

The CPA Profession in Japan

The Japanese Institute of Certified Public Accountants
July 2008
(Seventh Edition)

FOREWORD

The accountancy profession has experienced tremendous legal and regulatory changes during the past several years, which have come to be known as the "post-Enron era." Japan is not an exception and the Certified Public Accountants Act (CPA Act), which provides the entire regulation for CPAs, has been revised twice during the last five years. The Japanese Institute of Certified Public Accountants (JICPA) has been under public scrutiny as it faced accounting and auditing scandals over the last several years.

Under these circumstances, restoring confidence has been the most critical issue the profession has had to deal with. The JICPA has taken various actions to respond to the harsh criticism towards the accounting profession and also a number of initiatives to enhance the quality of services provided by members.

This seventh edition of "The CPA Profession in Japan" covers a wide range of topics from JICPA initiatives to regulatory framework, including the recent amendments of the CPA Act to help readers better understand the CPA profession in Japan as well as recent developments.

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Chairman and President

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Appendix: Code of Ethics

Chapter I Legal and Regulatory Framework of the CPA Profession in Japan

1. The CPA Act

The Certified Public Accountants Act ("CPA Act") provides the basic framework for the audit profession in Japan. It includes the scope of services to be provided by Certified Public Accountants ("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 Japanese Institute of Certified Public Accountants ("JICPA"), roles of the regulatory authority, and the disciplinary and criminal sanctions applicable to CPAs. The CPA Act grants the Financial Services Agency ("FSA") the authority to oversee CPAs and the JICPA. The CPA Act has been amended twice over the last several years. Details of those amendments are described in Chapter VI "History and Background: Development of CPA Profession."

2. FSA

As noted above, the FSA has oversight responsibilities over the audit profession in Japan. The CPA examination is conducted by the Certified Public Accountants and Auditing Oversight Board ("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 (Article 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, described below.

3. CPAAOB

The amended CPA Act 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 II "Quality Control Review System."

4. 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 of the CPA Act) 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:

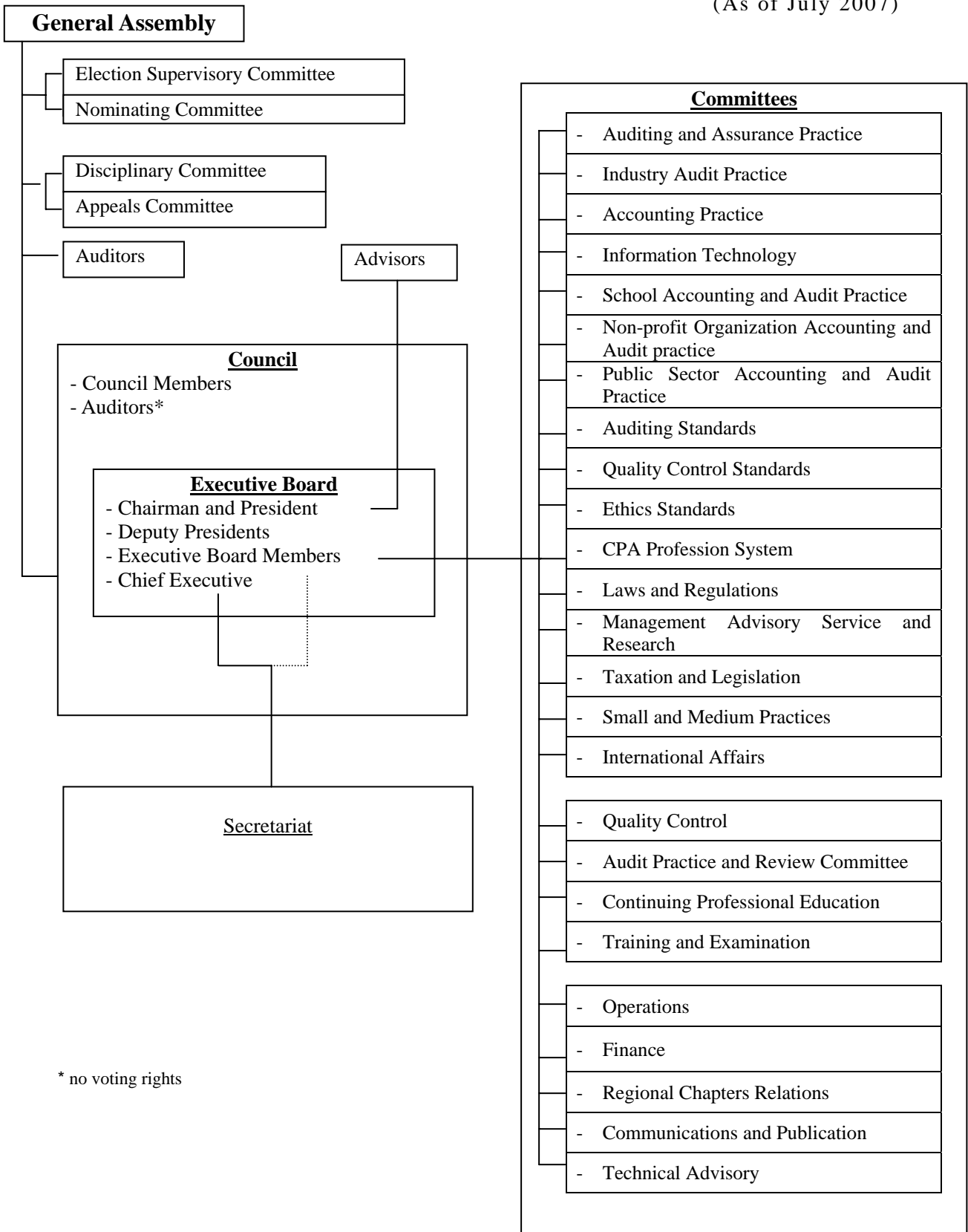
- (a) conducting research on and investigation into practices and systems of accounting, auditing and other related professional services in Japan and overseas;
- (b) providing guidance on auditing, accounting and other related professional services and submitting comments on various exposure drafts published by other organizations;
- (c) providing pre-qualification training courses and programs for continuing professional education ("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 International Federation of Accountants ("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 International Standards on Auditing ("ISA") in its own standard-setting.

The following chart illustrates the structure of the JICPA organization and major committees.

JICPA's ORGANIZATION CHART

(As of July 2007)



* no voting rights

5. Individual CPAs and Audit Corporations

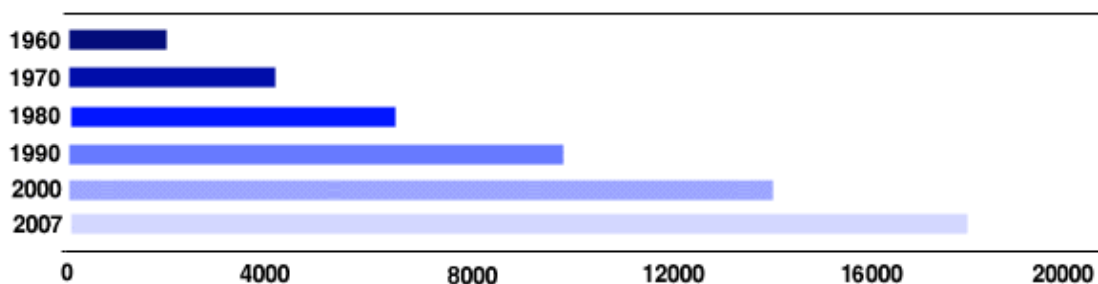
The total number of qualified Japanese CPAs was 17,795 as of December 31, 2007. It is estimated that more than half of the CPAs in Japan practice auditing. The remaining CPAs are either engaged in tax practices, management advisory services or other areas of public accounting, or are employed by government agencies or public and private enterprises.

In addition to CPAs, there are currently approximately 70,000 licensed tax accountants in Japan.

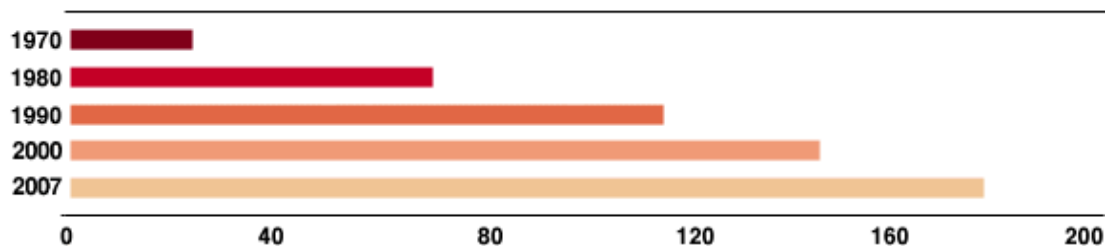
Prior to 1966, auditing was conducted exclusively by individual CPAs. In 1966, a measure aimed at forming the cooperative organizations of individual CPAs was developed by the national government. As a result, "audit corporations" with unlimited liability were introduced. As audit corporations have a number of benefits which include the availability of professional trained staff and a well-developed system of quality control over audit engagements, their establishment has been encouraged. With the amendment of the CPA Act in 2007, limited liability structure is allowed for audit corporations if they satisfy certain requirements.

