



Comprehensive Revision of the Certified Public Accountants Law in Japan

Financial Services Agency (FSA), Japan

June 2004



I. Schedule and Major Points

○ Schedule

- The Subcommittee on Regulations of CPAs of the Financial System Council, an important advisory council established within the FSA, issued on December 2002 the report calling for comprehensive reform of the CPA and audit firm system in Japan.
- The Japanese government made the Cabinet decision and submitted a bill to the regular Diet (the Japanese legislature) session on March 14, 2003 to comprehensively revise the CPA Law.
- **The Diet passed the bill on May 30, 2003.**
- **The Cabinet Orders were issued in December 2003.**
- **The amendments was in principle effective in April 2004.**

(Note) The amendments related to CPAs Examinations will be effective in January 2006.

○ Major Points

- Introducing explicit provisions on CPAs' missions and professional responsibilities
- Enhancing auditor oversight
- Enhancing auditor independence
- Reviewing CPAs examinations to increase the number and enhancing quality of CPAs



Internationally consistent system



II. Basic Structure of the revised CPA Law

- Chap.1 General Provisions
- Chap.2 CPAs Examinations
- Chap.3 Registration
- Chap.4 Duties of CPAs
- Chap.5 Responsibilities of CPAs
 - Chap.5-2 Audit firms
- Chap.6 CPA Auditing and Oversight Board (“CPAAOB”)
 - Chap.6-2 The Japanese Institute of CPAs (“JICPA”)
- Chap.7 Miscellaneous provisions
- Chap.8 Penal provisions



III. Introducing Explicit Provisions on CPAs' Missions and Professional Responsibilities

○ CPAs' Missions

CPAs' missions are to ensure **reliability of financial information** including financial documents, as **auditing and accounting profession**, and from **an independent viewpoint**, thereby ensure fair business activities of corporations and protect investors and creditors, and thus contribute to the sound development of the national economy (Article 1).

