



# Issues on J-SOX: A Comparative Study

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# An Overview

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- 2006 amendments of the SEL (now FIEL) included following provisions.
  - Listed companies shall submit reports evaluating their internal control over financial reporting (Art. 24-4-4 FIEL).
  - The reports shall be audited by independent auditors or auditing firms (Art. 193-2 FIEL).
  - Listed companies shall certify appropriateness of their annual reports (Art. 24-4-2 FIEL).
- The provisions became effective on September 30, 2007.
  - The first internal control report will appear in June 2009, evaluating its effectiveness as of the end of March 2009.



# J-SOX?

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- These provisions are commonly referred to as J-SOX.
- However, the amendments did not simply follow SOX model.
  - The discussion led to the amendments started in 2005, after SEIBU Railway Co. had been delisted from TSE.
- The discussion took criticism against US SOX into account, and tried to simplify the system.
  - Importance of top down, risk-based approach is emphasized.
  - Criteria for evaluation of effectiveness are simplified (effective, with a deficiency, material weakness).
  - Detailed guidelines (Standard for Implementation) were adopted before the law took effect.



# Problems in Implementation

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- Some accounting firms and consulting firms urged listed companies to prepare “set of three documents” (business manual, business flow chart, risk control matrix) for every business process.
- Even small or medium sized listed companies believe they must set up an independent body such as “Internal Audit Department” within their organization.
- Large costs associated with a preparation for internal control reporting let some private companies postpone their IPOs.



# Stalled IPO Market

Number of IPOs in Venture oriented Makets

	TSE Mothers	Jasdaq	Hercules	others	
1999	2	73	–	0	75
2000	27	97	40	0	164
2001	7	98	43	2	150
2002	8	70	24	0	102
2003	31	63	11	1	106
2004	56	71	18	7	152
2005	36	68	22	16	142
2006	41	59	38	21	159
2007	23	54	28	9	114
2008(~June)	8	9	3	2	22
1999~2007	239	662	227	58	1,186
Listed Co. as the end of 2007	198	979	172	54	1,403

note: Others means Centrex in Nagoya, Ambitious in Sapporo, and Q-Board in Fukuoka



# Efforts by the FSA

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- In March 2008 the FSA published “11 Misunderstandings on Internal Control Reporting System”.
- The document emphasizes the difference between US and Japanese system, importance of flexibility in implementation, etc.
- The FSA urge accountants not to be too defensive when they are consulted by the listed companies.



# Remaining Issues

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- How would Japanese investors react when a listed company reports “material weakness” in its internal control?
  - TSE made clear that material weakness would not directly lead to the delisting of the company.
- Is internal control reporting system really effective for preventing accounting frauds?
  - Number of accounting fraud cases is increasing, especially among smaller listed companies.
  - Some investors may argue that strict system is needed for Mothers companies rather than for Toyota Motors.
- Is principles behind the regulation understood, although the rule itself is followed rigidly?