required to preserve the confidentiality of information that they may learn during the course of a review.

The reviewers must establish a reasonable basis for expressing a conclusion on whether a firm's system of audit quality controls, both firm-wide and on an individual engagement basis, has been well designed in accordance with the Quality Control Standards, and that such quality control policies and procedures have been adequately implemented. The review does not determine whether an auditor's conclusions were appropriate; rather, it reviews the audit process conducted by auditors.

The review procedures include interviews with professional personnel at various levels and the review of relevant audit working papers. In accordance with JICPA Quality Control Standards Committee Statement No. 1 and Auditing Standards Committee Statement No. 32, which superseded No. 12, and other relevant standards, reviewers are to examine whether audit firms (including both audit corporations and sole practitioners) properly adopt the professional requirements of independence, integrity, confidentiality, and professional behavior. Also, reviewers examine: (a) whether necessary skills and competence are attained and maintained through CPE; (b) a proper assignment policy, such as to whether the partner rotation rule has been implemented; (c) audit engagements are independently reviewed by an independent engagement quality control reviewer; (d) acceptance and retention of clients are properly controlled; and (e) monitoring is adequately provided. The Standards for Quality Control Review and Procedures for Quality Control Review are established and revised in a timely manner to maintain the proper level of quality control review. These Standards and Procedures are distributed to all members of the JICPA to promote their full dissemination. Based on the review, a written report is addressed to the firm's chief executive partner after the deliberations of the Quality Control Committee. If reviewers learn of anything that needs improvement or that the reviewed firm has not conformed

to quality control policies and procedures, the findings and recommendations are to be reported to the firm. The firm must then respond in writing, in due course.

Since the registration system for listed company audit firms has been introduced, the Quality Control Committee has new responsibilities regarding registration of listed company audit firms and consideration of measures against registered audit firms. The details of the registration system are described in "(ii) Registration system for listed company audit firms."

(d) Review results

For the year ended March 31, 2009, 120 audit firms were reviewed. In addition, JICPA executed follow-up reviews to 82 firms.

Overall review results are published every year to ensure the transparency of the quality control review performed by the JICPA.

(e) Quality Control Oversight Board

The entire review system is monitored by the Quality Control Oversight Board, which has been created within the JICPA to monitor the review system's effectiveness and independence.

This Quality Control Oversight Board evaluates whether the Quality Control Committee and Review Team adequately perform quality control reviews. The Board is made up of five distinguished individuals from industry, the financial sector, the stock exchange, the media, and academia, and three members of the JICPA.

As the registration system for listed company audit firms has been introduced, the Quality Control Oversight Board has new responsibility to determine the registration of listed company audit firms and measures against registered audit firms.

The Quality Control Oversight Board reviewed the entire process of quality control review for the year ended March 31, 2007 and recommended, in June 2007, following items:

- i) Design and implementation of quality control systems;
- ii) New risk-based approach;
- iii) Consideration of significant matters in forming audit opinions;
- iv) Follow-up reviews related to the registration system of listed company audit firms;
- v) Thorough notification to those audit firms newly subject to a quality control review of the fundamental issues regarding quality control; and
- vi) Assistance to small and medium-sized audit firms in establishing systems of quality control.

The Quality Control Committee and other relevant committees of the JICPA have taken actions, such as making these recommendations, the items of focus in quality control reviews conducted during the year ended March 31, 2008.

**(ii) Registration system for listed company audit firms**

(a) Objectives and background of the implementation of the registration system

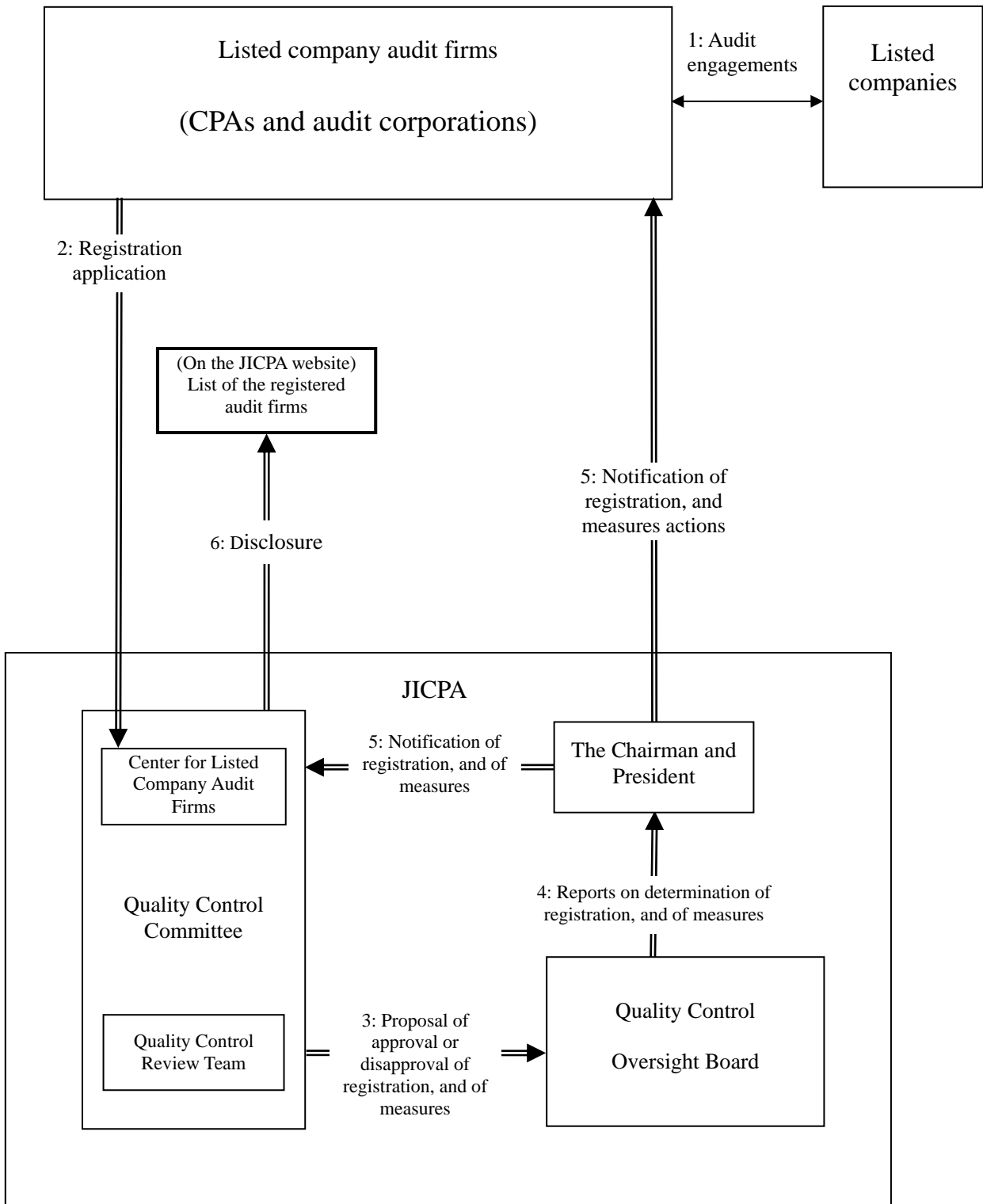
As described above, the JICPA has conducted the quality control review as part of a self-regulatory function since April 1999 to improve and enhance the quality control system of

audit firms that perform financial statement audits. The amendment in 2003 of the CPA Act, which took effect in April 2004, made this quality control review a legally-established system to be monitored by the CPAAOB.

