Corporate Disclosure in Japan

Overview

The Japanese Institute of Certified Public Accountants
2010
(Sixth edition)

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FORWARD

The importance of reliable corporate disclosure has been recognized globally in the wake of corporate misconduct in recent years. Corresponding to the movement, the internal control reporting system was introduced in listed companies in Japan in 2008. Also, the quarterly reporting system was introduced in 2008 in order to enhance disclosure.

The globalization of business increases the necessity of a high-quality single set of accounting standards. In June, 2009, the Business Accounting Council (an internal organization within the Japanese Financial Services Agency) published its “Opinion on the Application of International Financial Reporting Standards (IFRS) in Japan (Interim Report)” in order to provide direction for the implementation of the IFRS in Japan. Voluntary application of the IFRS was allowed for financial statements for the fiscal year ended March, 2010 and onwards. The Japanese Institute of Certified Public Accountants (JICPA) will provide support for the implementation of the IFRS, in close liaison with the relevant bodies and organizations.

As for the auditing standards, convergence has accelerated globally toward 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, JICPA is rewriting its Implementation Guidance issued by the Auditing Standards Committee.

This booklet is the sixth edition of "Corporate Disclosure in Japan – Overview" published by the International Relations Committee of the JICPA in order to provide both historical and current information, including the above-mentioned content regarding the outline of the corporate disclosure system in Japan. I am certain that this booklet will help you to better understand an overview of the current status of corporate disclosure in Japan.

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

July 2010

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Chapter I Participants in the Disclosure System

1. Companies

The Companies Act of Japan was promulgated on July 26, 2005 and went into effect on May 1, 2006, replacing a portion of the Commercial Code. Under the Companies Act, the following forms of companies are authorized:

(1) Kabushiki-kaisha (stock company)
(2) Gomei-kaisha (general partnership company)
(3) Goshi-kaisha (limited partnership company), and,
(4) Godo-kaisha (limited liability company).

Kabushiki-kaisha or a stock company whose shareholders' liability is limited to their investment, is the most common form of company in Japan and the form most closely related to the disclosure system discussed in this publication.

(i) Disclosure Requirements under the Companies Act

The principal objective of the disclosure requirements for a stock company under the Companies Act is to protect the interests of both creditors and shareholders.

A Kabushiki-kaisha is required to hold an annual shareholders meeting within three months after the balance sheet date to deliberate on certain company matters, including approval of its financial statements. Typically, notice of calling of annual shareholders meeting must be accompanied by a business report and financial documents including the company’s financial statements attested by the company auditor or the audit committee, which is an internal organization of a company not required to be or composed of certified public accountants. The financial statements are required to be submitted to and approved by the annual shareholders meeting.

These documents are subsequently mailed to the shareholders in the form of an annual report. In addition, the Companies Act stipulates that these documents be maintained at all times at the head office and at branches of the stock company for inspection by creditors and shareholders, and that the condensed balance sheet be published in newspapers or gazettes. However, this requirement does not apply to those companies that file financial statements with the Financial Services Agency (FSA), since those statements are published via Electric Disclosure for Investor’s NETwork (EDINET).

For a Large Company, which is capitalized at ¥500 million or more or whose liabilities are ¥20,000 million or more at the fiscal year end, certain special regulations apply. Firstly, its financial statements and supporting schedules are required to be audited not only by the company auditors or its audit committee but also by an independent certified public accountant (CPA) or an audit corporation. Secondly, after its financial statements have been attested by the company auditors or the audit committee and a CPA or an audit corporation, approval of these statements at the annual shareholders meeting is not required as long as the Board of Directors resolves to adopt the financial statements. Furthermore, both the balance sheet and the statement of income must be published in newspapers or on a website. Large companies which file their Securities Reports with the FSA are required to prepare consolidated financial statements and disclose these in their annual reports. The same audit requirements apply to the companies which appoint an accounting auditor on a voluntary basis and certain other companies.