Fig. 1 Number of CPAs and audit corporations in Japan

Number of CPAs in Japan



Number of audit corporations in Japan



	1960	1970	1980	1990	2000	2007
Number of CPAs (regular member) *1	1,508 (13)	4,162 (37)	6,036 (32)	8,799 (18)	13,220 (6)	17,795 (4)
Number of associate members *2	651	935	2,294	2,584	4,290	6,727
Number of audit corporations	NA *3	24	63	110	149	178

Note 1: The figures in parentheses represent registered foreign CPAs.

Note 2: Most of associate members are successful candidates of the CPA examination but yet to be qualified as a CPA.

Note 3: Audit corporations did not exist before 1967.

6. Statutory Audits

Statutory audits are required mainly under the Financial Instruments and Exchange Act ("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 also requires certain companies to be audited by independent CPAs or audit corporations regarding its financial documents sent together with the invitation letter to the annual general meeting of the shareholders

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

(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.

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.

Filed financial statements must be audited by independent CPAs or an audit corporation in accordance with Japanese generally accepted auditing standards ("GAAS"). The FIEA also requires audits of the financial statements of certain companies whose securities are not publicly traded.

(ii) Amendment of the Securities and Exchange Law to establish the FIEA

The bills for legislating the FIEA, which amends the Securities and Exchange Law, were enacted on June 7, 2006. The amendment introduced significant disclosure requirements covering listed companies to enhance investor protection and ensure the integrity and transparency of capital markets as follows:

- Statutory quarterly reporting system and review by independent CPAs or audit corporations in place of semiannual reporting;
- Mandatory management assessment of internal control effectiveness over financial reporting and audits by independent CPAs or audit corporations; and,
- Mandatory certification of annual reports by management

These requirements are applicable for periods beginning on or after April 1, 2008.

(iii) Audits under the Companies Act

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 business enterprise; and
- (c) To evaluate management's performance of its stewardship function.

Companies which have a Board of Directors must send out their shareholders business reports and financial documents along with an invitation letter to the general shareholders' meeting. The financial documents consist of the balance sheet, income statement, statement of changes in net assets and the notes to financial statements. Financial documents and its supporting documents of the companies, which appoint accounting auditors, have to be audited by accounting auditors. The consolidated financial documents of companies whose consolidated financial statements are filed with the FSA are also subject to an audit under the Companies Act.

The Companies Act allows wide discretion on design of corporate governance structure and stipulates mandatory financial audit in accordance with this. Certain joint stock companies must appoint accounting auditors and are subject to their audit regardless of the selected corporate governance structure.

Companies whose financial documents must be audited by accounting auditors are:

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

Company auditors are required to perform financial and operational audits. In respect of companies which restrict transfer of shares by articles of incorporation, shareholders may also limit the responsibility of company auditor to financial audit in the same document.

7. Accounting and Auditing Standards in Japan

The process of setting accounting and auditing standards, previously driven by the Ministry of Finance ("MOF"), and the FSA after the reorganization of government ministries and agencies, has been gradually changing.

With respect to the standard setting for auditing, even though basic standards are set by the Business Accounting Council ("BAC"), an advisory body established within the FSA, the role of the JICPA in setting standards has become increasingly important. In 1992, the JICPA

established the Auditing Standards Committee. Since then the Committee has set out the Implementation Guidance referred to as Auditing Standards Committee Statements as a guide for audit practice. The auditing standards established by the BAC and the Implementation Guidance by the JICPA, taken together, are deemed to comprise GAAS in Japan.

The Internal Control Committee, created by a reorganization of the BAC in 2005, published the Standards and Practice Standards for Management Assessment and Audit concerning Internal Control Over Financial Reporting on February 15, 2007.

In terms of global standard-setting for auditing, the International Auditing and Assurance Standards Board ("IAASB") functions as an independent standard-setting body under the auspices of the IFAC. The JICPA's Auditing Standards Committee closely monitors the activities of the IAASB and prepares comment letters regarding every exposure draft and other documents seeking input. The statements issued by the IAASB are incorporated into Japanese auditing standards and into the committee statements, issued in line with the progress toward global convergence.

As for standard-setting for accounting, 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, private-sector entity to develop accounting standards in Japan. Since its inception, the ASBJ has issued many accounting standards, guidance and other documents that address practical issues. 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 GAAP and International Financial Reporting Standards ("IFRSs").

In October 2006, the ASBJ has 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 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.

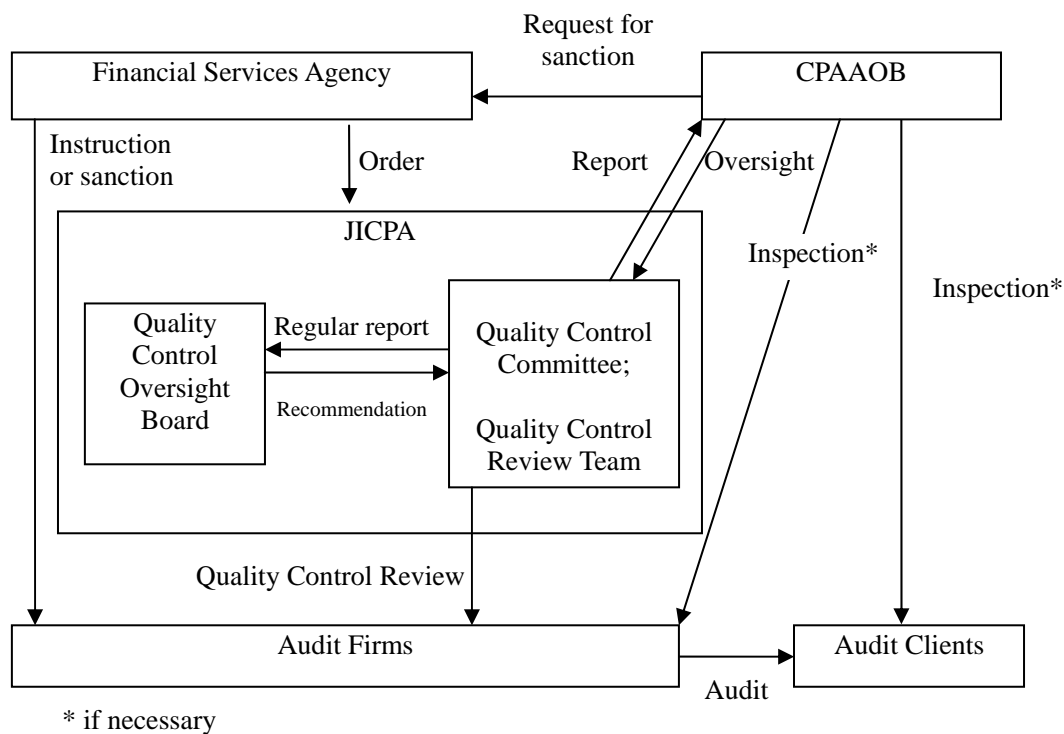
The new project plan issued in December 2007, in accordance with the content of the Tokyo Agreement. It classifies the project items into three categories (short-term, medium-term and medium and long-term) and indicates the schedule for each item. Items exhibited in "2. Items relating to the remaining differences (medium-term)" and "3. Items relating to MOU between IASB and FASB" are only the items that have already been launched or clearly planned.

Chapter II Quality Control Review System

1. 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:



2. 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.

3. 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, two deputy chief reviewers, nine senior reviewers and eight staff reviewers as of March 31, 2007. Each reviewer must be independent of a 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 "10. Registration System for Listed Company Audit Firms."

4. Review results

For the year ended March 31, 2007, 137 audit firms were reviewed by JICPA. Quality control review reports and recommendation reports were issued to 142 firms, including nine firms from the previous review period. Of these 142 firms, a qualified conclusion was expressed with respect to 69 firms, and a negative conclusion to two.

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

5. 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, 2006 and recommended, in June 2006, that the JICPA and the Quality Control Committee should:

- (a) continually confirm that audit firms establish policies and procedures adequately responsive to the enhancement of auditor independence in the amended CPA Act;
- (b) promote audits with the risk-based approach as well as revise policies and procedures of the quality control system, to be consistent with the newly issued or revised Auditing Standards Committee Statements;
- (c) promote the use of IT experts support, such as referrals of IT experts and the establishment

- of an Audit IT Consultation, so that each audit firm is able to respond in this area;
- (d) promote improvements to ensure that audit procedures of accounting estimates are properly performed;
 - (e) enhance follow-up visits to those audit firms that have made no improvement and to audit firms with unsatisfactory improvement; and
 - (f) confirm whether audit firms are properly responding to quality control standards.

6. JICPA responses to the Board's recommendations

In accordance with the above recommendations, the JICPA and the Quality Control Committee have taken the following steps:

- (a) ascertained whether auditor independence was ensured, the risk-based approach was taken, and audit procedures of accounting estimates were properly performed;
- (b) added and revised review tools for early application of Auditing Standards Committee Statements;
- (c) issued a Research Report in order to assist practitioners to respond to new standards related to the risk-based approach;
- (d) developed review procedures for early application of IT Committee Statement;
- (e) assisted audit firms with referrals to an IT expert, and by the creation of an Audit IT Consultation;
- (f) conducted a follow-up of recommendations including those related to large audit corporations;
- (g) obtained an understanding of the design of quality control systems of all audit firms that are subject to quality control review; and
- (h) established a Coordinating Committee for Small- and Medium-sized Practitioners.