Although the JICPA took various actions as a self-regulatory body including enhancement of the quality control review structure of the JICPA, corporate scandals involving listed companies relating to financial reporting have emerged successively since 2004. The scandals took place under circumstances where the Japanese Government has made efforts to achieve a financial policy, "from savings to investment," in the post-bubble period and is a sign that ensuring confidence in capital markets is becoming more important than ever. The reliability of the CPA auditing system was undermined by the scandals and public confidence in CPA audits was eroded. Acknowledging the criticism seriously, the JICPA decided to take new actions to further strengthen its quality control review system in order to restore confidence in CPAs' audits

The JICPA released, on April 6, 2006, the Chairman and President's Statement announcing the foundation of the Center for Listed Company Audit Firms ("the Center") and introduced the registration system for audit firms that engage in audits of listed companies ("the registration system"), as a visible concrete measure, on the basis of a belief that audit quality control should be enhanced not with excessive reliance on the CPAAOB, but through self-regulatory functions.

The registration system of audit firms that engage in audits of listed companies



(b) Fundamental framework of registration system implementation

The registration system has been established under the following fundamental frameworks as part of JICPA's measures to enhance the quality control system of audit firms which perform audits of listed companies, by being incorporated into the quality control review system currently conducted by the JICPA.

i) Enhancement of the self-regulatory function (maintenance of indirect regulation)

Ensuring the confidence in audits by CPAs should be accomplished through self-regulation by the JICPA, a professional accountancy body. The role of the government is to monitor the effectiveness of the self-regulation and to provide supplementary oversight as an indirect regulation according to need.

ii) Mandatory registration

From the viewpoint of enhancement of the quality control system of firms auditing listed companies which have substantial impact on capital markets, the revised JICPA Constitution places an obligation on audit firms subject to the quality control system to be registered with the Center created under the Quality Control Committee.

iii) Public accountability

The JICPA demonstrates its commitment to reinforce self-regulatory functions towards the restoration and improvement of confidence in audits by CPAs with an announcement of the implementation of this registration system as a visible concrete measure. Audit firms can also fulfill their public accountability by publishing this information in the overview of their policies and procedures of the quality control system regarding activities for strengthening their quality control.

iv) Measures by public disclosure

In the event that significant non-compliance in terms of quality control is identified during the quality control review, measures such as the publication of a summary of the quality control review report or revocation of the registration are imposed on the firms responsible for the non-compliance. These measures are expected to boost members' awareness of their social mission as CPAs.

v) Cooperation with stock exchanges

In order to accomplish the effective function, and to raise public recognition of the registration system, it is critical to ensure that firms with significant identified non-compliance in terms of quality control are virtually unable to provide audit services for listed companies. The JICPA collaborates with market participants such as stock exchanges to ensure effective and proper operation of the registration system.

vi) Ensuring fairness and transparency in administration of the registration system

The registration system allows for identification of registered firms whose quality reaches a certain standard, but does not provide assurance for the appropriateness of individual audit engagements. The fairness and transparency of the registration system are to be ensured through the publication of the report of its operation as well as a clear explanation of its objectives to the public so that it may not mislead the public and that it is acknowledged and properly valued.

(c) Outline of the registration system

The following outlines the registration system:

i) The JICPA created the Center for Listed Company Audit Firms ("the Center") under the Quality Control Committee to administer the overall registration system.

ii) The revised Constitution requires audit firms which audit listed companies (hereinafter

referred to as "registered audit firms") to register with the Center.

In order to avoid excluding non-registered audit firms from initiating audit services to listed companies, a category of "associate registered audit firms" was established.

iii) Applicant audit firms submit the following documents and declaration to the Center:

- Application form;
- Accompanying documents describing the overview of the audit firm (fundamental information on the firm is to be publicly available);
- Overview of policies and procedures of the quality control system of the audit firm (to be put on the publicly-accessible register); and
- A declaration describing the firm's agreement of:
  - Adherence to the policies and procedures of the quality control system;
  - Compliance with requirements imposed on registered audit firms, including faithful responses to recommendations made as a result of the quality control review;
  - Acceptance of any measures imposed on the audit firm for failure to adhere to the requirements; and
  - Acknowledgement that information and the declaration of the registered audit firm will be put on the publicly-accessible register.

iv) The Quality Control Committee proposes to the Quality Control Oversight Board whether to approve an application or not after consideration of the application based on past results of quality control reviews. The majority of members of the Quality Control Oversight Board consist of knowledgeable persons outside the profession. The Quality Control Oversight Board deliberates the proposal and makes the determination. The screening application criteria are:

- Upon the inception of this system, audit firms that audit listed companies are registered after the screening of the application documents. However, those audit firms are subject to urgent reviews of improvement in matters identified in past quality control reviews and compliance with the Standards on Quality Control for Audits, applicable for periods ended on March 31, 2007.
- Once the operation of this system starts, the quality control review should be conducted for applicant audit firms and then the conclusion is then reached based on certain screening criteria.

v) The Constitution was revised so that the JICPA can take the following measures when non-compliance of a registered audit firm is identified during the course of a quality control review:

- Admonish the firm and require additional CPE credits (to be nonpublic);
- Publish a summary of the qualified items identified during the quality control review (to be put on the publicly-accessible register); and/or
- Revocation of registration and publishing the facts (to be put on the publicly-accessible register).

The latter two measures are imposed when significant non-compliance is identified. Such significant non-compliance includes a qualified conclusion with a significant qualified item or an adverse conclusion, or refusal of or non-cooperation with a quality control review.

vi) Measures including a revocation imposed on a registered audit firm are proposed by the Quality Control Committee, and the Quality Control Oversight Board then deliberates the proposal and makes the determination.

The decision of the Quality Control Oversight Board is notified to the audit firm in writing by the Chairman and President. However, the determination of revocation is delivered directly to the

audit firm.

vii) Names of unregistered audit firms and reasons for which those firms are not registered with the Center will be published. Reasons may include:

- The audit firm has not yet applied for the registration;
- The audit firm did apply, but the application was not approved; or
- The registration of the audit firm was revoked.

viii) The JICPA seeks cooperation with market participants such as stock exchanges in order to ensure the appropriate operation of this system. Doing so ensure that an audit firm which has serious non-compliance in terms of quality control is unable to provide audit services to a listed company.