In addition, the Board of Directors of a large company needs to carry a resolution on the development of systems necessary to ensure that the execution of the duties by the directors complies with the laws and regulations and the articles of incorporation, and other systems prescribed by the applicable "Ordinance of the Ministry of Justice as systems necessary to ensure the properness of operations of a Stock Company" and this resolution should be included in the business report.

(ii) Disclosure Requirements under the Financial Instruments and Exchange Act (FIEA)

The purpose of FIEA is to contribute to the sound development of the national economy and protection of investors by developing comprehensive and cross-sectional systems.

(a) Disclosure at the Time of Issuing Securities

Companies which offer their own shares and/or bonds in public offerings are required to file registration statements with the FSA, except when certain conditions are met. If these registration statements are accepted without any amendment order for 15 days from the filing, they automatically take effect and the companies can offer their securities and/or bonds after issuing a prospectus for distribution to investors.

Typical registration statements describe the method of subscription, the nature of the business engaged in, information on capital expenditures, an outline of the corporate governance structure, an analysis of the company's financial position, operating results and cash flows and so forth. They also include comparative consolidated and non-consolidated financial statements and supporting schedules for two consecutive accounting periods audited by CPAs or an audit corporation. The contents of the prospectus are, in principle, the same as those of the registration statements filed with the FSA.

(b) Ongoing Disclosure

Companies that offered securities and filed registration statements in the past or whose shares are listed on Japanese stock exchanges are required to file Securities Reports annually with the FSA. The contents of a company's Securities Report are similar to those in the registration statement. From the accounting period beginning on or after April 2008, FIEA requires listed companies to submit quarterly reports. Quarterly financial statements included in the quarterly reports need to be reviewed by CPAs or an audit corporation.

From an accounting period beginning on or after April 1, 2008, the management of listed companies must assess the effectiveness of the internal control of financial reporting and prepare an Internal Control Report. This report needs to be audited by the same auditors who audit the companies' financial statements. This requirement is modeled after the one provided by Section 404 of the Sarbanes-Oxley Act.

Companies that are obligated to submit these reports are also required to submit an updated report to the stock exchanges if they offer securities for subscription overseas, if there is a major change in their shareholders, or if certain other specified events take place, in order to ensure timely disclosure.

(c) Filing

All Japanese public companies must use the EDINET to file annual securities reports and other regulatory reports with the FSA. All disclosure documents submitted through EDINET system can be browsed via the Internet.

In addition, those companies are required to submit financial statements in the eXtensive Business Reporting Language (XBRL) format to EDINET from the accounting period beginning on or after April 1, 2008.

(d) Number of Publicly Listed Companies

Figure 1 below shows the number of publicly listed companies subject to disclosure requirements under the FSA.

