

Kansayaku

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Agenda

- 1) Okurasho
- 2) The Satoshi Hirata Case
- 3) Japan's Independent Audit Function
- 4) The Kanebo Case
- 5) Questions

1) Okurasho

- Okurasho = „The great storehouse ministry“, founded in the 7th century
- Responsible for overseeing economic development
- Group of powerful and wealthy individuals
- Senior members chose successive generations (often their own children)
- After World War II, U.S. army supervised Japan
 - Underestimated Okurasho's influence

1) Okurasho

- Members of Okurasho quickly controlled the Ministry of Finance (MoF)
- MoF was an important part of the post-war economic miracle
- In 1990s: first major financial crisis since W.W. II
 - business failures → loans couldn't been paid back
 - Banks struggled
- MoF put pressures on auditors → clean audit opinions

2) The Satoshi Hirata Case

- Hirata was part of the audit staff of Asahi (affiliated with KPMG)
- Was assigned to the audit of Resona
- Committed suicide on the 24th of April 2003
- Back then, Resona had major financial problems and couldn't survive without a capital infusion
- Had been insolvent for years, yet always got unqualified audit opinions each year
- The death was “dramatic gesture to persuade his seniors that Japan could no longer afford to keep covering over the cracks.”

3) Japan's Independent Audit Function

- Small number of large audit firms dominated Japan's audit profession
- MoF picked individuals to serve in key executive positions in accounting firms
- Long tenure of auditors with their clients
- Japanese business aim harmonious working practices
- Credibility crisis in 1990s
- New reform-minded prime minister in 2001 – established new agencies

4) The Kanebo Case

- In the 1990s Kanebo was one of Japan's largest public corporations
- Manufacturing and selling cosmetics, apparel, textiles, pharmaceuticals, toiletries, and food products
- In 2005, three former executives were arrested
- Kanebo's financial statements illustrated a good financial condition
- Yet, the company was technically insolvent from 1995 to 2004
- Kanebo's accounting staff was ordered to falsify the company's accounting records

4) The Kanebo Case

- Its auditors from ChuoAoyama faced fraud accusations
- According to the auditors, they were blackmailed when pointing out the issue
- Auditors also recommended to deconsolidate certain subsidiaries
- It was the first time that auditors from a major CPA firm had faced criminal charges
- The judge said: “It is shameful that they have failed to realize the high professional morality as certified accountants and lost the true aim of auditing, which is to protect investors.”
- Yet he gave them suspended sentences ranging from one year to 18 months