(d) The role of organizations that administer the registration system

The registration system is intended to encourage the improvement and enhancement of the quality control system of registered audit firms through measures such as the publication of the summary of qualified items identified during the quality control review and revocations imposed on registered audit firms with non-compliance identified in the quality control review. The registration system is operated by the organization that conducts the quality control review for the JICPA.

i) The Center for Listed Company Audit Firms

The Center for Listed Company Audit Firms ("the Center") has been created under the Quality Control Committee. Registered audit firms belong to this Center. The Center has the following duties and responsibilities that are executed by the Secretariat under the supervision of the Quality Control Committee:

Acceptance of application;

- Preparation and maintenance of the register (including acceptance of request to view the register);
- Acceptance and custody of submitted documents including overviews of quality control systems and declarations;
- Acceptance of regular reports and changes to information from registered audit firms;
- Controls and maintenance of registration computer system; and
- Other matters relating to the register.

ii) Quality Control Committee

The Quality Control Committee examines registration applications and considers necessary measures against a registered audit firm that demonstrate non-compliance based on past quality control reviews. The Quality Control Committee then submits a proposal of approval or disapproval to the Quality Control Oversight Board.

iii) Quality Control Oversight Board

The Quality Control Oversight Board deliberates on the approval or disapproval of registration or of measures submitted by the Quality Control Committee and makes the appropriate determination.

Members of the Quality Control Oversight Board formerly consisted of knowledgeable persons outside the profession (except for one member who was a CPA) as the Board's responsibility is to monitor the quality control review conducted by the Quality Control Committee. Taking into consideration the additional responsibilities described above, the composition of members of the Board was re-examined in view of the emphasis on expertise. The number of members was also increased to eight: five knowledgeable persons outside the profession and three CPAs.

iv) Reporting to the CPAAOB

With respect to the operation of the registration system, the Quality Control Committee submits regular reports to the CPAAOB as part of the quality control review. Through independent monitoring by the CPAAOB, the JICPA believes that the objectives of the registration system will be achieved more effectively and appropriately.

As a result of the first year implementation of the registration system of listed company audit firms, the Quality Control Committee proposed measures against registered audit firms. The Quality Control Oversight Board deliberated upon the proposal and then JICPA announced the result of the deliberations. Those measures included an audit corporation to be revoked from the registration, 10 audit firms whose overview of qualified items to be disclosed to the public, and 82 audit firms to be admonished. As a result of the second year, as for five audit firms of 10 audit firms to which the above measures was taken, such disclosure was discontinued, because the Board had confirmed that the audit firms improved those items. Measures were taken five audit firms whose overviews of qualified items to be disclosed to the public, and 35 audit firms to be admonished.

**(iii) Individual engagement reviews and disciplinary actions**

(a) The Audit Practice and Review Committee

The purpose of the Audit Practice and Review Committee, established in 1978, is to support JICPA members in properly performing and developing their auditing work. Consisting of 15 members (including Deputy Presidents, Executive Board Members, and Council Members), the Review Committee examines how the CPAs or audit corporations perform their auditing work and whether their audit opinions are well substantiated. The Review Committee examines news articles for possible indications of window dressing in financial statements, fraudulent accounting, large reported losses, and bankruptcies; it also considers whistle-blowing information given to JICPA as necessary. JICPA has been formally collecting complaints about audits from members and the public since November 2005. The Review Committee makes inquiries of CPAs and audit corporations as to matters that come to its attention, and, if deemed necessary, carries out examinations.

Information collected through various measures is first reviewed by the Audit Practice and Review Committee. The duties of the Audit Practice and Review Committee are:

- to investigate the performance of audit engagements and appropriateness of auditors' opinions, and provide the Chairman and President with the committee's opinion on recommendations or instructions to be issued to the members concerned as appropriate;
- to investigate the performance of audit engagements and appropriateness of auditors' opinions, and make recommendations to the Chairman and President whether the Special Investigative Committee on Audit Issues should be formed or not;
- to investigate cases relating to ethical matters and provide the Chairman and President with the committee's opinion on recommendations or instructions to be issued to the members concerned;
- to determine if further examination of the case by the Disciplinary Committee is necessary and request the Chairman and President to further examine the case concerned where appropriate;

- to report to the Chairman and President on any significant matters in terms of the quality control system of an audit firm identified during investigations.

The Review Committee provides CPAs with guidance for strengthening their auditing work and investigates potential lapses but does not take disciplinary action against them.

#### (b) Disciplinary Committee

When the Chairman and President requests the Disciplinary Committee to further investigate cases based on the determination of the Audit Practice and Review Committee, the Disciplinary Committee starts its own investigation as to whether there is any violation of laws and regulations, or breaches of the JICPA Constitution and Regulations, and determines sanctions to be imposed. The Disciplinary Committee consists of seven members: five CPAs and two members outside of the profession. The Disciplinary Committee was reorganized in October 2005 in order to strengthen independence and improve transparency and objectivity. The investigation and discipline structure is independent of the Chairman and President, Deputy Presidents, the Executive Board and the Council. The Disciplinary Committee organizes investigative task forces on each case to investigate complaints and administers disciplinary actions separately from the task forces. The task forces consist entirely of JICPA members. CPAs are subject to inquiry and are required to report and submit necessary materials to the Disciplinary Committee (Article 55 of JICPA Constitution; Article 17 of Operating bylaw of Disciplinary Committee). Disciplinary sanctions are as follows: a) a reprimand, b) a suspension of member rights for a certain period, and c) a request to the FSA to revoke the CPA's qualification or to order the dissolution of the audit corporation and other sanctions stated in the CPA Act.

#### (c) Appeals Committee

When a member is not satisfied with the decision of the Disciplinary Committee, they are entitled to appeal to the Appeals Committee. The Appeals Committee consists of five members: three CPAs and two members outside of the profession. None of them are members of the Disciplinary Committee and are expected to make an impartial decision.

#### (d) Audit Practice Monitoring Board

The Audit Practice Monitoring Board was established as a permanent body in 2001 in order to ensure the objectivity and transparency of JICPA's monitoring activities concerning audit practices. The Board consists of a member appointed by the JICPA Chairman and President, and five distinguished individuals from the outside of the profession such as industry, the stock exchange and academia. The duties of the Board are:

- to review the activities of the JICPA Audit Practice and Review Committee, the Special Investigative Committee on Auditing Issue, the Disciplinary Committee and the Appeals Committee;
- to make recommendations to the above committees based on the reviews; and
- to make recommendations to the Chairman and President as to whether JICPA should publish the outlines of cases investigated by the above committees or not.

The meeting is held at quarterly intervals. The Board makes recommendations to improve the monitoring function of the JICPA as necessary.

## Chapter V History and Background: Development of Independent Auditing

### 1. Introduction of Independent Audits

The first group of professional accountants in Japan is said to have emerged around 1907, but it was not until 1927, when the Accountants Law was enacted, that a fledgling institute of professional accountants came into existence. However, the formal establishment of the audit profession had to wait until the enactment of the CPA Act in July 1948, following the enactment of the Securities and Exchange Law of that year. The first qualification examination under the CPA Act took place the following year.

The CPA Act was designed primarily to establish professional standards comparable to those in the U.S., and to establish a publicly recognized status for CPAs. Many such measures were introduced under the supervision of the GHQ during the period of occupation by U.S. Forces after World War II. These measures were in response to the growing post-war demand for the democratization of business, better disclosure of corporate information following the dissolution of the *zaibatsu* (large conglomerates), and the introduction of foreign capital. The JICPA started in 1949 as a voluntary association. In 1953, it was incorporated as an association (*shadan hojin*) under the Civil Code.