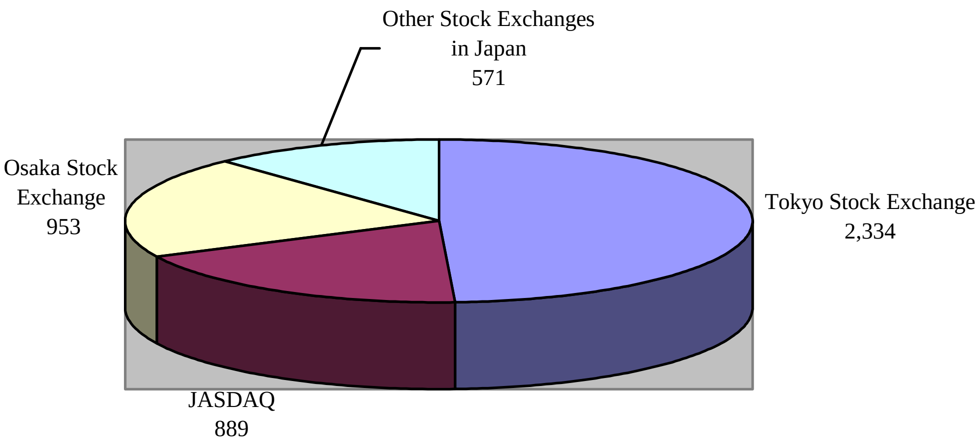


Fig. 1 Number of Listed Companies as of December 31, 2009

2. CPAs

(i) CPA Qualifications

CPAs, through their own audit practices, are closely related to the system of disclosure. In order to become a CPA, candidates must go through every step required by the Certified Public Accountants Act (CPA Act). The administration and the requirements of the CPA examination are provided by the CPA Act. The examination is conducted by the Certified Public Accountants and Auditing Oversight Board (CPAAOB), an advisory body to the FSA. The examination is held annually, only in Japanese. It consists of a multiple-choice test and an essay. Successful candidates of the multiple-choice test are entitled to sit the essay part of the test. In addition, a candidate is required to have practical audit experience at an accounting firm or specific training in industry for a minimum of two years. Candidates may obtain practical experience either before taking the CPA examination or after passing it. Also, successful candidates are required to complete the three-year long professional accountancy education program provided by JICPA. Those who completed this program are qualified to take the final assessment and successful candidates are eligible to register with JICPA. This registration is mandated by the CPA Act and is necessary for CPAs to represent themselves as such to the public.

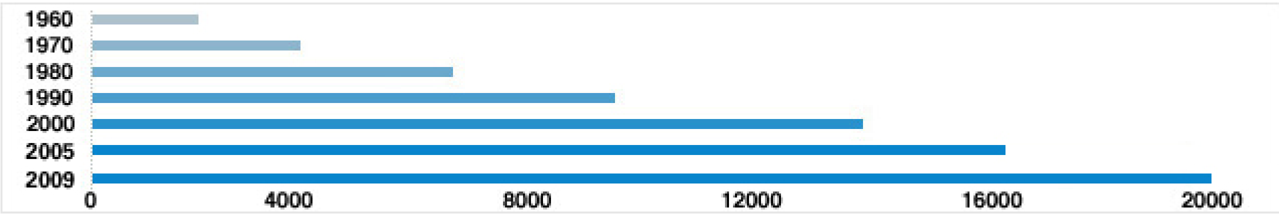
(ii) Individual CPAs and Audit Corporations

The total number of qualified Japanese CPAs was 19,935 as of December 31, 2009 as compared to more than 340,000 CPAs in the United States. It is estimated that more than half of the CPAs in Japan practice auditing. The remaining CPAs are either engaged in tax practices, management advisory services or other areas of public accounting, or are employed by government agencies or public and private enterprises.

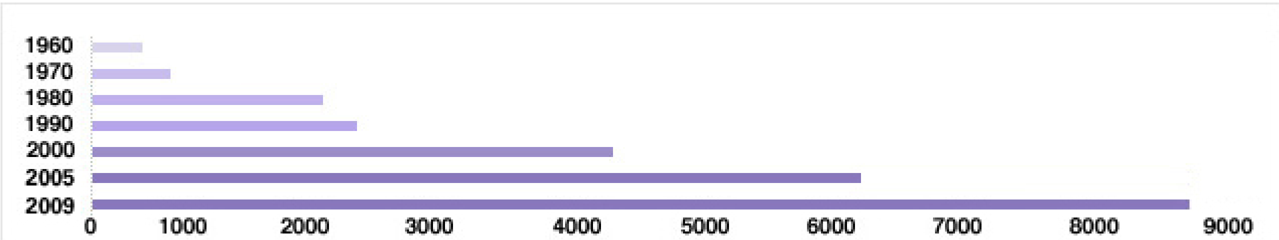
In addition to CPAs, there are approximately 71,000 licensed tax accountants in Japan as of December 31, 2009.

Prior to 1966, auditing was conducted exclusively by individual CPAs. In 1966, by the amendment of CPA Act, audit corporations with unlimited liability were introduced. In addition, limited liability system was introduced in 2007.