7. CPAAOB

The CPA Act amended in 2003 stipulates the establishment of the CPAAOB 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. The CPAAOB is comprised of ten members who are to be nominated by the Prime Minister with the approval of the Diet. At a minimum, least the chairperson and one member of the CPAAOB will serve full-time.

The CPAAOB published its "Oversight Policy and Plan" on June 29, 2004. In accordance with this policy and plan, the CPAAOB has undertaken a study and evaluation of quality control reviews performed by the JICPA during five years from 1999 to 2003. The purpose of this study were to enable the CPAAOB to gain a full understanding of the actual implementation of quality control reviews by the JICPA and to identify areas that need improvement; so that the public interest is protected, and that fair, neutral, and effective audits are achieved. As a result, the CPAAOB issued a report entitled, "Proposal for Further Improvements to Quality Control Review – Assessment of and Recommendations Pertaining to the Quality Control Review System of the Japanese Institute of Certified Public Accountants ("Proposal")."

8. CPAAOB recommendations and responses of the JICPA

In the report, "Proposal," issued on February 8, 2005, the CPAAOB identified the following as necessary areas for improvement:

- (a) the quality control review system and structure;
- (b) standards and procedures of quality control reviews;
- (c) implementation of quality control reviews;
- (d) auditor independence; and
- (e) improvement of communication and cooperation between the Quality Control Committee and other related committees within the JICPA.

The JICPA has undertaken necessary measures to further improve the quality control review system in order to respond to the above recommendations, including:

- (a) doubling the number of quality control reviewers in fiscal 2005;
- (b) disclosing some portions of reports issued as a result of quality control reviews on its website and in a monthly journal;
- (c) improving the review procedures and its tools; and
- (d) establishing collaboration by sharing relevant information between the Quality Control Committee and the Audit Practice and Review Committee.

9. CPAAOB inspections of Big 4 Audit Corporations

Following some corporate accounting scandals, the FSA and CPAAOB announced several measures to ensure appropriate disclosure of financial reporting and rigorous audits of financial statements. These measures included the CPAAOB direct inspection of the Big 4 audit corporations in Japan. Based on this announcement, the CPAAOB started its inspection in October 2005.

As a result of these inspections, the CPAAOB made a recommendation to the FSA that instructions pursuant to the provisions of Article 34-21, paragraph 1, of the CPA Act be issued to those audit corporations. On July 7, 2006, in response to this recommendation, the FSA issued instructions to improve operations of each audit corporation pursuant to the provision of the said Article. Each audit corporation developed the plans based upon the instructions and promoted organizational measures to improve their operations. In May 2007, the FSA received reports from each audit corporation on the progress of their endeavor for improvement.

10. Registration System for Listed Company Audit Firms

(i) Objectives and Background of the Implementation of the Registration System

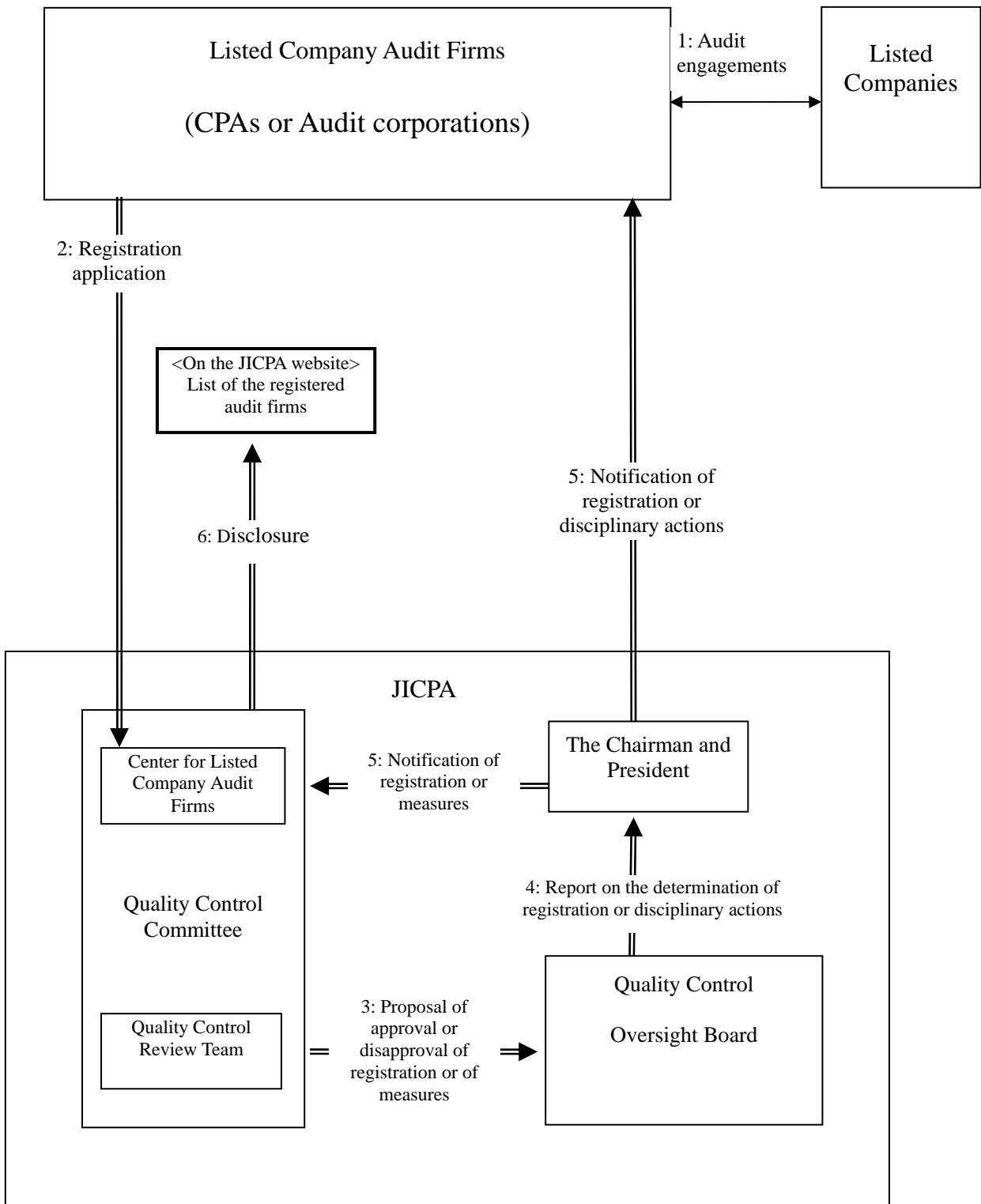
As described in "1. Overview" of this Chapter, the JICPA has conducted the quality control review as part of a self-regulatory function since April 1999 to improve and enhance the quality control system of audit firms that perform financial statement audits. The amendment in 2003 of the CPA Act, which 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 one after another 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 ensuring confidence in capital markets is becomes more important than ever. The reliability of the CPA auditing system was undermined by the scandals and public confidence in CPA's 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 CPA's 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 of 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



(ii) 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.

(a) 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.

(b) Mandatory registration

From the view point of enhancement of the quality control system of firms auditing listed companies which have substantial impact on capital markets, the revised 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.

(c) 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.

(d) 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 a CPA.

(e) 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.

(f) 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 provides 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.

(iii) Outline of the Registration System

The following outlines the registration system:

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

(b) 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.

(c) 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

(d) 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.

(e) 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
- 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.

(f) 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.

(g) 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

(h) 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.

(iv) 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.

(a) 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.

(b) 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.

(c) 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.

(d) 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.

Chapter III CPA Examination and Continuing Professional Education (CPE) System

1. CPA Examination and Pre-Qualification Education

Instituted in 1948, upon the promulgation of the CPA Act, the CPA examination is considered one of the most difficult examinations conducted by the Japanese Government. The examination has been adopted in order to ensure that those who perform audits have adequate professional capability and practical experience, together with a high level of professional ethics. Some amendments have been made due to the changing environment to improve the quality of Japanese CPAs. All examinations are prepared by knowledgeable experts, such as experienced CPAs and university professors, under the oversight of the CPAAOB.

(i) Examination system effected from 2006

The amendment of the CPA Act in 2003 reforms the CPA examination system and this amendment regarding the CPA examination was put into effect in January 2006. The examination is conducted annually by the CPAAOB, in Japanese. The new CPA examination is simplified to a single stage examination, compared to the former three-step examination. The new CPA examination is comprised of the multiple-choice tests and essay tests (Article 8). The multiple-choice tests include financial accounting, managerial accounting, auditing, and business law. Candidates who have passed the multiple-choice tests are allowed to take the essay tests, and are examined on the following subjects: accounting, auditing, business law, tax laws, and one of business administration, economics, the Civil Code, or statistics.

Those who satisfy certain requirements, successful candidates of certain other professional examinations, and those who are qualified professionals are exempt from taking certain subjects of the CPA examination.

The national CPA examination does not require a candidate to have a university degree in accounting or management. To eliminate university graduate requirements is one of national government's policies as enhancement of the equitability. However, the CPA examination tests whether a candidate has a thorough knowledge (equivalent to an undergraduate level) of accounting, auditing and related business subjects. The final assessment conducted by the JICPA examines professional knowledge obtained through three years of professional accountancy education program. In this sense, de facto pre-qualification education is required for Japanese CPAs.

(ii) Practical experience

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 or after passing the CPA examination.