The services provided by CPAs have expanded greatly since July 1951, in conjunction with the requirements of the amended SEL. Among other things, Article 193-2 of the SEL provided that "balance sheets, income statements, and other schedules relating to financial statements, which are filed in accordance with the provisions of this law, shall be examined by an independent CPA who has no special interest or connection therewith." It was under this Article that the examination of corporate financial statements by CPAs began. Until then, the relevant regulations and rules, which were the basis of audits by CPAs, were introduced under the direction of the MOF. These regulations and rules included the Auditing Standards, the Regulations on Auditors Certifying Financial Statements, the Accounting Standards, and the Regulations Concerning the Terminology, Forms, and Method of Preparation of Financial Statements.

Even though audits by CPAs began in 1951, it was not until 1957 that full-scope audits were introduced. It took time for audited companies to fully understand the requirements of the independent audit, and CPAs were not yet sufficient in number to perform full-scope audits. When audits were first conducted under the amended SEL, the number of companies subject to audits was some 450, and the number of CPAs was less than 400. The scope of audits expanded step by step, as follows:

Preliminary audits (1951-1956): Special emphasis was placed on reporting on the appropriateness of accounting procedures and internal controls.

- |             |   |
|-------------|---|
| 1951        | First-time audit for companies that were subject to audit:<br>Reporting on the design and operating effectiveness of internal controls. |
| 1952 (Jan.) | Second-time audit for companies that were to be audited for the second time:<br>Reporting on compliance with accounting procedures.     |
| 1952 (Jul.) | Third-time audit for companies that were to be audited for the third time:  |

- Reporting on the appropriateness of internal controls.
- 1953 (Jan.) Fourth-time audit:
- The examination of five important balance sheet items was introduced for companies that had been audited before;
  - Limited-scope audit (reporting on the appropriateness of accounting procedures and internal controls) for companies that were subject to audit for the first time.
- 1955 (Jan.) Fifth-time audit
- Some balance sheet items were added to be subject to audit for companies that had been audited before;
  - Limited-scope audit (reporting on the appropriateness of accounting procedures and internal controls) for companies that were subject to audit for the first time.
- 1957 (Jan.) Full-scope audits for all companies subject to audit, reporting on the fairness of presentation of financial statements.

## 2. Major Reform of the CPA Act

In 1965, after the introduction of auditing by independent CPAs, the profession faced its first ordeal. The business community was shocked by the accounting fraud and bankruptcy of Sanyo Tokusyu-ko, which is often compared with the famous 1940 McKesson and Robbins case in the U.S. In response, the MOF tightened supervision of the business community, initiating legislative revisions and intensive administrative guidance. Its staff compiled a blacklist of some 100 listed companies and performed focused inspections of registration statements and annual securities reports. It soon became apparent that accounting window-dressing was taking place in one out of two companies. Independent auditors were questioned and, in a number of cases, these auditors were reprimanded or suspended. The SEL was amended in 1971 in order to expand audit requirements, as well as to clarify auditors' responsibility in the event of bankruptcy accompanied by accounting fraud. Under the amended SEL, an independent auditor could be sued for malpractice.

The focused inspection, which was performed after the fact, did not solve the fundamental issues of insufficient independent auditing. Several steps were taken to correct fraudulent accounting and to improve auditing practices. By the end of the 1960s, it was a requirement that any auditor's disclaimer or adverse opinion be disclosed to the public. In most cases, the mere threat of public disclosure was sufficient to convince management to heed the auditor's recommendations. Also, the Auditing Standards and related rules were amended to tighten audit procedures. Observation of physical counts of inventory, confirmation of receivables with customers, and audit of subsidiaries all became mandatory. Further administrative guidance came with an amendment of the CPA Act, designed (i) to strengthen the self-regulatory function of JICPA as a special organization, and (ii) to establish a system for audit corporations, in order to promote uniform and systematic auditing among CPAs.

## 3. Reorganization of JICPA

Under the amended CPA Act in 1966, the JICPA underwent a drastic change. In order to strengthen its self-regulatory function, its legal form was changed from incorporated association to special judicial entity (*tokushu hojin*), and all CPAs were required to become members. Membership had formerly been voluntary, so that the JICPA had not been able to oversee all audit practices performed

by CPAs, resulting at times in uneven or low-quality practice. The JICPA was now patterned after the American Institute of Certified Public Accountants (AICPA), with the difference that it was to be closely supervised and guided by the MOF.

#### **4. Introduction of Audit Corporations**

Another principal feature of the 1966 amendment was that CPAs were permitted to set up audit corporations (*kansa hojin*). In order to promote the systematic and standardized audit of financial statements, the CPA Act encouraged and facilitated the organization of individual CPAs into corporations. An audit corporation is similar to a partnership in Western countries in that all partners have to bear liabilities of the firm jointly and severally.

The main requirements for an audit corporation were established as follows:

- (a) Membership was limited to CPAs;
- (b) There must have been at least five members;
- (c) All members must have had the right and duty to participate in the practice;
- (d) No member was to be under suspension from practice or have contravened provisions of the law;
- (e) The corporation must have had an organization, personnel, and facilities sufficient to ensure adequate conduct of the practice.

Before systematic audits by audit corporations were introduced, audits were performed mainly by sole practitioners. It was difficult for a sole practitioner to marshal the resources and expertise to audit large companies. Also, most sole practitioners depended on a relatively small number of clients for their livelihood, which could impair independence. Another problem was excessive continuity by a single auditor on a given client.

The first audit corporation was founded in 1967. A few more soon followed. However, they were still not large enough to perform systematic audits on large clients as contemplated under the CPA Act, so the MOF revised the regulations in order to promote consolidation among small corporations and/or sole practitioners. It took several years for the development of audit corporations of considerable size.

The major advantages of an audit corporation were: (i) a larger business base would justify the establishment of larger professional firms with the requisite organization and competence, and (ii) the audit corporations would assist CPAs in better maintaining their independence and integrity as professionals and improve the public credibility of the profession. The amendment paved the way for Japanese CPAs to render services to international business on an equal footing with CPAs from other countries.

#### **5. Development of Audit Corporations**

As Japanese corporate activities expanded globally, so did their methods of financing, including the sale of equity and debt securities overseas. In order to obtain global financing, it was necessary that the company's financial statements be prepared in accordance with Japanese or U.S. GAAP, and be examined in accordance with credible auditing standards.

In 1961, Sony offered, for the first time, a new stock issue for sale in the U.S. and had to hire an

American accounting firm to certify its financial statements for filing with the U.S. Securities and Exchange Commission (SEC). Sony's example was soon followed by a number of other Japanese companies offering stocks and bonds in the U.S. and European countries. Suddenly, the clientele of foreign auditing firms broadened to include Japanese companies. Until then, major foreign firms had operated branch offices in Japan to serve only subsidiaries of foreign multinational companies. After 1973, however, when the first foreign company was listed on the Tokyo Stock Exchange, a number of foreign companies followed and engaged Japanese CPAs to examine their financial statements. The need for international audit capabilities became imminent.