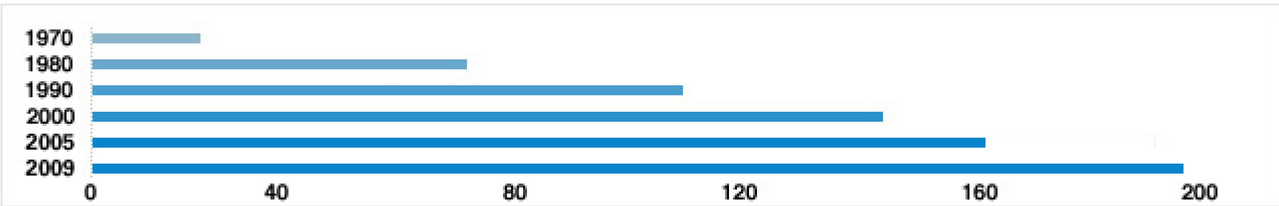
(a) Number of CPAs in Japan



(b) Number of associate members in Japan



(c) Number of audit corporations in Japan



	1960	1970	1980	1990	2000	2005	2009
Number of CPAs (regular member) in Japan*1	1,508 (13)	4,162 (37)	6,036 (32)	8,799 (18)	13,220 (6)	16,245 (4)	19,935 (4)
Number of associate members in Japan	651	935	2,294	2,584	4,290	6,345	8,405
Number of audit corporations in Japan	NA *2	24	63	110	149	162	195

Note 1: The figures in parentheses represent registered foreign CPAs.
Note 2: Audit corporations did not exist before 1967.

Fig. 2. Number of CPAs and Audit Corporations in Japan

(iii) 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 join the JICPA so that the JICPA 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 of those important 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;
(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 IFAC and the Confederation of Asian and Pacific Accountants (CAPA), and has contributed significantly to international cooperation in the promotion of 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.

3. Accounting and Auditing Standards in Japan

The process of setting accounting standards, which was previously driven by government organizations like FSA, has shifted to private sector entities.

The Financial Accounting Standards Foundation (FASF) was established in 2001, and the Accounting Standards Board of Japan (ASBJ) was subsequently organized under the auspices of the FASF as an independent, private-sector entity to develop accounting standards in Japan. Since its inception, the ASBJ has issued many accounting standards and guidelines. In addition, in January 2005, it announced the launch of a joint project with the International Accounting Standards Board (IASB) aimed at achieving convergence between Japanese and international accounting standards.

Facing the fact that more than 100 countries in the world have adopted IFRSs either on voluntary or mandatory basis, Business Accounting Council (BAC), an advisory body established within the FSA, published, on June 30, 2009 the "Interim Report: Application of International Financial Reporting Standards in Japan" which was a key step forward for Japan moving towards adoption of IFRSs.

As for the process of setting auditing standards, BAC 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 the Implementation Guidance, combined together, constitute the Generally Accepted Auditing Standards (GAAS) in Japan.

Also, convergence has been accelerated on a global basis toward the ISA developed by the International Auditing and Assurance Standards Board IAASB of IFAC. In order to respond to the clarity project of the IAASB, JICPA is rewriting its Implementation Guidance issued by the Auditing Standards Committee.

4. Regulatory Agencies

The FSA is responsible for disclosures required under the FIEA and the Ministry of Justice is in charge of corporate disclosure under the Companies Act. The difference between the two sets of regulations relates to the fact that the FIEA covers listed companies and unlisted public companies and is thus intended to protect investors in general whereas the Companies Act covers all companies.

With respect to registration statements, Securities Reports, Quarterly Securities Reports and other relevant reports, officials of the Securities and Exchange Surveillance Commission established within the FSA carefully review that the filings comply fully with the mandatory requirements. They also review for the existence of any misstatement and examine the reasonableness of the CPA's opinion. If necessary, they may order amendments, or suspension of the sale of shares or of a share offering (in the case of registration statements).

5. Stock Exchanges

From the viewpoint of ensuring fair pricing and the smooth distribution of securities, a rigorous disclosure system is very important to Japanese stock exchanges.

(i) Overview of Stock Exchanges

There are six stock exchanges in Japan (Tokyo Stock Exchange, Osaka Securities Exchange, Nagoya Stock Exchange, Fukuoka Stock Exchange, Sapporo Securities Exchange and TOKYO AIM.

The trading volume and the number of listed companies on each stock exchange vary considerably, with much higher transaction volume on the Tokyo, Osaka and Nagoya Stock Exchanges.