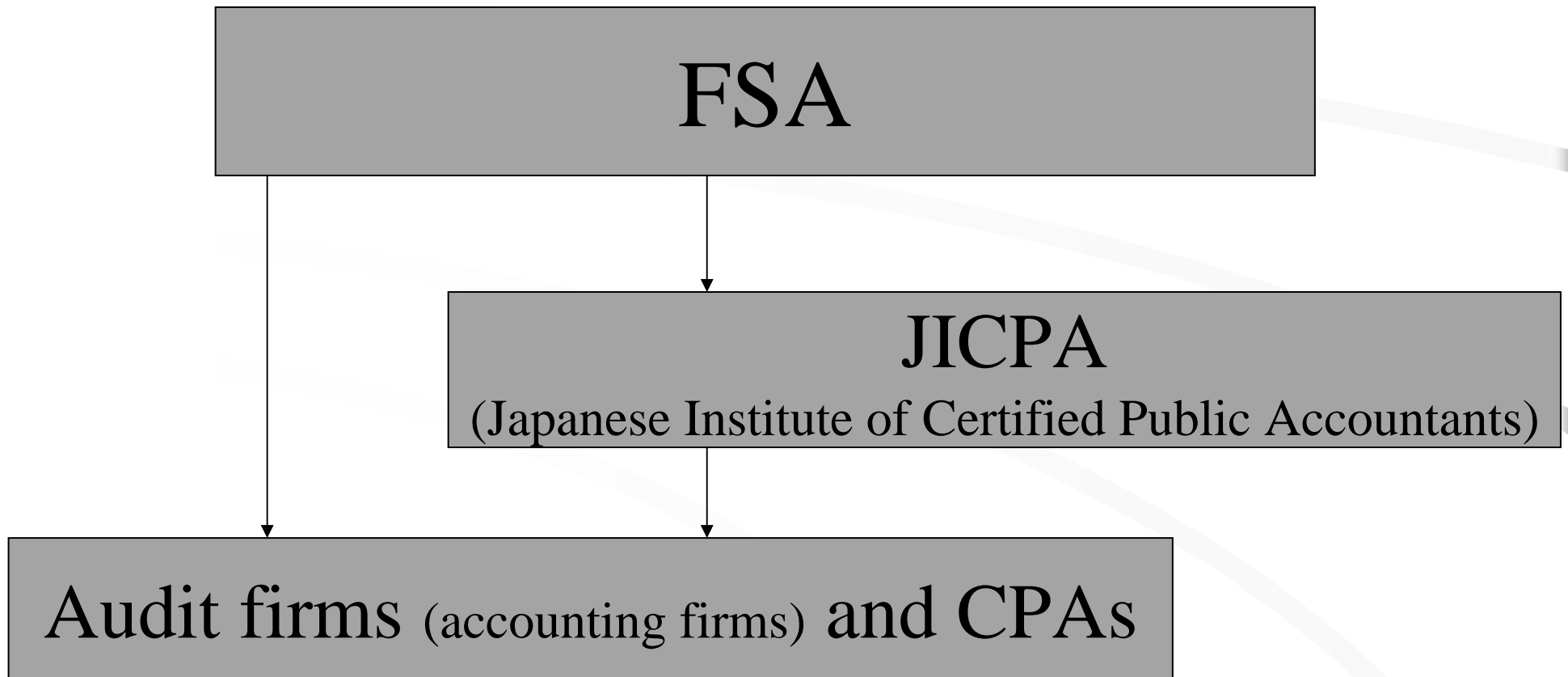
○ CPAs' Professional Responsibilities

CPAs shall always maintain **integrity**, make efforts to acquire **knowledge and skills**, and provide their services in **fair and sincere** manners (Article 2).



IV. Enhancing Auditor Oversight (1)

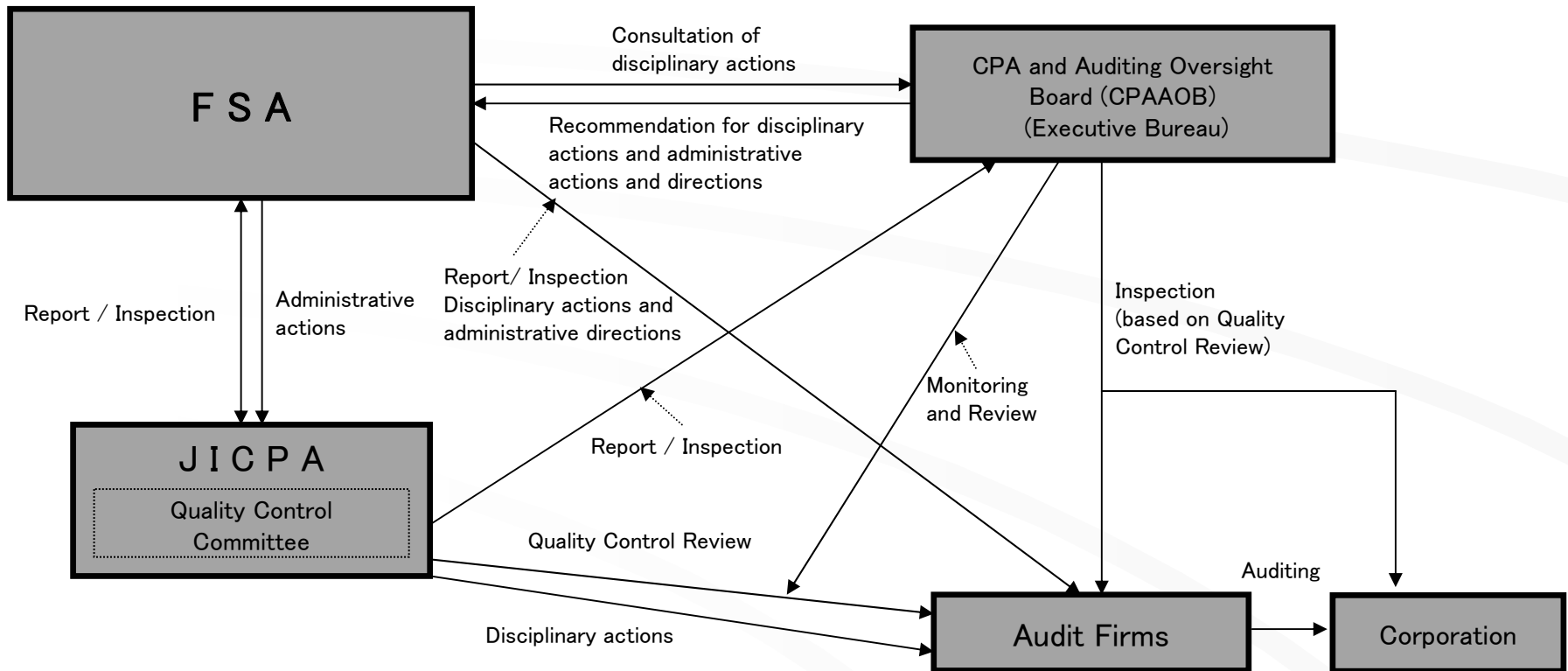
(1) Previous auditor oversight structure in Japan