Japanese audit corporations became aware of the need to enter into associations or affiliation agreements with foreign accounting firms. Major foreign accounting firms (mainly the Big Eight at the time) expanded business in Japan, and started to cooperate with Japanese audit corporations. The first formal affiliation took place in 1975. Thus the audit corporation, introduced by the amendment to the CPA Act, helped facilitate global cooperation and affiliation among auditors, resulting in improvements in Japanese auditing practices.

## **6. Introduction of Audits under the Commercial Code**

Discussions on expanding audit requirements started long before the series of accounting fraud bankruptcies that occurred in the 1960s. Before the introduction of audits under the Commercial Code in 1974, statutory audits were required only under the SEL. Audits under the SEL had serious flaws. For example, auditors often had to audit the financial statements only after the shareholders had approved them. Under this process, it was theoretically impossible to reflect in the financial statements necessary adjustments that were identified during the course of the audit. If the audit had been performed prior to the shareholders meeting, such adjustments could have been duly reflected and the effectiveness of the audit would have improved significantly. The Ministry with responsibility for the Commercial Code (the Ministry of Justice) and the MOF both recognized the importance of expanding the requirements for independent audits under the Commercial Code. However, under the Commercial Code, companies were subject to audits by company auditors (*kansa-yaku*), which might overlap with the audits by independent auditors. It was mainly this overlap problem that delayed the introduction of independent audits under the Commercial Code.

During the course of the discussions in the 1970s, there was another series of accounting fraud bankruptcies, including the FujiSash and the Nihon Netsugaku failures. It was necessary to regain public trust in audits. The MOF again conducted a focused inspection to confirm whether adequate audit procedures were being performed, and facilitated systematic audits by audit corporations. The JICPA conducted research on auditing practices, and set up the Audit Practice and Review Committee to encourage systematic audits and to strengthen and standardize audit procedures. In 1979, the JICPA also started to develop Audit Manuals that stipulated standard audit procedures as reference for CPAs.

In 1974, after a number of years of discussion and consultation, the Commercial Code was amended to require companies with a capital stock of ¥1,000 million or more to be subject to independent audit by accounting auditors, a newly established function. In 1981, in order to expand audit requirements, further amendments to the Commercial Code were effected. The criteria for the requirement for an audit were expanded to include companies with a capital stock of ¥500 million or more or with total liabilities of ¥20 billion or more. Furthermore, other expansions of the types of

companies required to undergo audit under other laws and regulations were undertaken.

## **7. Problems Emerging after the Bubble Economy Crash**

From the early postwar period, banks played a major role in funding the growth of industry, and operated in an environment protected by bureaucratic regulations that permitted them to enjoy record growth and large margins. In turn, they were closely monitored and subject to administrative guidance by the MOF.

Up until the middle of the 1970s, there was keen demand from industry for funds for growth. However, after the period of rapid economic growth ended, companies started accumulating surplus funds and seeking financial investment opportunities. Since banks had mostly accomplished their original objectives to fuel economic growth, they had to find new borrowers to expand their business; and they lent money for client investments. The trend to new types of lending was also spurred on by deregulation in financial markets and innovation in financial instruments. Many industrial companies invested their surplus funds, including funds borrowed from banks, into Money Trust Funds comprised mostly of marketable securities. They believed that the boom in the stock market would last forever. Industrial companies enjoyed unrecognized stock price appreciation on their investments, as did the financial institutions with equity stakes in companies.

Investments in real estate also increased. Throughout the period of the bubble economy, most Japanese financial institutions made loans indiscriminately, as long as the debtor provided real estate as collateral, in the widespread belief that in the long run, real estate collateral would appreciate and the loans be recoverable. These assumptions held until the bubble burst in 1990.

After the bubble economy crash, the sharp drop in land and stock prices created enormous problems, both to those who had invested directly and to those who had financed the investments. Unrealized losses mounted to alarming levels. Several scandals emerged involving financial institutions. Many securities companies, for example, were discovered to have compensated favored customers for trading losses. In the 1990s, real estate companies and construction companies went bankrupt because of the country's tight monetary policy. Bad debts became a major issue for financial institutions. Several financial institutions, including banks and housing loan companies whose audits had been conducted mainly by audit corporations, collapsed within less than a year after being given an unqualified opinion. The public questioned the standards of disclosure of banks and especially the adequacy of provisions for non-performing loans. Public criticism of audits for not providing advance warning of such failures also intensified. At that time, auditors' reports did not include an emphasis paragraph as to "the ability to continue as a going concern" when a company's ability to survive was in doubt.

In the late 1990s, the MOF changed its approach to the supervision of banks from one that depended on "administrative guidance" that was somewhat ambiguous and left room for manipulation to a more transparent approach based on written rules and regulations. Under the new approach, banks are to perform their own self assessment of loans and loss allowances (which had been set by to direct supervision), and these self assessments are to be subject to expanded audit procedures by the independent auditors. Credit unions and credit associations were to be audited and subject to the same discipline for loss allowances.

After the bubble burst, several important amendments to disclosure rules were also effected to improve the quality of disclosure in the depressed economic conditions. Information on the market value of marketable securities was to be disclosed.

However, the MOF continued to have considerable influence over banking accounting, and it exercised that influence. In order to assist banks to satisfy the requirements set by the Bank for International Settlements (BIS), the MOF manipulated certain accounting rules. Formerly, banks had been required to recognize marketable securities on the balance sheet at the lower of cost or market value, but in the prevailing environment of extensive and significant unrealized losses, the MOF allowed banks to recognize these securities at cost, so the banks did not have to recognize the losses in their financial statements. The MOF also allowed banks to write real property up when the market value was above cost, so as to recognize an accounting gain. These treatments were contrary to global accounting standards, which emphasize recognizing marketable securities at their market values, but the MOF insisted that these treatments were intended to protect the general public by protecting the banking system. Internationally, questions about the integrity of Japanese accounting became intensified. It was felt that these questionable accounting procedures would delay the resolution of the non-performing loan problem. Under the close supervision of the MOF, the JICPA was in a difficult position.

Even so, to restore and enhance public trust in the audit, the JICPA took the following steps:

- Established the Special Audit Committee on Financial Institutions in 1996 to discuss matters concerning audit procedures specific to banks;
- Started research on "going concern" disclosures and issued a report in 1997;
- Reorganized institutions supervising audit practice and set up the Task Force on Emerging Issues, in order to respond to fundamental issues as they emerge, in 1997;
- Established the Task Force to discuss issues in the construction industry in 1998.

The JICPA also responded to recommendations proposed by the CPA Investigation and Examination Board, and implemented the following measures:

- The CPE Program was introduced in 1998;
- The quality control review was introduced in 1998;
- The Code of Ethics was amended to further enhance professional ethics in 2000.