Figure 1 shows the number of companies listed on the exchanges as of December 31, 2009.

(ii) Listing and Delisting Criteria

All stock exchanges in Japan have their own listing criteria, but the details of these criteria are similar.

In the case of listing on the Tokyo Stock Exchange: (a) the number of shares to be listed, number of shares to be sold to the public, diversification and number of shareholders before and after sale, agent for share handling, classes and transferability of shares, and so on are checked to ensure smooth distribution of securities, and (b) information such as the amount of net assets, net income and market capitalization, and number of years since the establishment of the listing company are also examined to determine whether or not it has a stable financial base.

With respect to the Securities Registration Statement (similar to, but more detailed than, the Securities Report generally used under the FIEA), the company's consolidated and non-consolidated financial statements for the three most recent years and the quarterly financial statements for the prior year must be attached to the report. These financial statements must be audited by CPAs or audit corporations and have an unqualified opinion for the last year.

Upon receiving a listing application, the stock exchange is required to see whether the applying company meets the formal requirements mentioned above, ask the necessary questions to the company itself and to its CPAs or an audit corporation, and to execute other procedures, including a field survey, before the listing can be approved.

With respect to delisting, the shares of the companies may be delisted from a stock exchange under one or more of the following situations, among others:

- Number of tradable shares or shareholders is/are less than the minimum requirement
- Trading volume is less than the minimum requirement for the last one year.
- The value of market capitalization is less than the minimum requirement
- Debts exceed assets (one year grace period applies)
- False statements or unfair representation in Securities Report (material impact)
- An adverse opinion or disclaimer of opinion on the financial statements
- Bankruptcy/rehabilitation proceedings or liquidation; and others

(iii) Timely Disclosure

In the Securities Listing Regulations, the stock exchanges generally require preliminary report of business results of a year and preliminary quarterly report immediately after the most recent accounting period. Also the stock exchanges generally require the listed companies to present the relevant information fairly to investors when any important fact arises which may affect the investors' decision-making. If such disclosure is not made on a timely basis, the stock exchanges may request the listed companies to submit a report which contains its background and improvement measures. In addition, the stock exchanges shall make this report available for public inspection.

6. Securities Houses and Underwriters

Securities houses acting as dealers in securities and brokerage firms are the one of the key users of information disclosed by public companies. On the other hand, securities houses acting as underwriters of securities assume part of the responsibility for such information because they offer securities for subscription and purchase. Articles 17 and 21 of the FIEA specify the liabilities of securities houses as distributors of a prospectus and underwriters of securities.

In the event of loss to an investor arising from alleged reliance on any false statement in a prospectus or registration statement, the investor is entitled to claim damages from the underwriters and others involved. In order to avoid liability for compensation, the underwriters would be required to prove that he was no willful negligence on their part and that due care was exercised regarding the accuracy of the contents of the prospectus or registration statements.

With respect to the financial statements audited by CPAs or audit corporation which are included in a prospectus, securities houses are released from the provision citing “due care” but there are no exemption clauses for false statements made in the prospectus as a whole. For this reason, the underwriters, who act concurrently as distributors of a prospectus, undertake a thorough review of its financial statements.

Chapter II Reporting Standards and Practices

1. General

Two legal codes govern the preparation of financial statements in Japan, the Companies Act and the FIEA.

The form and content of the financial statements required under the Companies Act are dictated by the Ordinance for Companies Accounting. The regulations are legally binding standards of accounting and reporting to be applied to all companies incorporated and operating in Japan.

The standards of accounting and reporting to be followed under the FIEA by companies whose debt and equity securities are publicly traded or sold are regulated by "Regulations Concerning the Terminology, Forms and Preparation Methods of Financial Statements," which were first promulgated in 1963 by the Ministry of Finance.

Although there are certain differences in reporting under these two sets of regulations, over the years they have converged following a series of revisions.

2. Reporting under the Companies Act

All stock companies (kabushiki-kaisha) 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

In addition, large companies whose financial statements are filed with the FSA should prepare consolidated financial statements.

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.