(iii) Three year professional accountancy education program

Successful candidates of the CPA examination are required to complete three-years of professional accountancy education program provided by JICPA. The curriculum is established by taking into consideration the requirements set out in the International Education Statements issued by the International Accounting Education Standards Board of the IFAC.

(iv) Final assessment

Those who completed the professional accountancy education program are qualified to take the final assessment, which is conducted annually by JICPA. Subjects are accounting, auditing, taxation, business administration, including the theory of information technology, rules, regulations and ethics related to CPA's service. Those who passed the final assessment 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.

2. Continuing Professional Education

In April 1998, JICPA has introduced CPE programs to enhance the capabilities and competence of members in order to enable them to respond to changes in environment and to satisfy the needs of the public. It was first introduced to JICPA members as a voluntary program that each member was recommended to participate in. JICPA sets 40 hours of training as an annual CPE target. The mechanism for the maintenance of post-qualified professional competency is provided by CPE. It became mandatory in April 2002 for CPAs, who are full members of JICPA (Article 116, (2) of the JICPA Constitution).

JICPA classifies CPE training into seminar and self-study components. JICPA holds topical subject seminars frequently throughout the year. In addition, it holds three- or four- day intensive seminars several times a year.

Members can also earn credits by attending seminars organized by various institutions: JICPA, audit corporations, the ASBJ, the Bar Association or the Licensed Tax Accountants Association.

Self-study is a broad category that includes not only reading but also making use of e-learning programs, CD-ROMs and taking part in distance education programs. A member can earn required credits by applying one or more self-study methods. For example, a member can earn a certain amount of credits by reading books and articles. Up to 40 credits a year can be earned by reading the articles in the Accounting and Auditing Journals and JICPA Newsletters, both of which are monthly JICPA publications. When a member reports which articles he or she has read, he or she has to write a short essay on each article.

When members fail to submit CPE reports, JICPA follows up by sending them a reminder. CPE results are maintained on the JICPA website to which members can access. If a member does not obtain 40 credits in a year, he or she has to earn extra credits in the following year(s). If a member fails to earn the required number of credits without any good reason, he or she will be sanctioned. When the JICPA quality control reviewers review audit firms, CPE credit completion by audit team members at reviewed audit firms is an important part of their review.

Members who are engaged in professional services as a CPA, including tax services, have been required to earn four credits or more a year, out of the total CPE credits, in professional ethics since April 2006. Members who are engaged in statutory audit engagements have been required to earn four credits or more, out of the total CPE credits, in quality control for audit engagements since April 2007 (two credits were required for the year 2006 as a transitional measure).

Chapter IV Code of Ethics

1. Ethics Committee

The JICPA Ethics Committee was established in July 2004 in order to promote stronger independence of auditors, as required by the amended CPA Act. The Ethics Committee consists of JICPA members and those outside of profession and is supported with full time staff.

The responsibilities of the Ethics Committee include (1) preparing and revising the Code of Ethics and its interpretive guidance, (2) answering JICPA members' inquiries as to how to interpret the Code of Ethics, and (3) providing JICPA members with educational materials, such as a checklist of auditors' independence, a booklet of ethics case studies, and questions and answers on ethical issues.

2. Comprehensive Amendment of the JICPA Code of Ethics in 2006

(i) Purpose of the revision and its background

In recent years, a flood of international and domestic accounting and auditing scandals has raised the urgent need to ensure the reliability of disclosed information, especially of financial information, in capital markets. Measures have been taken to improve disclosure systems and the public expects a more rigorous Code of Ethics for CPAs.

The JICPA Code of Ethics ("JICPA Code") has passed through two major revisions up to the present date. The first one was the total revision in 2000 which was aimed at harmonization with the "Code of Ethics for Professional Accountants" of the IFAC (revised in January 1998); the second was the partial revisions in December 2003 and July 2004, following the enactment of the revised CPA Act which further tightened independence requirements for auditors. The revised CPA Act was enacted in May 2003 to improve the reliability of the CPA auditing system after a series of domestic and international scandals in accounting and auditing.

(a) Toward the global convergence of Code of Ethics for professional accountants

The IFAC Code of Ethics for Professional Accountants ("IFAC Code") has been revised several times since 1998. Section 8 "Independence" (Paragraph 290 of the current version) of the IFAC Code had been established as the international standard on which national standards should be based. Subsequently, IFAC Statements of Membership Obligations ("SMO") 4 "IFAC Code of Ethics for Professional Accountants," effective on or after December 31, 2004, changed the authority of the IFAC Code. SMO 4 and the revised IFAC Code strengthened the status of the IFAC Code with the provision that "no member body or firm is allowed to apply less stringent standards than those stated in this Code, except as allowed where laws or regulations in a jurisdiction prohibit the member body or firm from complying with certain parts of this Code."

(b) Establishment and enhancement of a comprehensive Code of Ethics

• Five-year rotation rule

"Reform of the partner rotation rule," which was referred to in the press release; "Measures for ensuring appropriate disclosure and stricter auditing system" issued by the CPAAOB on October 21, 2005; and the JICPA Chairman and President's Statement "Toward the restoration of confidence in audits by CPAs" released on October 25, 2005, have been

incorporated in the Notes regarding the Code of Ethics issued on February 16, 2006. The Notes stipulate that lead audit engagement partners of audit firms over a certain size are required to rotate after serving for no more than five years with a five year cooling-off period. This rule took effect for audit engagements for periods beginning on or after April 1, 2006.

- **Elimination of predecessor's influence during cooling-off period**

JICPA captured the attention of its members on March 17, 2006 by issuing the Interpretive Guidance for the Professional Ethics, a document which covers the need to eliminate predecessor's direct and/or indirect pressures during the cooling-off period after the lead audit engagement partners' rotation.

- **Enhancement of the self-regulatory function of JICPA**

JICPA announced the establishment and enhancement of a comprehensive Code of Ethics in the Chairman and President's Statement "Restoring Confidence in Certified Public Accountants' Audits - Enhancement of the self-regulatory function of JICPA –" on April 6, 2006.

Taking into consideration the circumstances described above, the JICPA Ethics Committee decided to revise the JICPA Code to make it equivalent with international standards and to strengthen independence requirements for auditors.

(ii) Fundamental policies for the revision

The JICPA Ethics Committee has deliberated the revision of the JICPA Code under the following fundamental policies, taking into account consistency with relevant national laws and regulations, as well as the IFAC Code.

(a) Ensuring the international level of standards

JICPA has incorporated the philosophy of the IFAC Code in its Code, unless otherwise prohibited in national legislation.

(b) Maintaining the former level of JICPA Code of Ethics

The provisions of the former JICPA Code, which are more rigorous than that of IFAC Code or are not stipulated in IFAC Code, are maintained in the revised JICPA Code.

(c) Clarity

The revised JICPA Code is written in the simplest and clearest terms possible.

(d) Transparency and availability

Professional ethics require that one conducts oneself in a disciplined manner as a professional. In addition, the JICPA Code is also required to be publicly available, as it constitutes the bedrock of self-regulation. JICPA intends to release an exposure draft and invite comments from the public and its members in case of future revision.

(iii) Major changes

(a) Chapter 1 - General

The former JICPA Code defined minimum requirements with which a professional accountant should comply with. Throughout the revised JICPA Code, JICPA incorporates a conceptual framework approach ("Framework Approach"), providing examples of relationships and circumstances which threaten professional accountants' compliance with the fundamental principles. A conceptual framework requires a professional accountant to

identify, evaluate and address those threats and assists in applying appropriate safeguards to eliminate or reduce the threats to an acceptable level.

The former JICPA Code was divided into three chapters: Chapter 1 - General Provisions (Article 1-2), Chapter 2 - Rules Applicable to All Members (Article 3-13.2), and Chapter 3 - Rules Applicable to Members Engaged in Audits (Article 14-18). The revised JICPA Code is reorganized into Chapter 1 – General Provisions, Chapter 2 – Rules Applicable to Accounting Firms and Members in an Accounting Firm, which retains contents of former Chapter 2 and 3 and combined into one Chapter, and Chapter 3 – Rules Applicable to Members in Business. Members who work for business entities, public sector organizations, and educational institutions are subject to this Chapter 3, although they were not covered by the former JICPA Code.

Definition of terms is set in the revised JICPA Code in order to clarify the extent and nature of the Code. Examples of terms are as follows:

- Accounting firm (including controlling and/or controlled by entities)
- Members in public practice (including members who work for a consulting company which affiliated with the accounting firm)
- Related entity (including parent entities, subsidiary entities and affiliated entities of the client, and entities with a material financial interest in the client)
- Assurance team (including persons who provide direct supervision, management or other oversight of the assurance engagement partner)

Contents of the former Notes regarding the Code of Ethics which should be maintained are integrated into JICPA Code.

(b) Chapter 2 – Rules Applicable to Accounting Firms and Members in an Accounting Firm

The following sections which are stipulated in IFAC Code are added to the revised JICPA Code:

- Consideration of Integrity of Clients (Article 4)
- Conflicts of Interest (Article 8)
- Second Opinions (Article 9)
- Objectivity of Professional Services (Article 15)

The scope of the following sections, which are applied to members who conduct audit engagements only under the former JICPA Code, is expanded to encompass members who provide a broad range of professional services;

- Changes in a Professional Appointment (Article 16 of the former JICPA Code)
- Notifying the Existing Accountant (Article 17 of the former JICPA Code)
- Contingent fee (Article 18 of the former JICPA Code)
- Gifts and Hospitality (Article 11-2-(3) of the former the Notes regarding the Code of Ethics Article 14 - Independence)

Article 19 "Name of an Audit Corporation" is retained in the revised JICPA Code and an additional guideline is planned to be issued in order to serve as a reference to members.