IV. Enhancing Auditor Oversight (2)

(2) Revised auditor oversight structure in Japan





IV. Enhancing Auditor Oversight (3)

(3) Auditor oversight structure under the revised CPA Law

[FSA ⇒ Audit firms and CPAs]

- ▲ Audit firms shall submit information on their establishments to the FSA (Articles 34-7 and 34-9-2).
- Audit firms shall submit financial statements and business reports annually to the FSA (Article 34-16).
- ▲ Audit firms shall submit changes of by-laws, and information on mergers and dissolutions to the FSA (Articles 34-10, 34-18③ and 34-19③).
- ▲ CPAs and audit firms shall be subject to **the requirements of reporting and submission of materials** by the FSA when necessary and appropriate for public interests or investors' protections (Article 49-3①).
- ▲ CPAs and audit firms shall be subject to **disciplinary actions** including services suspension orders up to 2 years and revocations of registration or dissolution orders (Articles 29~31 and 34-21②), and **investigations including inspections** for this purpose (Articles 32, 33 and 34-21③) by the FSA.
- CPAs and audit firms shall be subject to inspections by the FSA when necessary and appropriate for public interests or investors' protections (Article 49-3②)
- CPAs and audit firms shall be subject to necessary administrative directions by the FSA (Articles 34-2 and 34-21①)
- The FSA shall make public notices of its disciplinary actions (Articles 34③ and 34-21③).

(○⇒unchanged, ●⇒newly enacted, ▲⇒revised)



IV. Enhancing Auditor Oversight (4)

[JICPA ⇒ Audit firm and CPAs]

- ▲ CPAs shall be registered with the JICPA with additional items of registration rejection (Articles 17 and 18-2).
- Both CPAs and audit firms shall be members of the JICPA (Article 46-2).
- ▲ Members of the JICPA shall observe its charter (Article 46-3). Pursuant to the charter of the JICPA, they shall be subject to **reporting requirement, direction, disciplinary actions and audit quality control review by the JICPA** (Article 44①).
- The JICPA shall conduct audit quality control review of audit firms and CPAs (Article 46-9-2①).

[FSA ⇒ JICPA]

- The establishment of the JICPA is compulsory under the CPA Law (Article 43①).
- Changes in the JICPA's charter shall be approved by the FSA (Article 44②).
(Note) The JICPA's charter includes the provisions on ethics, supervision, audit quality control review, and the Audit Standards Committee.
- The JICPA shall be subject to the reporting and submission of materials requirements, inspection (Article 46-12①) and orders for revocations of resolutions of its general meetings (Article 46-13) by the FSA.
- The JICPA shall, when it finds facts regarding its members that fall under disciplinary provisions, report them to the FSA (Article 46-10).
- The JICPA shall be subject to administrative improvement orders by the FSA (Article 46-12-2).

(○⇒unchanged, ●⇒newly enacted, ▲⇒revised)

IV. Enhancing Auditor Oversight (5)

[CPAAOB]

- ▲ The CPA and Auditing Oversight Board (“CPAAOB”) shall be established within the FSA (Article 35①).
(Note) The current CPA Examination and Investigation Board shall be reorganized and its functions will be expanded and strengthened.
- ▲ The CPAAOB shall **examine disciplinary actions against CPAs and audit firms by the FSA** (Article 35②(1)).
- Quality control review by the JICPA shall be **monitored and reviewed by the CPAAOB** (Article 46-9-2①).
- The JICPA shall make reports on the quality control review of its members’ auditing to the CPAAOB (Articles 46-9-2② and 49-4②). The CPAAOB shall have the authority to **inspect CPAs and audit firms in this respect** (Article 49-4②).
- The CPAAOB shall be composed of Chairman and no more than 9 commissioners (Article 36①). Chairman shall be full-time (Article 36②). **Members of the CPAAOB shall be appointed by the Prime Minister with the consents of both Houses of the Diet** (Article 37-2). The term of office of the members shall be three years (Article 37-3①). The members shall exercise their authorities independently (Article 35-2). The CPAAOB shall have its Executive Bureau including the Secretary-General (Article 41).
- The CPAAOB shall be authorized to **issue recommendations to the FSA for administrative actions or directions** against CPAs, audit firms or the JICPA (Articles 35②(2) and 46-12-2).
- ▲ The CPAAOB shall conduct CPAs Examinations (Articles 13① and 35②(3))