3. Reporting under the Japanese 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.

In addition, listed companies are required to submit the following reports to FSA:

- Internal control report audited by CPAs included in the annual securities report
- Quarterly reports with financial statements reviewed by CPAs

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.

Chapter III Accounting Principles and Practices

1. Standards Setting for Accounting and Recent Developments

Accounting principles and practices in Japan have evolved through general usage and practice over a period of time and have been codified into a series of promulgations and related amendments by the BAC. Accounting standards or principles for business enterprises issued by the BAC have been regarded as Generally Accepted Accounting Principles (GAAP) in Japan.

The FASF was established in 2001, and the ASBJ was organized under the auspices of the FASF as an independent, private-sector entity to develop accounting standards in Japan substantially taking over the role of setting accounting standards from the BAC. Since its inception, the ASBJ has issued many accounting standards, guidance and other documents that address practical issues.

Major accounting standards issued by ASBJ are as follows:

- Accounting Standard for Business Divestitures (No.7) (final revision December 2008)
- Accounting Standard for Share-based Payment (No.8) (December 2005)
- Accounting Standard for Measurement of Inventories (No.9) (final revision September 2008)
- Accounting Standard for Financial Instruments (No.10) (final revision March 2008)
- Accounting Standard for Related Party Disclosures (No.11) (October 2006)
- Accounting Standard for Quarterly Financial Reporting (No.12) (final revision June 2009)
- Accounting Standard for Lease Transactions (No.13) (final revision March 2007)
- Accounting Standard for Construction Contracts (No.15) (December 2007)
- Accounting Standard for Equity Method (No.16) (final revision December 2008)
- Accounting Standard for Disclosures about Segments of an Enterprise and Related information (No.17) (final revision March 2009)
- Accounting Standard for Asset Retirement Obligations (No.18) (March 2008)
- Accounting standard for Retirement Benefits (Part3) (No.19) (final revision July 2008)
- Accounting Standard for Disclosures about Fair Value of Investment and Rental Property (No.20) (November 2008)
- Accounting Standard for Business Combinations (No.21) (final revision December 2008)
- Accounting Standard for Consolidated Financial Statements (No.22) (December 2008)
- Accounting Standard for Accounting Changes and Error Corrections (No.24) (December 2009)

Most of these standards were issued as a part of convergence of accounting standard discussed in the next section.

2. Convergence of Accounting Standards and Recent Movements towards IFRSs Adoption in Japan

In January 2005, the ASBJ announced the launch of a joint project with the IASB aimed at achieving convergence between Japanese GAAP and IFRSs.

In October 2006, the ASBJ decided to formulate and release "ASBJ Project Plan" focusing on accounting standards development projects, related to convergence, in an attempt to indicate the status of initiatives of the ASBJ to various constituencies in Japan and abroad.

In this report, based on the proposal concerning a time-framed approach in light of the European Union (EU) equivalence assessment, titled "Towards the International Convergence of Accounting Standards" issued by the Planning and Coordination Committee of the BAC in July 2006, primary emphasis was placed on mapping out the work planned to be achieved through the end of 2007, and also on clarifying the prospects of convergence status as of the beginning of 2008 concerning the initiatives to be undertaken with respect to the 26 issues for which the remedies were advised by the Committee of European Securities Regulators (CESR in July 2005).

In August 2007, the ASBJ and the IASB jointly announced an agreement (known as the Tokyo Agreement) to accelerate convergence between Japanese GAAP and IFRSs, a process that was started in March 2005. As part of the agreement, the two boards will seek to eliminate by 2008 major differences between Japanese GAAP and IFRSs (as defined by the July 2005 CESR assessment of equivalence), with the remaining differences being removed on or before 30 June 2011. Whilst the target date of 2011 does not apply to any major new IFRSs now being developed, that will become effective after 2011, both boards will work closely to ensure the acceptance of the international approach in Japan when new standards become effective.

The new project plan was issued in December 2007, in accordance with the content of the Tokyo Agreement. It classifies the project items into three categories (short-term, medium-term and medium and long-term) and indicates the schedule for each item.