(c) Article 16 - Independence Requirements for Members in an Accounting Firm who Perform Assurance Engagements

The revised JICPA Code stipulates independence requirements when performing assurance engagements in general and is not limited to audits of financial statements.

The revised JICPA Code deals with the relationship of members' controlling entities, network firm and clients.

Application Guidance for the Conceptual Framework of Independence was released separately from JICPA Code in order to indicate how a framework approach should be applied to certain relationships and circumstances which threaten professional accountants' independence.

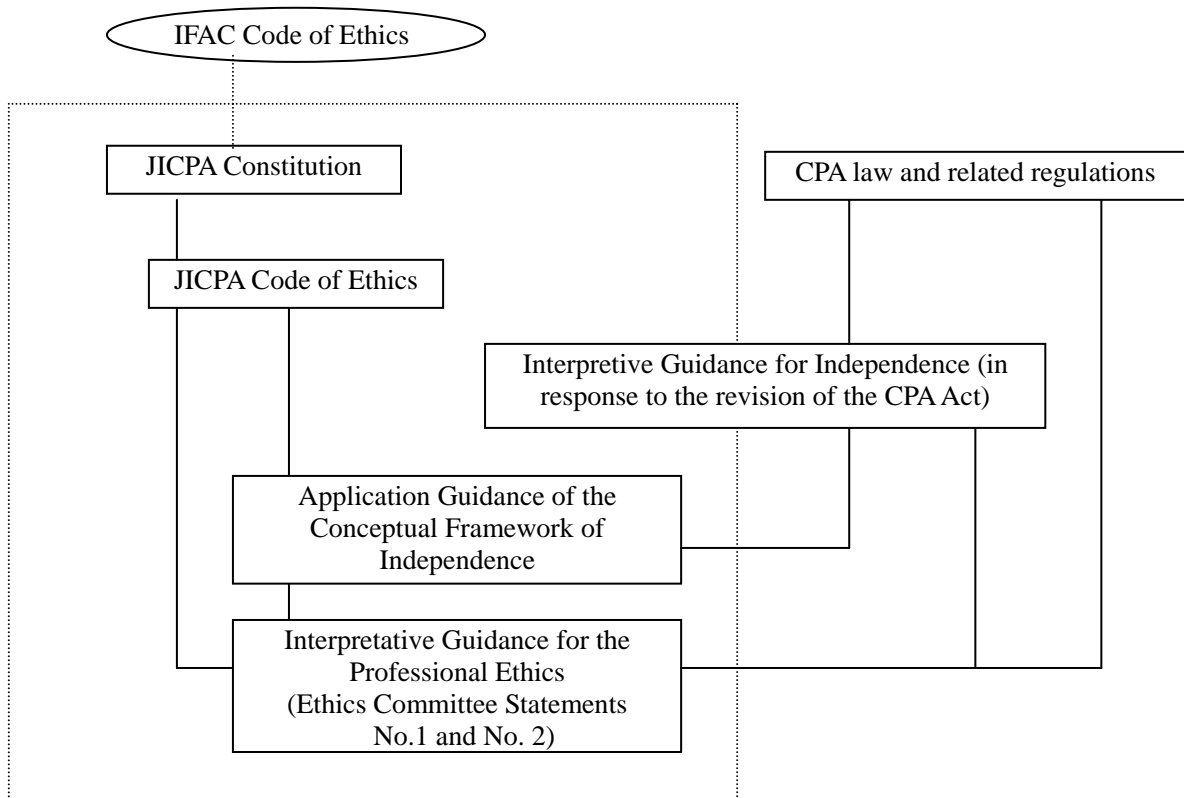
(iv) Measures for Dissemination and Effective Implementation of This Revision

As this revision includes significant changes to the entire JICPA Code, the revised JICPA Code should be disseminated and fully understood by every member through an education program such as CPE.

JICPA will improve the Code and release an Interpretive Guidance to make it an example of effectively-functioning self-regulation.

(v) Structure of JICPA Code, Other Pronouncements and Relevant Laws and Regulations

The following diagram indicates the structure of the JICPA Code, and other pronouncements and relevant laws and regulations which are closely interrelated:



3. Revision in response to the Amended CPA Act

In order to conform to the amended CPA Act of 2007 (which came into effect on April 1, 2008) the JICPA Code has been revised. The five-year rotation rule, which JICPA introduced as a self-regulatory measure in 2006, has been legislated under the amended CPA Act.

Chapter V Disciplinary Actions and Sanctions of CPAs

1. Creation of Audit Hotline to Receive Complaints

In addition to the traditional "information-based" approach, JICPA adopts a "complaints-based" approach to investigate potential misconduct by auditors. Complaints-based actions are taken when JICPA receives a complaint against a member from another member or from the public. JICPA has been formally collecting complaints about audits from members and the public since November 2005. These complaints may be related to not only statutory audits required under the FIEA or Companies Act, but also statutory audits for schools and certain not-for-profit organizations.

2. Audit Practice and Review Committee

Information collected through various measures is first reviewed by the Audit Practice and Review Committee. The Audit Practice and Review Committee consists of 15 members and includes Deputy Presidents, Executive Board members and Council members. 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;
- 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;
- report to the Chairman and President on any significant matters in terms of the quality control system of an audit firm identified during investigations.

3. 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 or audit firm's qualifications and other sanctions stated in the CPA Act.

4. 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.

5. 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 VI History and Background: Development of CPA Profession

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 ("SEL") 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 firms 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:
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:

- 1952 (Jul.) Reporting on compliance with accounting procedures.
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 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:

- (1) Membership was limited to CPAs;
- (2) There must have been at least five members;
- (3) All members must have had the right and duty to participate in the practice;
- (4) No member was to be under suspension from practice or have contravened provisions of the law;
- (5) 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. 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. On the other hand, after 1973, 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 ("the 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 Code (the Ministry of Justice) and the MOF both recognized the importance of expanding the requirements for independent audits under the Code. However, under the 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 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 for CPAs to refer to.

In 1974, after a number of years of discussion and consultation, the Code was amended to require companies with a capital stock of ¥1,000 million or more to be subject to audit by accounting auditors. In 1981, in order to expand audit requirements, further amendments to the 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, and real property that had incurred unrealized losses could be written down to reflect current market values.

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 BIS (Bank for International Settlements), 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 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 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 FASF was established in 2001, and the 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,
- Other services that are equivalent to the above listed services and that involve management decisions or lead to the self-audit.

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 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 time-out period. Under the amended CPA Act, all engagement partners are legally required to rotate after serving for no more than seven years with time-out 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 Code for the 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 least 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 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 which Kanebo's former auditors belonged to. 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 this statement 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 II, the registration system of listed company audit firms has been in place since April 2007. JICPA set the deadline as July 15 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 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 in Japan 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 monetary sanction 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 conduct is found to be willful (i.e. 1.5 times the audit fee). The monetary sanctions are administrative actions and would not be considered 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 several years 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.

- 2006 * The Securities and Exchange Law and other related laws were amended and reorganized into the Financial Instruments and Exchange Law.
- * 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 for Evaluation and Audit for 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.

APPENDIX

Code of Ethics

Code of Ethics

Established: December 1, 1966
Final revision: December 10, 2007

THE PRINCIPLES AND SPIRIT OF THE CODE OF ETHICS

Certified Public Accountants should, as professional accountants, sincerely and fairly perform their duties on the basis of professional competence, in order to contribute to the public interest and the sound development of society.

In a society based on the principles of self-responsibility, the enhancement of the disclosure system for financial information and the ensuring of the reliability of disclosed financial information is necessary. Certified Public Accountants, as professional accountants, should therefore act in compliance with the following principles:

- (1) To ensure quality at the level that should be achieved when rendering services, and
- (2) To act in accordance with stringent professional ethics governing their behavior when providing professional services, in order to realize their social responsibilities and fulfill their duties.

Certified Public Accountants should recognize the importance of their mission and code of professional conduct. In addition, they should devote themselves to continuous improvement of their expertise, endeavor to acquire a wide range of general knowledge, maintain high standards of integrity, and exercise due professional care and proper judgment in rendering their services. In addition, Certified Public Accountants should always maintain a fair and independent attitude, and behave in a manner that will ensure firm public confidence is gained through their performance of audits and other assurance services.

The Japanese Institute of Certified Public Accountants (hereinafter referred to as "the Institute") prescribes here in the Code of Ethics that Certified Public Accountants should be aware of their social roles, discipline themselves, and be able to meet the public's expectations.

The members and associate members of the Institute should act not only in compliance with the Code of Ethics, which is explained later, but also conduct themselves properly in a manner based upon an understanding of the principles of this Code of Ethics, though these principles may not be explicitly prescribed here.