4) The Kanebo Case

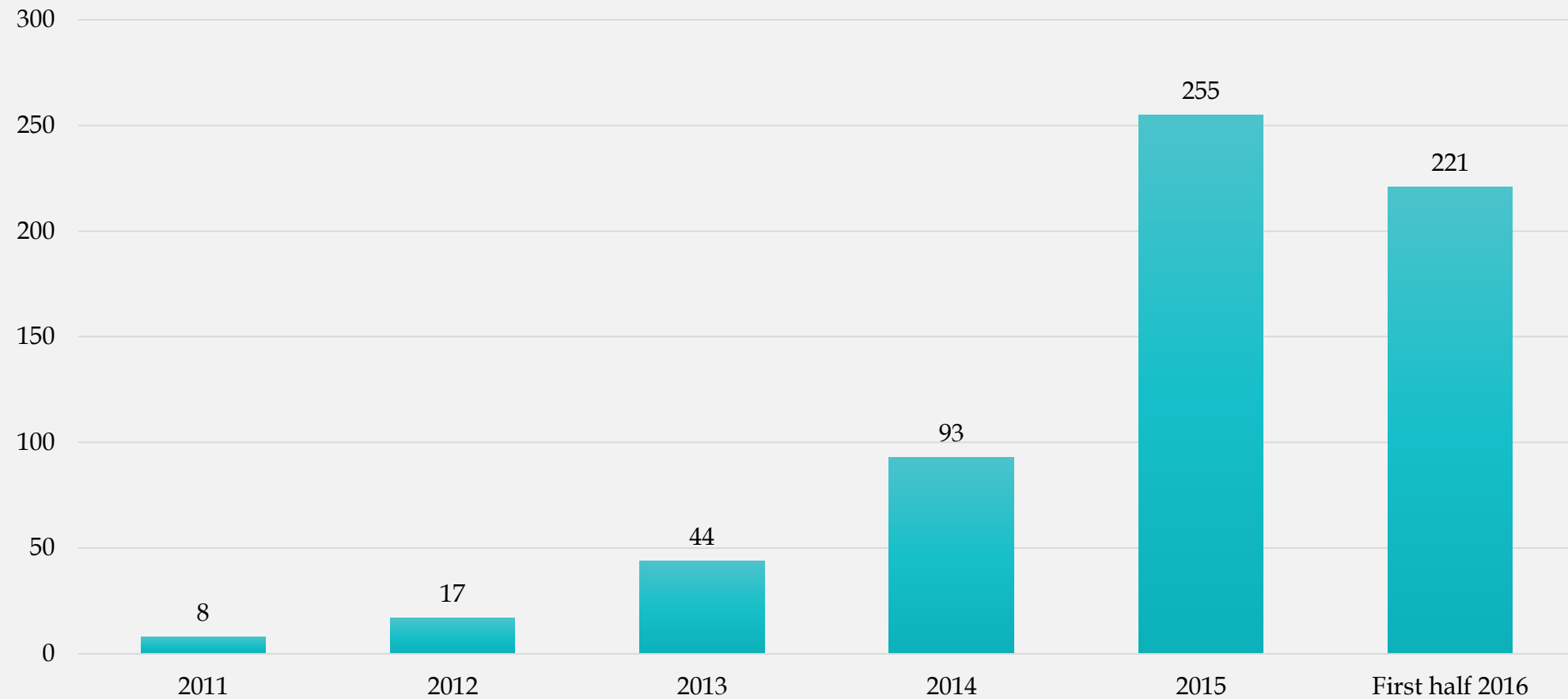
- Auditor's CPA qualifications were revoked
- Afterwards, Kanebo was placed in a rehabilitation program
- ChuoAoyama got a 2 month suspension → lost 200 of their clients
- Directly after the announcement, PwC (ChuoAoyama's affiliate) created a new accounting firm, known as Aarata (which means new and fresh)

5) Questions

Research online news services to identify recent developments impacting the accounting and auditing profession in Japan. Briefly summarize these developments in a bullet format

- Since 2010, companies that meet certain criteria have been permitted to voluntarily apply IFRS Standards for consolidated financial statements in Japan
- In 2015, Japan introduced Japan's Modified International Standards (JMIS)
- For its consolidated financial statement, a company can apply:
 - IFRS
 - US-GAAP
 - Japanese GAAP
 - JMIS

The number of listed companies voluntarily adopting IFRS



5) Questions

In both Japan and the United States, a small number of accounting firms audit the great majority of large public companies. Identify the advantages and disadvantages of this “market structure” for independent audit services

- In general, large accounting firms pay better → possibility, that large accounting firms have more qualified employees who are more capable of dealing with complex (large) public companies
- On the other hand, small companies don't even get the chance to demonstrate their abilities. Large accounting firms have a better prestige.

5) Questions

The much higher barriers to enter the public accounting profession in Japan (as compared with other major industrialized countries) has resulted in a relatively small number of CPAs in that nation. Identify and briefly discuss the comparative advantages and disadvantages of high barriers to entry for a given profession

Advantages	Disadvantages
Higher Quality of CPAs	More clients per CPA
Higher payment	More unqualified subordinates
Possibly, less corrupt CPAs	Skills shortage
Higher Appreciation	

5) Questions

In both Japan and the United States, external auditors have frequently been accused of failing to maintain a proper degree of independence from their clients. What measures have and should be taken to promote the independence of auditors from their clients?

- The auditor should not be accounting advisor simultaneously
- Auditors should not have shares of the company the audit
- Rotating auditors and CPA firms
- Peer assessments