The process of setting accounting and auditing standards, previously driven by the MOF, is gradually changing. Even though the basic standards are to be set by the BAC, an advisory body to the MOF, the role of the JICPA in setting standards has become more important because of continued international pressure and forces encouraging deregulation in Japan. The JICPA is now authorized to decide on the details of auditing standards. In 1992, the JICPA established the Auditing Standards Committee. Since then, the Committee has issued Standards to guide audit practice. The Financial Accounting Standards Foundation (FASF) was established in 2001, and the Accounting Standards Board of Japan (ASBJ) was organized under the auspices of the FASF as an independent and private-sector entity to develop accounting standards in Japan.

## **8. Amendment of the CPA Act in 2003**

The amendment of the CPA Act, the biggest change since the 1970s, was discussed for several years after the crash of the bubble economy in the early 1990s and was strongly influenced by the U.S.

Sarbanes-Oxley Act of 2002.

The following features are included in the amendment:

**(i) Auditor independence rules**

**(a) Non-audit services**

The prior CPA Act allowed CPAs to provide their audit clients such services as preparation of financial statements, researching or planning financial matters, and providing consultation on financial matters to the extent that it did not impede the performance of the audit.

The amended CPA Act, put into effect in April 2004, prohibits an audit corporation from providing certain non-audit services to any audit client, in addition to tax services which had been prohibited by the prior Act.

Non-audit services prohibited in the amendment include the following:

- Services related to book keeping, financial documents, and accounting books;
- Design of financial or accounting information systems;
- Services related to appraisal of contribution-in-kind reports;
- Actuarial services;
- Internal audit outsourcing services;
- Securities brokerage services;
- Investment advisory services; and
- Other services that are equivalent to the above listed services and that involve management decisions or lead to the self-audit.

Among the above non-audit services, securities brokerage services and investment advisory services were eliminated by the amendment of the CPA Act in 2007.

It is prohibited to provide these non-audit services to any clients that are required to be audited in accordance with the SEL and certain large companies that are audited in accordance with the Commercial Code.

**(b) Audit partner rotation**

Prior to the amendment, engagement partner rotation was required under the JICPA's Auditing Standards Committee Statement as a seven-years term with a two-years cooling-off period. Under the amended CPA Act, all engagement partners are legally required to rotate after serving for no more than seven years with cooling-off periods that are prescribed in a cabinet order (two years). The amended partner rotation rules apply to statutory audit engagements that are required under the SEL and the Commercial Code for certain large companies. In this respect, the audit engagements to which the partner rotation rule is applied are the same as those for which the rules as to the prohibition of certain non-audit services apply.

**(c) Cooling off**

The prior CPA Act had no prohibitions as to audit clients hiring a retired partner of the audit corporation.

Under the amended CPA Act, an engagement partner who performs audit services to a client is

prohibited from joining the management of the audit client as a director or other important position until at least one year after the end of the accounting period during which the partner was involved in auditing this client.

**(ii) Strengthening auditor oversight**

Prior to the amendment, the FSA oversaw auditors and the JICPA to protect the public interest. The FSA's CPA Investigation and Examination Board oversaw the CPA examination and disciplinary actions against CPAs.

The amended CPA Act directed that the CPAAOB be established within the FSA by reorganization of the former CPA Investigation and Examination Board in order to enhance the monitoring and oversight of CPAs and the JICPA quality control review. The CPAAOB consists of ten members who are nominated by the Prime Minister with consent by the Diet. At the minimum, the chairperson and one member of the board serve full-time.

The amendment also mandated the performance of quality control reviews and grants the legal authority for the JICPA to conduct quality control reviews.

**(iii) Reform of CPA examination**

The amended CPA Act contains reforms of the CPA examination system that became effective as of January 2006. The new CPA examination was simplified to a single-step examination from the former three-step examination.

In order to obtain their certification as CPAs, all candidates who have passed the CPA examination are also required to have two years practical experience, which can be taken either before or after sitting for the examination, three year professional accountancy education program, and a final assessment provided by the JICPA.

**(iv) Introduction of limited liabilities of partners**

Prior to the amendment, every partner of an audit corporation was jointly and severally liable for liabilities without limitation. Under the amended CPA Act, a new category of "designated partner" was created to alleviate the legal burdens of partners who are not designated as engagement partners. Only the partners who perform audits (the "designated partners") are jointly and severally liable for misconduct and negligence, and other partners who are not involved in the audits in question are liable, at a maximum, to the extent of their interest in the audit corporation with regard to the liabilities claimed by audit clients.

This designated partner system is different from a limited liability partnership. Non-engagement partners are still liable for third-party claims. In this respect, non-engagement partners are jointly and severally liable, without limitation, for third party claims together with the engagement partner(s).

## **9. JICPA Commitment to Restore Public Confidence in CPA Audits**

Corporate scandals relating to financial reporting involving listed companies have come out one after another since 2004; these scandals have undermined public confidence in the disclosure system in Japan. The growing public distrust in CPA audits hit a peak when the Kanebo scandal was

revealed in 2005. Kanebo had a long history as a household goods and cosmetics conglomerate and was delisted from the Tokyo Stock Exchange after admitting to accountancy fraud over a four-year period. In association with this accountancy fraud, four CPAs were arrested for allegedly aiding and abetting Kanebo executives in the falsification of financial reports.

Before the Kanebo scandal was disclosed to the public, the JICPA has already taken several steps to enhance auditing practices. Some of these measures included:

- (a) An increase in full time quality control reviewers from 10 to 20 to reinforce the effectiveness of JICPA quality control reviews to maintain and improve the quality of auditing practices at individual audit firms. An information technology expert was also hired to assist in these reviews;
- (b) Creation of the Disciplinary Committee and the Appeals Committee and improved transparency in disciplinary processes by making these committees independent from the Executive Board and assigning members from outside the accountancy profession; and
- (c) Establishment of audit hotlines to collect information on audits from CPAs and relevant people in companies.

Subsequent to the indictment of Kanebo's former auditors, the Chairman and President of the JICPA released a statement on October 25, 2005, entitled "Toward the restoration of confidence in audits by CPAs." In this statement, the JICPA indicated it was determined to take the following actions in response to the public scrutiny towards CPAs:

- (a) Request for the immediate implementation of audit partner rotation by the Big 4 audit corporations and revision of the rotation rule of lead audit partners in certain large audit corporations as a five-year engagement with a five-year cooling-off period;
- (b) Make mandatory requirements in the taking of certain subjects such as the Code of Ethics and audit quality control out of the total CPE credits (40 hours annually);
- (c) Conduct urgent quality control reviews for the Big 4 and provide full cooperation to the monitoring of the CPAAOB; and
- (d) Address issues related to the Quality Control Standards of audit firms issued by the BAC.

The Chairman and President urged all members who perform audits to realize what the public expects of CPAs and to perform their audits fairly and strictly as independent auditors.

Further to these measures, the JICPA also announced its plan to set up a registration system of listed company audit firms and the establishment of a comprehensive Code of Ethics on April 6, 2006.

One month after the above announcement, the FSA announced that it had decided to take administrative action against the audit corporation to which Kanebo's former auditors belonged. The audit corporation was to suspend part of its business for two months between July and August 2006, and ordered the revocation of certification, or one-year suspension, of CPAs who were partners in connection with the alleged misconduct connected with Kanebo.