CHAPTER I GENERAL PROVISIONS

Article 1. Objective

1. The Code of Ethics prescribes matters concerning professional ethics which should be complied with by members and associate members of the Institute (collectively hereinafter referred as "a member") in accordance with provision of Article 43 of the Constitution of the Institute.
2. If there is doubt concerning the interpretation of the Code or a lack of clarity in matters concerning ethics not prescribed in the Code, members may consult with the Institute.

Article 2. Fundamental Principles

1. A member should comply with the following fundamental principles in performing professional services.

2. Integrity

A member should always act with integrity, and should not be associated with the preparation of information or disclosure where they believe that the information:

- (a) Contains a false or misleading statement;
- (b) Contains information with material errors; or
- (c) Omits or obscures information required to be included where such omission or obscurity would be misleading.

3. Objectivity

A member should always maintain objectivity and should not allow bias, conflict of interest or the undue influence of others, which may compromise objectivity.

The principle of objectivity requires members to maintain objectivity in judgment in the course of work, including reasonableness of the purposes of performing services, impartiality in determining matters that should be considered when services are performed, and unbiased judgment. The appropriateness of these judgments should be verifiable by others.

4. Professional Competence

A member should maintain professional knowledge and skill at the level required to ensure that clients or employers receive competent professional service.

5. Due Care

A member should act diligently, as is required of professional accountants, and comply with the following requirements:

- (1) The professional requirements and professional standards when providing professional services.
- (2) The requirement to make clients, employers or other users of the professional services aware of limitations inherent in the services.

6. Confidentiality

A member should not, without any justifiable reason, disclose to others or use any confidential information acquired as result of professional and business relationships to their personal advantage or the advantage of third parties.

Confidential information acquired as result of professional and business relationships means a secret that a member obtained from an accounting firm, an employer (including a potential employer), a client (including a potential client) and a company to which professional services of the member were rendered.

A member should bear in mind that they should not give an impression that may suggest to other people that a member or members might use confidential information acquired as result of professional and business relationships.

7. The requirement of the preceding paragraph 6 (hereinafter referred to as "confidentiality") continues even after the end of relationships between a member and an accounting firm, a client or employer.

8. A member should take all reasonable steps to ensure that member's employees, other staff and persons from whom advice and assistance is obtained respect the member's duty of confidentiality.

9. The following are circumstances where a member is or may be required to disclose confidential information or when such disclosure may be appropriate:

(1) Disclosure is authorized by the client. However, a member should consider whether the interests of all parties, including third parties whose interests may be affected, could be harmed;

(2) Disclosure is required by law, for example:

(i) Production of documents or other provision of evidence in the course of legal proceedings;

(ii) Response to an inquiry, investigation or inspection based on the laws and regulations;
or

(iii) Reports on facts concerning illegal acts or other violations based on the laws and regulations; and

(3) There is a professional duty or right to disclose, when not prohibited by law:

(i) To protect the professional interests of a member in legal proceedings;

(ii) To comply with the quality control review of the Institute; or

(iii) To respond to an inquiry or investigation by the Institute in accordance with provisions of the Constitution and other regulations of the Institute; or

(iv) To ensure communication between predecessor and successor auditors.

10. Professional Behavior

A member should always behave as a professional accountant, comply with relevant laws and

regulations and avoid any action that may bring discredit to members or negatively affects the good reputation of the profession.

Article 3. Conceptual Framework Approach

1. A member has an obligation to evaluate any threats to compliance with the fundamental principles when the member knows of circumstances or relationships that may compromise compliance with the fundamental principles described in the preceding Article.
2. If identified threats are other than clearly insignificant, a member should, where appropriate, consider and apply safeguards to eliminate the threats or reduce them to an acceptable level.
3. A member should take qualitative as well as quantitative factors into account when considering the significance of a threat.
4. If a member cannot implement appropriate safeguards, they should decline or discontinue the specific professional service involved, or where necessary resign from the client or the employing organization.
5. Once the violation of the provisions of this Code of Ethics is discovered, the violation should be corrected promptly and any necessary safeguards applied.
6. A member should bear in mind that the provisions of the preceding paragraphs 1 through 5 are applicable to professional services performed by a company that controls, or is controlled by, a member.

CHAPTER II RULES APPLICABLE TO ACCOUNTING FIRMS AND MEMBERS IN AN ACCOUNTING FIRM

Article 4. Consideration of Integrity of Clients

1. When accepting a new client relationship, threats to integrity and professional behavior may be created. Client issues that could threaten compliance with the fundamental principles include, for example, client involvement in illegal activities, dishonesty or questionable financial reporting practices. The significance of any threats should be evaluated. If identified threats are other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate them or reduce them to an acceptable level.
2. Appropriate safeguards that a member should apply may include:
 - (1) Obtaining knowledge and understanding of the client, its owners, managers and those responsible for its governance and business activities, or
 - (2) Securing the client's commitment to improve corporate governance practices or internal controls.
3. Where it is not possible to eliminate or reduce the threats to integrity or professional behavior to an acceptable level, a member should decline to enter into the client relationship.
4. Acceptance decisions should be periodically reviewed for recurring client engagements.

Article 5. Professional Competency of an Engagement Team

1. When accepting a specific client engagement, threat to professional competence and due care may be created if the engagement team does not possess the competencies necessary to properly carry out the engagement. Alternatively, a threat to professional competence and due care is created if the engagement team gives the client expectations that exceeds its professional competencies. Before accepting a specific client engagement, a member should evaluate the significance of identified threats and, if they are other than clearly insignificant, safeguards should be applied as necessary to eliminate them or reduce them to an acceptable level.
2. Such safeguards that a member should apply may include:
 - (1) Acquiring an appropriate understanding of the nature of the client's business, the complexity of its operations, the specific requirements of the engagement and the purpose, nature and scope of the work to be performed.
 - (2) Acquiring knowledge of relevant industries or subject matters.
 - (3) Acquiring knowledge of relevant regulatory and reporting requirements.
 - (4) Assigning sufficient staff with the necessary competencies.
 - (5) Using experts where necessary.
 - (6) Agreeing on a realistic time frame for the performance of the engagement.
 - (7) Complying with quality control policies and procedures designed to provide reasonable assurance that specific engagements are accepted only when they can be performed competently.

3. When a member intends to rely on the advice or work of an expert, a member should consider factors such as expertise, resources available and applicable professional and ethical standards, and evaluate whether such reliance is warranted.

Article 6. Changes in a Professional Appointment

1. A member who is asked to replace another member, should determine whether there are any professional reasons for not accepting the engagement, such as circumstances that threaten compliance with the fundamental principles. For example, there may be a threat to professional competence and due care if a member accepts the engagement before knowing all the pertinent facts. The significance of the threats should be evaluated. If identified threats are other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate them or reduce them to an acceptable level.
2. A member should bear in mind the following points pertinent to the preceding paragraph:
 - (1) Depending on the nature of the engagement, the apparent reasons for the change in appointment may not fully reflect the facts and may indicate disagreements with the existing member. In such circumstances, a member is required to partake in direct communication with the existing member to establish the facts and circumstances.
 - (2) An existing member is bound by confidentiality. The extent to which the existing member can and should discuss the affairs of a client with a proposed member will depend on the nature of the engagement and on:
 - (i) Whether the client's permission to do so has been obtained; or
 - (ii) The legal or ethical requirements relating to such communications and disclosure.
3. Safeguards that a member should apply may include:
 - (1) Discussing the client's affairs fully and freely with the existing member.
 - (2) Asking the existing member to provide known information on any facts or circumstances that, in the existing member's opinion, the proposed member should be aware of before deciding whether to accept the engagement.
 - (3) When replying to requests to submit tenders, stating in the tender that, before accepting the engagement, contact with the existing member will be requested so that inquiries may be made as to whether there are any professional or other reasons why the appointment should not be accepted.
4. If a proposed member is unable to communicate fully with the existing member, the proposed member should more prudently consider whether to accept the engagement.

Article 7. Acceptance of Work that is Complementary or Additional to the Work of the Existing Member

1. A member may be asked to undertake work that is complementary or additional to the work of the existing member. Such circumstances may give rise to potential threats to professional competence and due care resulting from a lack of or incomplete information. The significance of the threats should be evaluated. If identified threats are other than clearly insignificant,

safeguards should be considered and applied as necessary to eliminate them or reduce them to an acceptable level.

2. Such safeguards that a member should apply may include:
 - (1) Confirming whether any other member is involved in the proposed work, and obtaining necessary information.
 - (2) Notifying, after obtaining the client's permission, the existing member of the proposed work, which would give the existing member the opportunity to provide any relevant information needed for the proper conduct of the work.

Article 8. Conflicts of Interest

1. A threat to objectivity may be created when a member competes directly with a client or has a joint venture or similar arrangement with a major competitor of a client. A threat to objectivity or confidentiality may also be created when a member performs services for clients whose interests are in conflict or the clients are in dispute with each other in relation to the matter or transaction in question. The significance of the threats should be evaluated. If threats are other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate them or reduce them to an acceptable level.
2. Such safeguards that a member should apply may include:
 - (1) Notifying the client of the member's business interest or activities that may represent a conflict of interest, and obtaining their consent to act in such circumstances; or
 - (2) Notifying all known relevant parties that the member is acting for two or more parties in respect of a matter where their respective interests are in conflict, and obtaining their consent to so act; or
 - (3) Notifying the client that the member does not act exclusively for any one client in the provision of proposed services and obtaining their consent to so act.
3. The following additional safeguards should also be considered:
 - (1) The use of separate engagement teams; and
 - (2) Procedures to prevent access to information; and
 - (3) Clear guidelines for members of the engagement team on issues of information security and confidentiality; and
 - (4) The use of confidentiality agreements signed by employees (including partners for audit corporations) involved in the engagement or transaction in question; and
 - (5) Regular review of the application of safeguards by a senior individual not involved with relevant client engagements.
4. Where a conflict of interest poses a threat to one or more of the fundamental principles including objectivity or confidentiality that cannot be eliminated or reduced to an acceptable level through the application of safeguards, the member should not accept a specific engagement.