(○⇒unchanged, ●⇒newly enacted, ▲⇒revised)



IV. Enhancing Auditor Oversight (6)

List of Members of Certified Public Accountants and Auditing Oversight Board (CPAFOB)

Chairperson (full-time)	Akira Kaneko	Former President Board of Audit of Japan (Constitutional Organization independent of the Cabinet)
Commissioner (full-time)	Yoshikazu Wakita	Former President Meiji Gakuin University
Commissioner (part-time)	Mami Indo	Senior Corporate Analyst Daiwa Securities SMBC
Commissioner (part-time)	Akio Okuyama	Chairperson Japanese Institute of Certified Public Accountants
Commissioner (part-time)	Atsuo Takahashi	Deputy President Japan Securities Dealers Association
Commissioner (part-time)	Yuko Tashima	Lawyer
Commissioner (part-time)	Eiko Tsujiyama	Professor Waseda University
Commissioner (part-time)	Yoshio Nakamura	Senior Managing Director Nippon Keidanren
Commissioner (part-time)	Kazuo Hiramatsu	President Kwansei Gakuin University
Commissioner (part-time)	Takeshi Yoshii	Chairperson Japanese Corporate Auditors Association



V. Enhancing Auditor Independence (1)

(1) Prohibition of providing auditing services in specific cases

▲ An audit firm shall not conduct an audit of the following financial documents (Article 34-11①):

- in cases that the audit firm owns **stocks** of or **invest** in the corporation
- in cases that a partner of the audit firm or its spouse is, has been, or was within the past one year **a director or a responsible officer** in charge of financial matters of the corporation
- in cases that a partner of the audit firm who was involved in providing auditing services to the corporation has **become directors or officers** of the corporation during the same or next accounting years.
- in cases that the audit firm or its partners have “**substantial interests**” in the corporation

(Note) “Substantial interests” are prescribed in the Cabinet Order implementing the CPA Law as follows (Article 34-11②)

- in cases that the audit firm is **a creditor or debtor** of the corporation
- in cases that the audit firm receives **special economic interests** from the corporation or its directors
- in cases that a partner of the audit firm is a **director, corporate statutory auditor, or an employee** of the corporation, its parent corporation, or subsidiary
- in cases that a partner of the audit firm receives continuous remuneration for **tax accounting services** from the corporation
- in cases that a half or more of partner or its spouse of the audit firm have **substantial interests** in the corporation

○ A partner of an audit firm who has specific relationship stipulated in Article 24 ① and ③ shall not be involved in auditing of financial documents of the corporation (Article 34-11③).

(Note) Article 24 stipulates the similar prohibition of CPAs’ providing auditing services in specific cases.

(○⇒unchanged, ●⇒newly enacted, ▲⇒revised)



V. Enhancing Auditor Independence (2)

(2) Prohibition of providing tax accounting services

- **Audit firms are not allowed to provide tax accounting services**
(Article 52 of the Licensed Tax Accountant Law)

(○⇒unchanged, ●⇒newly enacted, ▲⇒revised)



V. Enhancing Auditor Independence (3)

(3) Prohibition of providing certain non-audit services (1)

- A CPA and an audit firm shall be prohibited from providing certain non-audit services (which shall be prescribed by Ordinance of Cabinet Office) to a large corporation, contemporaneously with audit services (Articles 24-2 and 34-11-2).

(Note) Large Corporations include the followings:

- Large corporations which shall be subject to external audits under the Law for Special Exceptions to the Commercial Code concerning Audits, etc of Corporations (excluding corporations to be prescribed by Cabinet Order)
⇒ Corporations with less than 10 billion capital and less than 100 billion debt are excluded.
- Corporations which shall be subject to external audits under the Securities and Exchange Law (excluding such entities as SPC and investment corporation by the Cabinet Order)
- Banks, Long-term credit banks, Insurance companies
- Other institutions prescribed by the Cabinet Order

(○⇒unchanged, ●⇒newly enacted, ▲⇒revised)



V. Enhancing Auditor Independence (4)

(3) Prohibition of providing certain non-audit services (2)

- The Ordinance of Cabinet Office prescribes the following services as prohibited non-audit services in order to avoid involvement in business judgment and auditing own works.
 - bookkeeping or other services related to financial documents or accounting records
 - financial or accounting information systems design and management
 - attestation or appraisal services such as contribution-in-kind reports
 - actuarial service
 - internal audit outsourcing services
 - broker or dealer, investment adviser, or investment banking services
 - any other services which are likely to be involved in business judgment or correspond to auditing own works
- Provision of such non-audit services through related persons of the CPA or its spouse and the audit firm (which shall be prescribed by Ordinance of Cabinet Office) shall be also prohibited.