The Chairman and President reaffirmed the statement on April 6, 2006 by stating that the JICPA would make every effort to strengthen self-regulatory function through various measures including a registration system of listed company audit firms and establishment and enhancement of a comprehensive Code of Ethics.

At a special assembly on December 11, 2006, the JICPA approved the amended JICPA Code of Ethics and resolved to introduce the registration system of listed company audit firms. As described in Chapter IV, the registration system of listed company audit firms has been in place since April 2007. JICPA set the deadline as July 15 of application for the registration of audit firms that audit listed companies as of April 1, 2007. After deliberations by the Quality Control Committee and the JICPA Quality Control Oversight Board, 196 firms were allowed to register at the time of the deadline. No non-registered audit firms were identified. The final register has been released for public viewing.

## **10. Amendment of the CPA Act in 2007**

Following these accounting and auditing scandals, the subcommittee on CPAs in the Financial System Council under the FSA began deliberations on a wide variety of issues including reinforcement of audit corporations' governance and further enhancement of auditor's independence. Based on the subcommittee conclusion, a further amendment of the CPA Act was proposed to the National Diet and enacted on June 20, 2007.

The revision of the Act includes measures (a) to enhance the quality control, governance, and disclosure of audit corporations, (b) to reinforce the independence of auditors, and (c) to strengthen oversight of auditors and revise auditor's liability. Major amendments are as follows:

### **(i) Enhancing the quality control, governance, and disclosure of audit corporations**

#### **(a) Establishment of an appropriate operational control system of audit corporations**

The previous CPA Act required audit corporations to maintain sufficient operational control systems to perform audit engagements fairly and properly. In addition to the requirements, the amendment specifies the following obligations of audit corporations in the establishment of operational control systems:

- To ensure appropriate management of audit corporations;
- To establish and implement appropriate quality control policies.

#### **(b) Enlargement of qualification for partners of audit corporations**

The amendment relaxes qualification for partners of audit corporations to include non-CPAs under the following conditions:

- Non-CPA partners shall register with the JICPA;
- The percentage of non-CPA partners amongst partners in audit corporations shall be limited to a certain level (this is up to 25% as specified by the Cabinet Office Ordinance).

#### **(c) Disclosures by audit corporations and certain CPAs**

Audit corporations are required to disclose documents explaining their operations and financial information to the public. Individual CPAs who audit listed companies and certain large companies are also required to disclose information on their operations to the public.

### **(ii) Reinforcing the independence of auditors**

#### **(a) Review measures to enhance independence**

The amendment provides the statutory principles covering the duties of CPAs that CPAs and audit corporations shall act in an independent manner in the performance of their work.

(b) Expansion of the scope of restrictions on employment with audit clients

Under the previous CPA Act, engagement partners were prohibited to join the management ranks of audit clients as a director or other important position during a certain period. The amendment expands the scope of the restriction on employment to prohibit the engagement partner from joining the management of the parent company, consolidated subsidiaries, or sister companies of the audit client.

(c) Strengthening the rotation rule

The JICPA established a self-regulatory rotation rule for large audit corporations that audit 100 or more listed companies to follow a five-year rotation rule with a five-year cooling-off period for the lead engagement partners and engagement quality control review partners. JICPA made this rule effective in April 2006. The amendment has made it a legal requirement.

(d) Report to the FSA about fraudulent conduct by management

Along with the amendment of the CPA Act, the FIEA was also amended to require auditors to report to the board of company auditors or the audit committee when auditors discover a fraudulent conduct that materially affects the fair presentation of financial statements. Auditors would be required to report to the FSA if the client fails to take necessary action or if the auditor believes preventative action is needed.

**(iii) Strengthening of oversight on auditors and revision of auditor liability**

(a) Enhancement of disciplinary actions

Disciplinary actions against audit corporations were previously limited to censure, suspension orders, and dissolution orders. The amendment added an order to improve the operational management system of audit corporations. It will be within the remit of the FSA to order an audit corporation to improve its quality control and management, and to forbid any partners who are found to be responsible for seriously inappropriate conduct from further execution of audit, quality control, and management of the audit corporation. Furthermore, the FSA may impose a surcharge upon an audit failure: the amount may be equal to the audit fee when a partner of an audit corporation is found to have been negligent, or equal to the audit fee plus 50 percent when an audit corporation partner's misconduct is found to be willful (i.e. 1.5 times the audit fee). The surcharges are administrative actions and not a criminal penalty.

(b) Introduction of limited liability company (LLC) structure

The previous CPA Act only allowed general partnership as a legal form of audit corporations. The amendment allows an audit corporation to be formed as an LLC if certain conditions, such as minimum capitalization and mandatory deposit requirements, are satisfied.

(c) Introduction of oversight on foreign audit firms

Foreign audit firms that audit companies listed in Japanese capital markets were not subject to supervision of Japanese authority under the previous CPA Act. The amendment requires audit firms that provide audit attestation to foreign issuers whose securities are publicly traded in Japanese capital markets, to notify the FSA of their identities and be subject to the oversight of Japanese authorities.

## **11. The Way Forward**

The CPA profession has faced a number of legal and regulatory changes over the last decade in response to some high-profile accounting failures. Among other things, public oversight systems have emerged around the globe in the post-Enron era and this new regulatory structure has influenced the profession to change the way in which it performs its services.

The crisis after a series of accounting scandals drove home the lesson that the JICPA has to be more active in self-regulation of our profession. The JICPA is committed to address the challenges facing the accountancy profession, to serve the public interest through stricter self-regulation and ensure members provide services of the highest quality.

## Chronological Table Outlining Corporate Disclosure in Japan

- 1947 \* The SEL went into effect.  
\* The Anti-monopoly Law went into effect.
- 1948 \* The CPA Act went into effect.  
\* The Investigation Committee on Enterprise Financial Accounting System of the Economic Stabilization Board (predecessor of the Business Accounting Deliberation Council) was established.
- 1949 \* The Tokyo, Osaka and Nagoya Stock Exchanges were opened.  
\* The first CPA examination was held.  
\* "Financial Accounting Standards for Business Enterprises" was issued.  
\* The JICPA was established.
- 1950 \* "Regulations Concerning the Terminology, Forms and Preparation Methods of Financial Statements" was issued.  
\* "Auditing Standards" and "Working Rules for Fieldwork" were issued.
- 1951 \* Audits by CPAs under the Securities and Exchange Law began.  
\* "The Licensed Tax Practitioners Law" went into effect.
- 1952 \* "The Law for the Reorganization and Rehabilitation of Joint Stock Corporations" went into effect.
- 1953 \* The JICPA became an incorporated association under the Civil Code.
- 1956 \* "Working Rules for Reporting" was issued.
- 1958 \* Debentures by private Japanese enterprises were issued outside Japan for the first time since World War II.
- 1961 \* The second section of the stock exchange was opened.  
\* American Depositary Receipts (ADRs) were issued by private Japanese enterprises in New York.
- 1962 \* "The Security Analysts Association of Japan" was established.  
\* "Cost Accounting Standards" was issued.
- 1963 \* Financial statements of corporations whose shares were traded over-the-counter became subject to audit.  
\* "Regulations concerning the Balance Sheet, Income Statement and Supporting Schedules of Joint Stock Corporations" was issued.