Article 9. Second Opinions

1. Situations where a member is asked to provide a second opinion on the application of

accounting, auditing or other standards or principles to specific circumstances or transactions by or on behalf of a company or an entity that is not an existing client may give rise to threats to compliance with the fundamental principles. For example, there may be a threat to due care in circumstances where the second opinion is not based on the same set of facts that were made available to the existing member, or is based on inadequate evidence. The significance of the threat will depend on the circumstances of the request and available facts and evidence relevant to the expression of a professional judgment. A member should evaluate the significance of the threats and, if they are other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate them or reduce them to an acceptable level.

2. Such safeguards that a member should apply may include:
 - (1) Seeking client permission to contact the existing member.
 - (2) Describing the limitations surrounding any opinion in communications with the client when disclosure of facts and obtaining evidence are restricted.
3. If the company or entity seeking the opinion will not permit communication with the existing member, a member should consider more prudently whether it is appropriate to provide the opinion sought.

Article 10. Fees

1. A member should charge fair fees which reflect the nature and value of the professional services performed for the clients. A member should not quote or charge unjustifiably low fees.
2. When quoting a fee, a member should consider the following matters and make the client aware of the terms of the engagement and, in particular, the basis on which fees are charged and which services are covered by the quoted fee.
 - (1) Knowledge and skill required to perform the engagement.
 - (2) Degree of training and experience required for team members assigned to the engagement.
 - (3) Appropriate time assigned to the engagement.
 - (4) Degree of responsibility imposed with regard to performance of the engagement.

Article 11. Contingent Fees

1. The acceptance of an assurance engagement based on an arrangement in which a fee calculated on a predetermined basis relating to the outcome or result of a transaction or the result of the work performed (hereinafter referred to as "contingent fee") is involved, gives rise to threats to objectivity. Since no safeguards are sufficient to eliminate such threats or reduce them to an acceptable level, a member should not accept an assurance engagement based on a contingent fee.
2. When accepting a non-assurance engagement based on a contingent fee, such acceptance may give rise to threats to objectivity. The significance of such threats should be evaluated and, if they are other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate or reduce them to an acceptable level.

3. Such safeguards that a member should apply against the threats in the preceding paragraph may include:
 - (1) An advance written agreement with the client as to the basis of remuneration.
 - (2) The establishment of appropriate policies and procedures relating to contingent fees and adherence to them.

Article 12. Referral Fees

When accepting or performing professional services, a member, with respect to referring or accepting an engagement, should not receive or pay a referral or brokerage fee, or other fee or consideration resulting from the engagement.

Article 13. Marketing Professional Services

1. A member should be honest and truthful when soliciting professional services through advertising or other forms of marketing, and should not bring the profession into disgrace or disrepute.
2. In order to avoid bringing the profession into disgrace or disrepute, a member should:
 - (1) Not make exaggerated claims for services offered, qualifications possessed or experience gained;
 - (2) Not make disparaging references to or comparisons to the work of another member;
 - (3) Communicate true information;
 - (4) Not make any advertisement that violates laws and regulations, the Constitution and regulation of the Institute.
3. If a member is in doubt whether a proposed form and contents of advertising or marketing is appropriate, the member may consult with the Institute.

Article 14. Gifts and Hospitality

1. A member may be offered gifts or hospitality from a client to whom it provides assurance services. A member may also offer gifts or hospitality to a client to whom it provides assurance services. Such an offer gives rise to threats to objectivity. If evaluated threats are other than clearly insignificant, no safeguards are sufficient enough to reduce them to an acceptable level. Therefore, an accounting firm or members of the assurance service team should not accept such offers unless evaluated threats are clearly insignificant.
2. A member may be offered gifts or hospitality from a client to whom it provides non-assurance services. A member may also offer gifts or hospitality to a client to whom it provides non-assurance services. Such an offer gives rise to threats to objectivity. The significance of such threats will depend on the nature, value and intent behind the offer. The significance of identified threats should be evaluated and, if they are other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate them or reduce them to an acceptable level.

3. Such safeguards that a member should apply against the threats in the preceding paragraph may include:
 - (1) Establishing appropriate policies and procedures about gifts and hospitality and abiding by them.
 - (2) Obtaining approval of persons responsible for gifts and hospitality.
 - (3) Documenting contents of gifts and hospitality and reporting them.

Article 15. Objectivity of Professional Services

1. When providing any professional service, there are potential threats to objectivity resulting from the fact that a member, the spouse of the member or any relative within the second degree of kinship (parents, siblings, grandparents and grandchildren in addition to spouse and children) who share the same livelihood as the member, have interests in, or close relationships with, a client or directors or employees. The existence of threats to objectivity when providing any professional service will depend upon the particular circumstances of the engagement and the nature of the work. A member should evaluate the significance of identified threats and, if they are other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate them or reduce them to an acceptable level.
2. Such safeguards that a member should apply may include:
 - (1) Withdrawing from the engagement team.
 - (2) Supervisory procedures.
 - (3) Terminating the financial or business relationship giving rise to the threat.
 - (4) Discussing the issue with higher levels of management within the firm.
 - (5) Discussing the issue with those charged with governance of the client.

Article 16. Independence

1. When accepting or continuing an assurance engagement, a member should maintain independence from clients.
2. 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.
3. Independence requires:
 - (1) 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.
 - (2) 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.

4. A member should not have interests that are prescribed in the laws and regulations in their relationship with the clients of financial statement audits.
5. When a member accepts or continues audit engagements other than audits that are prescribed in the Financial Instruments and Exchange Law, a member should not have any of the following relationships in addition to the one described in the preceding paragraph:
 - (1) A member, being engaged in financial statement audits as an assistant, with relationships as described in paragraph 1, item 1 or 2, or paragraph 3 of Article 24 of the Certified Public Accountants Law, or paragraph 1, item 1, 4, 5, 6, 8 or 9 of Article 7 of the Ministerial Ordinance for the Certified Public Accountants Law.
 - (2) In the case that a member is a Certified Public Accountant, a foreign Certified Public Accountant, or partners who have prepared an audit certification for clients in an audit corporation, the member's relatives within the second degree of kinship have such relationships as shown on Article 24 paragraph 1 item 1 of the Certified Public Accountants Law and Article 7 paragraph 1 item 1 of the Ministerial Ordinance for the Certified Public Accountants Law.
6. If a member knows of circumstances or relationships that might compromise independence when the member accepts or continues an assurance engagement, the member should evaluate the significance of identified threats based on the particular circumstances or relationships and, if they are other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate them or reduce them to an acceptable level to ensure independence.
7. A member is required to judge his or her independence on the basis of "the application guidance for conceptual framework of independence" that is separate from this Code and adapt it to the particular circumstances under consideration.

Article 17. Quality Control

A member should endeavor to ensure quality in the performance of professional services by having a good organizational structure and by providing appropriate guidance or supervision to employees, etc.

Article 18. Prohibition of Name Lending

A member should not permit anyone who is not in the employment of the member to render professional services in the name of the member, and should not express any opinion on any professional services by people not in the employment of the member.

Article 19. Expression of Opinions Regarding Future Events

A member should refrain from expressing opinions in any manner which may mislead others to believe that the member is attesting to the attainability of a forecast regarding future events.

Article 20. Other Inappropriate Business

A member should not concurrently engage in any business, occupation, or activity which impairs or might impair professional integrity, objectivity, or public confidence in the performance of professional services.

Article 21. Prohibitory Conduct against Other Members

A member should refrain from the following conduct:

- (1) Slandering or impairing the professional reputation of other members.
- (2) Encroaching upon the practice of other members by unfair means.
- (3) Offering employment to other members' employees when such offers would significantly hinder the practices of the other members.

Article 22. Mutual Conference between Members

Members jointly performing professional services should communicate and confer with each other to a sufficient extent.

Article 23. Name of an Audit Corporation

1. A member should not use a name that may bring the profession into disrepute when forming an audit corporation, changing the name of the audit corporation or merging with another audit corporation.
2. A member should not use the same name or similar name to other audit corporations and others (joint firms, foreign offices that are equivalent to a professional accountant's firm), when forming an audit corporation, changing the name of the audit corporation or merging with some other audit corporation.
3. A member should make an inquiry to the Institute as to the name of an audit corporation before forming an audit corporation, changing the name of the audit corporation or merging with some other audit corporation, in view of the public interest associated with audit services.

CHAPTER III RULES APPLICABLE TO MEMBERS IN BUSINESS

Article 24. Compliance with the Fundamental Principles

Members in business must realize the importance of the mission and code of professional conduct of Certified Public Accountants, and abide by the fundamental principles described in Article 2.

