

On the issuance of a Cabinet order and Cabinet Office ordinances in response to the enforcement of the amended Certified Public Accountant Law

1. Background

The "Law to Amend Part of the Certified Public Accountant Law" was promulgated on June 6, 2003 with the aim of improving and strengthening audits by CPAs in view of ensuring the fairness and transparency of the securities market and making sure that the market wins investors' confidence. A related Cabinet order and Cabinet Office ordinances need to be amended to respond to the new CPA Law.

2. Summary of the "Cabinet Order to Amend Part of the Enforcement Order of the Certified Public Accountant Law"

The Cabinet proposes necessary amendments to the "Enforcement Order of the Certified Public Accountant Law" (the "Order") to respond to the enforcement of the "Law to Amend Part of the Certified Public Accountant Law."

I. Summary of the Enforcement Order of the Certified Public Accountant Law (regarding portions effective from April 1, 2004)

1. Material Interest/Relationship involving Certified Public Accountants

- (1) A CPA is prohibited from providing audit/attestation services to the clients which the CPA or the spouse of the CPA holds equity securities or other ownership interests. This rule does not apply to the cases where he or she has inherited the equity securities or other ownership interests within the past twelve months.
- (2) A CPA is prohibited from providing audit/attestation services to the clients of which the CPA or the spouse of the CPA is a creditor or a debtor. This rule does not apply to the cases where the debtor-creditor relationship is derived from the engagements prescribed in Item 1 or 2 of Article 2 of the CPA Law; where the amounts of the receivables or payables are below one million yen; where he or she has inherited the debtor-creditor relationship within the past twelve months; or where the debtor-creditor relationship is in need of special consideration under a Cabinet Office ordinance.
- (3) In this Order, the term "related entities" means those entities which an audit client could have a material influence or those which could have a material influence on the audit client.
- (4) In this Order, the term "parent company" means any company which controls other entities' decision-making bodies; the term "subsidiaries" means any entities of

which decision-making body is controlled by the parent company.

(Article 7 of the Order)

2. The Scope of Large Corporations

(1) Among the large corporations as defined in Paragraph 1 of Article 24-2 of the CPA Law (hereinafter referred to as "Large Corporations") for which CPAs' provision of audit/attestation services are restricted, joint-stock corporations with the capital stock of less than 10 billion yen as well as liabilities of less than 100 billion yen are excluded from the corporations with legal obligations of getting the financial statements audited under the Special Law of the Commercial Code.

(Article 7-2 of the Order)

(2) Among the Large Corporations for which CPAs' provision of audit/attestation services are restricted, those entities which issue only the securities specified in Paragraph 1 of Article 24 of the Securities and Exchange Law are, on condition that they are neither listed on any exchanges nor registered with the OTC, excluded from the corporations with legal obligations of getting the financial statements audited under the Securities and Exchange Law.

(Article 7-3 of the Order)

(3) The following entities are included in Large Corporations as the equivalent to the corporations subject to audits under the Special Law of the Commercial Code, corporations subject to audits under the Securities and Exchange Law, banks, long-term credit banks, and insurance companies.

(a) The Norinchukin Bank (i.e. a special financial institution for agriculture, forestry and fishery established under a certain Japanese law)

(b) Shinkin Central Bank (i.e. the central financial institution of credit associations established under a certain Japanese law)

(c) The Rokinren Bank (i.e. the central financial institution of labor credit associations established under a certain Japanese law)

(d) The Shinkumi Federation Bank (i.e. the central financial institution of credit unions established under a certain Japanese law)

(e) Japan Post

(f) The Government Pension Investment Fund

(g) independent administrative institutions subject to independent financial audits

(h) national university corporations and inter-university research institute corporations

- (i) local independent administrative institutions subject to independent financial audits

(Article 7-4 of the Order)

3. Limitation on Consecutive Audits

- (1) The consecutive provision of audit-related services shall not exceed seven accounting periods.

(Article 7-5 and 8-2 of the Order)

- (2) The time-out period after the rotation shall be two accounting periods.

(Article 7-6 and 8-2 of the Order)

4. Material Interest/Relationship involving Audit Corporations

Audit corporations are prohibited from issuing audit reports on the clients in which the engagement partners or designated partners of the services or their spouses have material interest/relationship.

(Article 8 of the Order)

5. Other Rules

The rules shall be prescribed to decide which authorities shall be delegated to the Directors-General of regional finance bureaus (of the Ministry of Finance) among the authorities delegated to the Commissioner of the Financial Services Agency.

6. Effective Date

This Order shall be effective beginning April 1, 2004.

II. Summary of the Enforcement Order of the Certified Public Accountant Law (regarding the portions effective from January 1, 2006)

1. Exemption from the First-Stage Examination

As the first-stage examination shall be abolished, the rules on the exemption from it shall be deleted.

(on Article 1 of the present Order)

2. Partial Exemption from the Multiple-Choice Tests for Designated Academic Degree Holders

Those who have been bestowed a certain academic degree from "professional graduate

schools" are, upon request, exempted from financial accounting and reporting, managerial accounting, and auditing of the multiple-choice tests.

(Article 1 of the Order)

3. Partial Exemption from the Multiple-Choice Tests Based on Designated Practical Experience

Candidates are, upon request, exempted from financial accounting and reporting of the multiple-choice tests if they have been engaged in the accounting-related or auditing-related work or services designated by a Cabinet Office ordinance for more than seven years in the aggregate at listed corporations, large corporations as defined in the Special Law of the Commercial Code, the State or local public entities, or other legal entities designated by a Cabinet Office ordinance.