(Note) The Ordinance of Cabinet Office prescribes subsidiaries and affiliate entities.

(○⇒unchanged, ●⇒newly enacted, ▲⇒revised)



V. Enhancing Auditor Independence (5)

(4) Disclosure of interests in a corporation

- ▲ An audit firm, in certifying the financial documents of corporations, shall **disclose** in their certificates whether or not it has any interest in such corporation, and the details of such interests and other matters to be prescribed by Ordinance of Cabinet Office (Articles 34-12^③ and 25^②).

(○⇒unchanged, ●⇒newly enacted, ▲⇒revised)

V. Enhancing Auditor Independence (6)

(5) Requirement of rotation of engagement partners and review partners

- A CPA and an associate or a partner of an audit firm shall be prohibited from engaging in audit-related services to a large corporation over certain consecutive period (to be prescribed by Cabinet Order) (Articles 24-3 and 34-11-3).

- There shall be “time out” period (to be prescribed by Cabinet Order).

(Note 1) Audit-related services include the followings:

- audit services by CPAs
- involvement in audit services as partners of audit firms (including engagement partners and independent review partners)
- other similar services to be prescribed by the Ordinance of Cabinet Office (such as substantially engaged in audit services as employees of audit firms)

(Note 2) The Cabinet Order prescribes initially 7 years for allowable consecutive period and 2 years for time-out period.

(6) Restriction of assuming office as a director or an officer

- A CPA or an engagement partner of an audit firm who provides audit services to a corporation is prohibited from assuming office as a director or an officer of such corporation during current and next accounting years except in unavoidable cases (to be prescribed by Ordinance of Cabinet Office) with approvals by the FSA (Articles 28-2 and 34-14-2).
- In such unavoidable cases, audit firms whose former engagement partners assume office as a director or officer are prohibited from providing auditing services to such corporation during current and next accounting years (Article 34-11①-3).



VI. Additional Legal Duties for CPAs and Audit Firms

- Legal duty of CPAs and audit firms to appropriately supervise their employees (Articles 28 -3 and 34-14-3).
- Legal duty of audit firms to develop management structure for conducting their services in fair and proper ways in accordance with provisions of Ordinance of Cabinet Office (Article 34-13).
- Legal duty of a CPA to provide audit services to an large corporation either jointly with the other CPA or an audit firm or by employing the other CPA except in unavoidable cases (to be prescribed by Ordinance of Cabinet Office) (Article 24-4)

(○⇒unchanged, ●⇒newly enacted, ▲⇒revised)

VII. Reviewing CPAs examinations to increase the number and enhancing quality of CPAs

(1)

(1) Background

In view of increase in the needs for auditing in volume and quality, the objective of this revision is to increase the number of CPA while maintaining high quality, by reviewing the system of CPAs examinations so that larger number of qualified people including financial experts in enterprises may take such examinations.

(2) Present Situations

- Total number of CPAs : 14,873 (end of December 2003)
- Total number of junior CPAs : 5,347 (")

(Note) The junior CPAs system shall be abolished under the revised CPA Law.

- Annual number of successful candidates for junior CPAs
 - 1998 : 672
 - 2001 : 961
 - 2002 : 1,148
 - 2003 : 1,262



VII. Reviewing CPAs examinations to increase the number and enhancing quality of CPAs (2)

(3) Target

- Annual number of successful candidates \Rightarrow 2,000 ~ 3,000
- Total number of CPAs \Rightarrow about 50,000 by 2018

(4) Measures for increasing the number of CPAs

- Simplification of the present system of CPA examination (Article 5 of the revised CPA Law)
- Extension of partial exemption from CPAs examinations to persons who have certain professional qualifications (Article 8 ~ Article 10)

(5) Enhancing quality of CPAs

- Explicit legal duty for CPAs to take continuing professional educational program by the JICPA (to be prescribed by Ordinance of Cabinet Office)(Article 28)