Article 25. Potential Conflicts

1. When a member in business is under direct or indirect pressure to act or behave in ways that could threaten compliance with the fundamental principles of objectivity, the significance of threats arising from such pressures should be evaluated and, if they are other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate them or reduce them to an acceptable level. A member in business may face pressure to:
 - (1) Act contrary to law or regulation.
 - (2) Act contrary to technical or professional standards.
 - (3) Facilitate fraud or illegal earnings management strategies.
 - (4) Lie to, or otherwise intentionally mislead the auditors of the employing organization or regulators.
 - (5) Be associated with a financial or non-financial report that materially misrepresents the facts.
2. Safeguards that a member in business should apply may include:
 - (1) Obtaining advice from superiors of the employing organization, an independent professional advisor or a relevant professional body.
 - (2) Relying on a formal dispute resolution process within the employing organization.
 - (3) Seeking legal advice.

Article 26. Preparation and Reporting of Information

1. When involved in the preparation or reporting of information, a member in business should prepare or present such information in accordance with relevant professional standards.
2. A member in business who has responsibility for the preparation or approval of the financial statements of an employing organization should ensure that those financial statements are presented in accordance with the applicable financial reporting standards.
3. Threats to compliance with the fundamental principles such as objectivity, professional competence and due care may be created where a member in business may be pressured to become associated with preparation or reporting of misleading information. The significance of threats should be evaluated and, if they are other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate them or reduce them to an acceptable level.
4. Such safeguards that a member in business should apply may include consultation with superiors within the employing organization, an independent expert or a relevant professional

body.

Article 27. Acting with Sufficient Expertise and Experience

1. A member in business should not intentionally mislead an employer as to the level of expertise or experience possessed, nor should a member in business fail to seek appropriate expert advice and assistance when required.
2. The following circumstances may threaten the ability of a member in business to perform duties with the appropriate degree of professional competence and due care. The significance of threats should be evaluated and, if they are other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate them or reduce them to an acceptable level.
 - (1) Incomplete, restricted or otherwise inadequate information for performing the duties properly.
 - (2) Insufficient experience, training and/or education for performing the duties properly.
 - (3) Inadequate resources for performing the duties properly.
 - (4) Insufficient time for performing the duties properly.
3. Safeguards that a member in business should apply may include:
 - (1) Obtaining additional advice or assistance from someone with the necessary expertise.
 - (2) Obtaining training for properly performing the relevant duties.
 - (3) Ensuring that there is adequate time available for performing the relevant duties.
 - (4) Consulting with superiors within the employing organization, or
 - (5) Consulting with independent experts or a relevant professional body

Article 28. Financial Interests

1. When a member in business, the spouse of the member or relatives within the second degree of kinship who share the same livelihood as the member, has financial interests in the employing organization, threats to objectivity or confidentiality may be created. A member in business should evaluate the significance of such a threat, and if threats are other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate them or reduce them to an acceptable level.
2. Examples of circumstances that may create threats to objectivity or confidentiality include cases in which a member:
 - (1) Holds a direct or indirect financial interest in the employing organization and the value of that financial interest could be directly affected by decisions made by the member in business;
 - (2) Is eligible for a profit related bonus and the value of that bonus could be directly affected by decisions made by the member in business;
 - (3) Holds, directly or indirectly, share options in the employing organization, the value of which could be directly affected by decisions made by the member in business;
3. Safeguards that a member in business should apply may include:
 - (1) Consultation with superiors within the employing organization.
 - (2) Consultation with independent experts or relevant professional bodies.

Article 29. Manipulation of Information and Use of Confidential Information

A member in business should neither manipulate information nor use confidential information for personal gain.

Article 30. Inducements

1. A member in business, the spouse of the member or relatives within the second degree of kinship who share the same livelihood as the member, may be offered an inducement. Inducements may take various forms, including gifts, hospitality, and preferential treatment. Threats to objectivity or confidentiality are created where an inducement is made in an attempt to unduly influence actions or decisions, encourage illegal or dishonest behavior or obtain confidential information. A member in business should evaluate the significance of such a threat, and if evaluated threats are other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate them or reduce them to an acceptable level.
2. Safeguards that a member in business should apply may include:
 - (1) Where such offers have been made, immediately inform higher levels of management of the employing organization;
 - (2) Inform third parties of the offer – for example, a professional body or the employer of the individual who made the offer; a member in business should, however, consider seeking legal advice before taking such a step; and
 - (3) Advise the spouse and relatives within the second degree of kinship in the same livelihood of relevant threats and safeguards where they are potentially in positions that might result in offers of inducements as a result of their employment situation.
3. A member in business should not offer an inducement to improperly influence the professional judgment of another individual or organization, or obtain confidential information.

DEFINITIONS

Professional services

Services that are set forth in Article 2, paragraph 1 and 2 of the Certified Public Accountants Law, or services performed by a member in business.

Potential client

Companies and others that plan to commission professional services to members.

Threats to fundamental principles

Circumstances that may impede compliance with the fundamental principles. Many threats fall into the following categories:

- (1) Self-interest threats, which may occur as a result of the financial or other interests of a member, the spouse or relatives within the second degree of kinship;
- (2) Self-review threats, which may occur when a previous judgment needs to be re-evaluated by a member responsible for that judgment;
- (3) Advocacy threats, which may occur when a member promotes a position or opinion of the client or the employing organization to the point that subsequent objectivity may be compromised;
- (4) Familiarity threats, which may occur when, because of a close relationship, a member becomes too sympathetic to the interests of others; and
- (5) Intimidation threats, which may occur when a member may be deterred from acting objectively by threats, actual or perceived.

Safeguards

Measures to be taken when the member knows of circumstances or relationships that may compromise compliance with the fundamental principles.

Accounting firm

Firms that are operated by a member (excluding firms established pursuant to the laws other than the Certified Public Accountants), audit corporations and the entities controlling, or controlled by, such parties through ownership, management or other means.

Members in an accounting firm

Members, irrespective of functional classification (e.g., audit or consulting) in an accounting firm.

Engagement team

All personnel performing certain professional services, including any experts contracted by the firm in connection with that engagement.

Existing member

A member in an accounting firm currently conducting an audit engagement or carrying out accounting, consulting or similar professional services for a client.

Advertising

The communication to the public of information as to the services or skills provided by

members with a view to procuring professional business.

Financial interest

An interest in an equity or other security, debenture, loan or other debt instrument of an entity, including rights and obligations to acquire such an interest and derivatives directly related to such interest.

Assurance engagement

An engagement in which a member expresses a conclusion designed to enhance the degree of confidence of the intended users about the outcome of the evaluation or measurement made by the responsible party of a subject matter against criteria or the subject matter directly, based on the evidence obtained by the member.

Assurance team

(1) All members of the engagement team for the assurance engagement, all others within an accounting firm who can directly influence the outcome of the assurance engagement, including:

(i) those who recommend the compensation of, or who provide direct supervisory, management or other oversight of the assurance engagement partner in connection with the performance of the assurance engagement. For the purposes of a financial statement audit engagement this includes those at all successively senior levels above the engagement partner through the firm's chief executive;

(ii) those who provide consultation regarding technical or industry specific issues, transactions or events for the assurance engagement; and

(iii) those who provide quality control for the assurance engagement, including those who perform the engagement quality control review for the assurance engagement; and

(2) For the purposes of a financial statement audit client, all those within a network firm who can directly influence the outcome of the financial statement audit engagement.

Network firm

An accounting firm or an entity that belongs to a network.

Network

A large structure:

(1) That is aimed at cooperation among accounting firms or entities that belong to it, and

(2) To which any of the following are applicable:

(i) is clearly aimed at profit or cost sharing,

(ii) shares a common business strategy,

(iii) shares common ownership, control or management,

(iv) shares common quality control policies and procedures,

(v) shares the use of a common brand-name, or

(vi) shares a significant part of business resources.

Members in business

Members employed or engaged in an executive or non-executive capacity in such areas as commerce, industry, service, the public sector, education, the not for profit sector, regulatory bodies or professional bodies, or a member contracted by such entities.

Related entity

An entity that has any of the following relationships with the client:

- (1) An entity that has direct or indirect control over the client provided the client is material to such entity;
- (2) An entity with a direct financial interest in the client provided that such entity has significant influence over the client and the interest in the client is material to such entity;
- (3) An entity over which the client has direct or indirect control;
- (4) An entity in which the client, or an entity related to the client under (3) above, has a direct financial interest that gives it significant influence over such entity and the interest is material to the client and its related entity in (3); and
- (5) An entity which is under common control with the client (hereinafter a "sister entity") provided the sister entity and the client are both material to the entity that controls both the client and sister entity.

Direct financial interest

A financial interest:

- (1) Owned directly by and under the control of an individual or entity (including those managed on a discretionary basis by others); or
- (2) Beneficially owned through a collective investment vehicle, estate, trust or other intermediary over which the individual or entity has control

Indirect financial interest

A financial interest beneficially owned through a collective investment vehicle, estate, trust or other intermediary over which the individual or entity has no control.

Director or officer

A director, its equivalent position, or an administrative person responsible for financial matters, including employees significantly associated with management decision-making.

Supplementary Provisions (revised on December 10, 2007)

This revised Code should be effective on December 11, 2007, and becomes applicable from the day when the Act on the amendment of the CPA Law (Act No. 99 of 2007) comes into effect (April 1, 2008).