In March 2008, CESR announced that Japanese GAAP is considered to be equivalent to IFRSs if the progress of convergence had been made as scheduled in Tokyo Agreement above. Thereafter, in December 2008, European Commission (EC) also reached the conclusion that Japanese GAAP was found to be equivalent to IFRSs adopted by EU together with U.S. GAAP. Consequently, those decisions made it possible for Japanese companies to continue to be listed by using the financial statements based on Japanese GAAP in European capital markets after 2009 as well.

While the convergence of accounting standards was progressing in Japan, there was another major movement with respect to IFRS in U.S. In November 2007, SEC (Securities and Exchange Commission) approved rule amendments under which financial statements from foreign private issuers in the U.S. will be accepted without reconciliation to U.S. GAAP only if they are prepared using IFRSs as issued by IASB. In November 2008, SEC published Roadmap that could lead to the mandatory use of IFRSs by U.S. issuers beginning in 2014. SEC would make a decision in 2011 on whether adoption of IFRSs is in the public interest and would benefit investors.

In February 2010, SEC published a statement to provide an update regarding its consideration of global accounting standards, including its continued support for the convergence of U.S. GAAP and IFRS and the implications of the convergence with respect to the SEC's ongoing consideration of incorporating IFRS into the financial reporting system for U.S. issuers. According to this statement, mandatory application is going to be introduced in or after 2015.

In response to the movement in the U.S. and the fact that more than 100 countries decided to allow the adoption or the mandatory application of IFRSs, Japan leaned towards the adoption of IFRSs. This series of movements initiated discussion in BAC. As a result, BAC published the "Opinion on the Application of International Financial Reporting Standards (IFRS) in Japan (Interim Report)" on June 30, 2009, which was a key step forward for Japan in moving toward adoption of IFRSs. The main points are as follows:

- Optional application is permitted, from the fiscal year ending March 2010, for the consolidated financial statements of listed companies whose financial or business activities are conducted internationally that has worldwide business operations and are widely recognized among international investors.
- The enforcement of mandatory application of IFRS to the consolidated financial statements of listed companies is appropriate.
- The decision regarding the mandatory use of IFRSs is planed to be made in around 2012.
- In introducing mandatory application, it is considered necessary to provide a preparation period of at least 3 years from the time when the mandatory application is decided, which is necessary for the adaptation of practices (i.e., if the decision of mandatory application is made in 2012, mandatory application will be introduced in 2015 or 2016)

In July 2009, the IFRS Council, the private-sector promotion council to determine the Japanese roadmap toward IFRS implementation, was organized in Japan as agreed by market constituents and supported by the FSA. The members will discuss the issues raised in the adoption of IFRSs. A wide range of market constituents including JICPA participate in the Council.

- IFRS Council: The Council identifies issues concerning the implementation of IFRS, and establishes overall policies and strategies. Based upon the exercise, the council requests each task force committee to decide on specific measures, and it calls for relevant organizations to take appropriate actions.
- International Affairs Committee: This committee establishes policies related to international affairs with the aim of promoting the Japanese presence at the international forefront.
- Education and Training Committee: This committee is establishing an education and training system of IFRS mainly for accounting practitioners, and is implementing it immediately.
- Translation Committee: This committee is establishing a system to promote an accurate Japanese translation of IFRS.

- Committee for Separate Financial Statements: This committee deliberates on how separate financial statements can be simplified, given the current focus on consolidated financial statements.
- Public Relations Committee: This committee undertakes PR activities addressing a wide range of stakeholders, including investors, company executives, analysts, and the media, in cooperation with relevant organizations.

In December 2009, FSA published a set of Revised Cabinet Office Ordinances, including “Regulation for Terminology, Forms and Preparation of Consolidated Financial Statements” and “Cabinet Office Ordinance on Disclosure of Corporate Information,” etc. The publication of these Revised Cabinet Office Ordinances, etc. officially provides an operational framework for the voluntary application of IFRSs, starting from the fiscal years ending on or after March 31, 2010, as the first step toward the application of IFRSs in Japan (Interim Report).