(Article 1-2 of the Order)

4. Partial Exemption from the Essay Tests

(1) Candidates are exempted from accounting of the essay tests if they have been engaged in the development and improvement of the business accounting system in such a way as accounting standard setting and if they are certified by the Certified Public Accountant and Auditing Oversight Board as having the necessary competences required of those who are to become certified public accountants including academic knowledge and the ability to apply it.

(2) Candidates are exempted from auditing of the essay tests if they have been engaged in the development and improvement of the auditing system in such a way as auditing standard setting and if they are certified by the Certified Public Accountant and Auditing Oversight Board as having the necessary competences required of those who are to become certified public accountants including academic knowledge and the ability to apply it.

(Article 1-3 of the Order)

5. Other Provisions

The rules shall be prescribed to decide which authorities shall be delegated to the Directors-General of regional finance bureaus (of the Ministry of Finance) among the authorities delegated to the Commissioner of the Financial Services Agency.

6. Effective Date

This Order shall be effective beginning April 1, 2006.

3. Summary of the "Cabinet Office Ordinance to Amend Part of the Cabinet Office Ordinance concerning Interest and Relationship involving Certified Public Accountants"

The Cabinet proposes necessary amendments to the "Cabinet Office Ordinance concerning Interest and Relationship involving Certified Public Accountants" (the "Interest/Relationship Ordinance") to respond to the enforcement of the "Law to Amend Part of the Certified Public Accountant Law" and the corresponding amendments to the Order.

1. Debtor-Creditor Relationship in Need of Special Consideration

The Cabinet Office shall define the debtor-creditor relationship in need of special consideration which shall be excluded from the material interest/relationship between CPAs and their audit clients for which their provision of audit/attestation services are restricted.

(Article 1 of the Interest/Relationship Ordinance)

2. Substantive Criteria regarding Entities Related to Certified Public Accountants

(1) The definition of the term "related entities" based on the influence criteria shall be provided.

(Article 2 of the Interest/Relationship Ordinance)

(2) The definition of the term "parent company" based on the control power criteria shall be provided.

(Article 3 of the Interest/Relationship Ordinance)

3. Restriction on the Provision of Non-Audit Services to Large Corporations

(1) The Cabinet Office shall specify the legal entities or other organizations which are controlled by a CPA or the spouse of the CPA.

(Article 4 of the Interest/Relationship Ordinance)

(2) It shall be unlawful for a CPA to provide Large Corporations with the following non-audit services contemporaneously with the audits.

- (a) compilation of financial documents, bookkeeping or other services related to the preparation of financial documents of the audit clients;

- (b) financial or accounting information systems design and implementation;
- (c) appraisal or valuation services, fairness opinions, or contribution-in-kind reports;
- (d) actuarial services;
- (e) internal audit outsourcing services;
- (f) securities services under Item 8 of Article 2 of the Securities and Exchange Law;
- (g) investment advisory services under Item 2 of Article 2 of the Law for Regulating Securities Investment Advisory Business;
- (h) in addition to the services in the preceding items, such services as deemed to be (a) the auditor's self-compilation of the financial documents to be audited or attested or (b) the engagement in the management decision of the audit client.

(Article 5 of the Interest/Relationship Ordinance)

4. Audit-Related Services

- (1) The audit-related services under the restriction on consecutive audits shall be specified.
- (2) The justifiable cause for providing audit-related services for the consecutive periods exceeding the legal limit shall be specified.
- (3) The approval procedures for providing audit-related services for the consecutive periods exceeding the legal limit shall be specified.

(Article 6 of the Interest/Relationship Ordinance)

5. Justifiable Cause for Being a Single Independent Auditor

The justifiable cause for being a single independent auditor of Large Corporations where joint audits are legally required shall be specified.

(Article 7 of the Interest/Relationship Ordinance)

6. Additional Notes in the Audit Report

Additional notes in the audit report concerning the interest/relationship between a CPA and the audit clients shall be specified.

(Article 8 of the Interest/Relationship Ordinance)

7. Justifiable Cause regarding a CPA's Employment with Audit Clients

The justifiable cause for a CPA's employment with his or her audit clients as an officer or equivalent shall be specified.

(Article 9 of the Interest/Relationship Ordinance)

8. Effective Dates

This Ordinance shall be effective beginning April 1, 2004.

4. Summary of the "Cabinet Office Ordinance to Amend Part of the Cabinet Office Ordinance concerning Audit and Attestation of Financial Statements"

The Cabinet proposes necessary amendments to the "Cabinet Office Ordinance concerning Audit and Attestation of Financial Statements" (the "Audit/Attestation Ordinance") to respond to the enforcement of the "Law to Amend Part of the Certified Public Accountant Law" and the corresponding amendments to the Order.

1. Scope of Designated Interest/Relationship

The contents of interest/relationship shall be coordinated in light of the introduction of the special provisions of the restriction on audit services for Large Corporations (according to Articles 24-2 and 24-3 of the CPA Law) and the amendment to the provisions concerning interest/relationship (according to Articles 7 and 8 of the Order).

(Article 2 of the Audit/Attestation Ordinance)

2. Addition of Designated Partners

In light of the establishment of the system of designated attestation and the designated partner (according to Article 34-10-4 of the CPA Law) designated partners are added to the list of the personnel who should sign and seal the auditor's report.

(Article 4 of the Audit/Attestation Ordinance)

3. Form of the Audit Overview Statements

The description of designated partners, the fee for the audit service and other services, and other relevant items shall be added to the form of the audit overview statements.

(Article 5 of the Audit/Attestation Ordinance)

4. Effective Date

This Ordinance shall be effective beginning April 1, 2004.