- 1966 \* The JICPA was reorganized as a special legal entity and all CPAs were required to join as members.
- 1967 \* Capital liberalization began.  
\* The first audit corporation permitted under the special law was established.
- 1969 \* European Depositary Receipts (EDRs) were issued in London.
- 1970 \* Stock exchanges began to delist shares of corporations which had issued fraudulent financial statements.  
\* Shares of a Japanese enterprise were listed on the New York Stock Exchange for the first time.
- 1971 \* Following President Nixon's announcement regarding the U.S. dollar policy, a significant decline in stock prices took place.
- 1973 \* Foreign shares were listed on the Tokyo Stock Exchange for the first time.
- 1974 \* Audits by CPAs under the Commercial Code began.
- 1975 \* The number of CPAs in practice exceeded 5,000.  
\* "Financial Accounting Standard on Consolidated Financial Statements" was issued.
- 1976 \* Semiannual reporting went into effect.  
\* "Regulations Concerning the Terminology, Forms and Preparation Methods of Consolidated Financial Statements" was issued.
- 1977 \* "Opinion on Interim Financial Statements included in Semiannual Reports" was issued.  
\* Audits of interim financial statements by CPAs began.  
\* Preparation and filing of consolidated financial statements went into effect.  
\* A requirement for the timely disclosure of events which may have material effect on the market price of listed shares went into effect.
- 1979 \* "Accounting Standards for Foreign Currency Transactions" was issued.
- 1981 \* Disclosure and audit requirements were expanded and strengthened following a revision of the Commercial Code.  
\* The meeting of International Accounting Standards Committee was held in Tokyo.
- 1982 \* "Financial Accounting Standards for Business Enterprises," "Financial Accounting Standards on Consolidated Financial Statements," "Auditing Standards" and "Working Rules of Reporting" were partially amended.
- 1983 \* "Guidelines for Equity Method Accounting" was issued.

- 1985 \* "Auditing Standards for EDP Systems" was issued.  
\* "Accounting Standards for Labor Unions" was issued.
- 1986 \* "Auditing Manual for Private Schools" was issued.
- 1987 \* The 13th World Congress of Accountants was held in Tokyo.
- 1988 \* The Securities and Exchange Law was amended to require segment information to be included in the consolidated financial statements.
- 1990 \* "Disclosure of Segment Information" went into effect.  
\* "Disclosure of Market Prices of Marketable Securities, Futures, Options" went into effect.
- 1991 \* Consolidated financial statements were required to be included in annual Securities Reports.  
\* "Disclosure of Related Parties Transactions" went into effect.  
\* "Auditing Standards," "Working Rules for Fieldwork," "Working Rules for Reporting" and "Auditing Standards and Procedures Relating to Interim Financial Statements" were amended. Major changes included "Emphasis of a Significant Matter," "Disclaimer of Opinion," and obtaining a management representation letter.
- 1993 \* The definition of marketable securities under the Securities and Exchange Law was changed to include commercial paper, beneficial certificates of mortgage securities notes trust.  
\* Segment Information became subject to audit.  
\* "Opinion concerning Accounting Standards for Lease Transactions" was issued.
- 1994 \* Provisions regarding the scope of consolidation, application of the materiality concept in the determination of the scope of consolidation, and application of the equity method were withdrawn.  
\* "Disclosure of Forward Exchange Contracts" went into effect.
- 1995 \* "Disclosure of Diluted Earnings per Share" went into effect.  
\* "Amendment to Accounting Standards for Foreign Currency Transactions" was issued.  
\* "Accounting for Disclosure of Segment Information" was issued.
- 1997 \* "Amendment to Accounting Standards for Foreign Currency Transactions" went into effect.  
\* "Disclosures of Derivative Transactions" went into effect.  
\* "Opinion concerning Amendment to Accounting Standards for Consolidated Financial Statements" was issued.

- 1998 \* "Accounting Standards for Preparing Consolidated Statements of Cash Flows" was issued.  
 \* "Accounting Standards for Preparing Interim Consolidated Financial Statements" was issued.  
 \* "Accounting Standards for Research and Development Costs" was issued.  
 \* "Accounting Standards for Retirement Benefits" was issued.  
 \* "Accounting Standards for Tax Effect Accounting" was issued.  
 \* Quality Control Review was introduced by the JICPA.  
 \* The Continuing Professional Education Program was introduced by the JICPA.
- 1999 \* "Accounting Standards for Deferred Income Taxes" went into effect.  
 \* "Accounting Standards for Financial Instruments" was issued.  
 \* "Amendment to Accounting Standards for Foreign Currency Transactions" was issued.
- 2000 \* The Code of Ethics was amended.
- 2001 \* The FASF was established and the ASBJ was organized under the auspices of the FASF.
- 2002 \* "Auditing Standards and Related Rules" was drastically amended.  
 \* The ASBJ issued its first accounting standard: "Accounting Standards for Repurchased Stock"  
 \* "Accounting Standards for the Impairment of Assets" was issued.  
 \* The second accounting standard "Accounting Standards for the Computation of Earnings per Share" was published by the ASBJ.
- 2003 \* The CPA Act was drastically amended to strengthen auditors' independence and auditor oversight.  
 \* "Accounting Standards for Business Combinations" was issued by the BAC. The BAC completed its role as an accounting standards setter.
- 2004 \* Amended CPA Act went into effect, except for amendments to the qualifying examination system, which went into effect in 2006.  
 \* The CPA Investigation and Examination Board was reorganized into the Certified Public Accountants and Auditing Oversight Board under an amendment to the CPA Act.  
 \* Discussion paper entitled "The Conceptual Frameworks of Financial Reporting" was issued by the Working Group of the ASBJ.  
 \* The BAC published "A Conceptual Framework for Assurance Engagements of Financial Information."
- 2005 \* The Commercial Code and other related laws and regulations were amended reorganized into the Companies Act, effective 2006.  
 \* The ASBJ and the IASB held their initial meeting on the joint project for convergence of accounting standards.  
 \* Standards on Quality Control for Audits were issued by the BAC.  
 \* Auditing Standards were amended.

- 2006 \* The Securities and Exchange Law and other related laws were amended and reorganized into the Financial Instruments and Exchange Act.  
\* The ASBJ started a regular meeting with the Financial Accounting Standards Board (FASB) in pursuit of global convergence.  
\* JICPA's Code of Ethics was comprehensively revised by incorporating IFAC's Code of Ethics.
- 2007 \* The BAC issued Standards and Practice Standards for Management Assessment and Audit concerning Internal Control Over Financial Reporting.  
\* Accounting Standards and Guidance to their Implementation, and the Review Standards for Quarterly Financial Reporting, were issued.  
\* The registration system of listed company audit firms was initiated by JICPA.  
\* The CPA Act was amended.  
\* The Tokyo Agreement between the ASBJ and the IASB was released.
- 2008 \* JICPA commemorated the 60th anniversary of the CPA profession's establishment
- 2009 \* Auditing Standards were amended.  
\* Application of International Financial Reporting Standards (IFRS) in Japan (Interim report) was issued by BAC