Chapter IV Auditing

1. Introduction

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

The amendment of 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 CPA examination, and limited liability audit corporations. 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 companies, and reinforcing the independence of auditors.

With respect to auditing standards, convergence has been accelerated globally with ISA developed by IAASB of IFAC. In June 2009, the International Organization of Securities Commissions (IOSCO) issued a statement to the media to encourage securities regulators to accept audits performed and reported in accordance with the clarified ISA for cross-border offerings and listings. In addition, IOSCO encouraged securities regulators to set auditing standards for national purposes, recognizing that factors at the national and regional level will be relevant to their considerations.

2. Auditing Standards and Standard-Setting Bodies

In Japan, (BAC), an advisory body established within 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 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. Outline of Audit Practice in Japan

Audits conducted by independent CPAs or audit corporations are broadly classified into statutory and voluntary audits. Statutory audits are required mainly under the FIEA and the Companies Act. Financial statements of public companies must be audited by independent CPAs or audit corporations under the FIEA. The Companies Act requires certain companies described in (ii) below to be audited by independent CPAs regarding its financial documents sent together with notice of calling of annual shareholders meeting.

Some companies request voluntary audits in order to obtain independent assurance regarding the accuracy and reliability of their financial statements.

(i) Financial Statement Audits under the FIEA

Companies must file security registration statements with the FSA in case of the issuance and/or sale of its securities and public companies must file annual Securities Reports with the FSA. The security registration statements and the annual Securities Reports include both audited consolidated financial statements and audited non-consolidated financial statements. Public companies are also required to file quarterly reports which include quarterly financial statements, which are subject to "quarterly review."

(a) Audit Requirements under the FIEA

Filed financial statements must be audited by independent CPAs or an audit corporation 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 Japanese GAAP. The independence of the auditor, together with the independent auditor's reporting requirements, are established under the Cabinet Office Ordinance entitled "Ordinance Concerning Audit Certification of Financial Statements".

(b) Review of quarterly financial statements

The FIEA, requires listed companies to submit quarterly reports. Quarterly financial statements included in the quarterly reports need to be reviewed by independent CPAs 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.

(c) 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 are the audit corporation, but the engagement partners identical as well.)

Independent 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 independent 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.

(ii) Audits under the Companies Act

(a) Companies subject to an audit of financial statements

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 their financial statements audited:

- 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 as defined in the articles of incorporation.

An independent 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.

(b) 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 appoint 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.

<table>
<tr><th colspan="5">Company with Board of Directors and Accounting Auditors</th></tr>
<tr><th colspan="2">Categories</th><th colspan="3">Components</th></tr>
<tr><td>1</td><td>A company that is a large company and whose share transfer is not restricted</td><td>Board of directors</td><td>Board of company auditors, or Committees</td><td>Accounting auditor</td></tr>
<tr><td>2</td><td>A company that is a large company and whose share transfer is restricted</td><td rowspan="3">Board of directors</td><td rowspan="3">Company auditor, Board of company auditors, or Committees</td><td rowspan="3">Accounting auditor</td></tr>
<tr><td>3</td><td>A company that is not a large company and whose share transfer is not restricted</td></tr>
<tr><td>4</td><td>A company that is not a large company and whose share transfer is restricted</td></tr>
</table>

The Companies Act also provides that the company auditor (kansayaku) or the audit committee (kansaiinkai) has a duty to examine the financial documents prior to the annual shareholders meeting. The company auditor or equivalent is also responsible for monitoring the activities of the directors as a part of corporate governance.

4. 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.

(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:

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

As a part of its international activities, the JICPA has been cooperating as a member of the IFAC and 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.

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 Law.
* 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 reorganized into the Corporation Law.
* 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 (IFRSs) in Japan (Interim Report) was issued by BAC.
* The IFRS Council, the private-sector promotion council to determine the Japanese roadmap toward IFRS implementation, was established.
* FSA announced the issuance of the “Cabinet Office Ordinance to revise part of the Regulation for Terminology, Forms and Preparation of Consolidated Financial Statements” toward the voluntary application of IFRSs in the fiscal year ending March 31, 2010.