



KANSAYAKU

JAPAN'S ENRON



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COVERING THE CRACKS

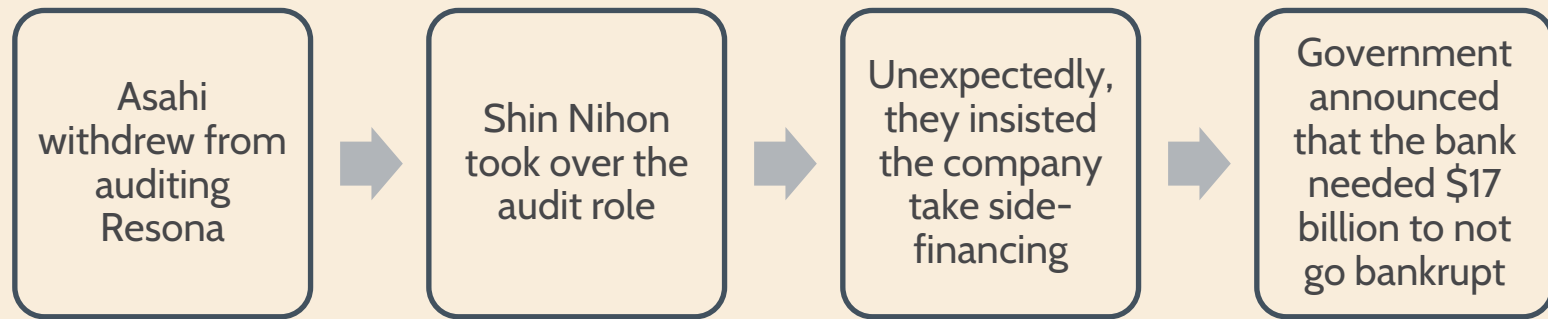


Satoshi Hirata, an audit of Asahi (Big4), committed suicide after auditing Resona Bank.

Resona and other major banks were having financial problems, refusing to provide adequate reserves for their expected loan losses.



COVERING THE CRACKS



THE BEGINNING OF NEW JAPAN

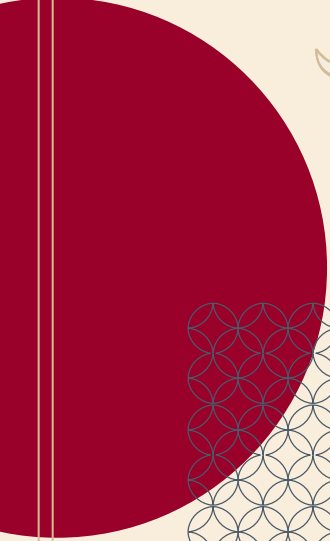
General MacArthur had the mission to convert Japan into a democratic nation and to establish a free market economic system.



Okurasho was created, which was responsible for overseeing the economic development and well-being of the nation.



They took control of the Ministry of Finance. Its policies created the second-largest economy in the world after U.S.



OKURASHO (MOF)



Volatile interest rates,
inflation, unemployment



Stock market decline sharply.
Large business failures



Huge losses in loan portfolios
of major metropolitan banks

- Group of powerful and wealthy individuals who advised the Japanese emperor on all major economic decisions and who controlled the nation's banking system.
 - The organization was self-perpetuating.
- In the early 90's, Japan faced the first crisis since WWII.







JAPAN

VS



U.S

- 1 CPA for 9,600 citizens
- Audit fees are one-tenth of the U.S.
- Japanese auditors and clients had a cordial relationship.
- MOF rarely imposed sanctions of any kind on auditors who had failed.

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- 1 CPA for 800 citizens
 - Auditor independence was key factor that contributed to the success of the audit process.



NEW ERA UNDER KOIZUMI

- In 2001, the MOF lost most of its authority as Junichiro Koizumi was chosen prime minister.
- FSA created two agencies to help her: CPAAOB and SESC
- The revised law required CPA candidates to pass one examination instead of three.
- He established the Financial Services Agency (FSA) which had most of the MOF's responsibilities.
- In 2004, Japan's federal legislative body, rewrote the Certified Public Accountant's Law. Major purpose was to increase the number of CPAs.
- JICPA also took measures including prohibition of independent auditors from having a financial interest on public client.

KANEBO LTD, JAPAN'S ENRON

Founded in 1887,
destroyed during WWII



In 1940, it started working
on a smaller scale



By '90s, it ranked among
largest public corporations

KANEBO LTD, JAPAN'S ENRON

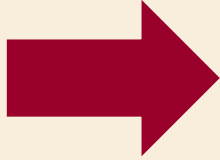
IN JULY 2005:

Three former Kanebo executives, including the company's former president, were arrested on charges of violating the Securities and Exchange Law.

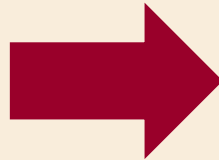
They conspired to conceal their company's deteriorating financial health starting in 1990s. During this time, its audited financial statements indicated good financial condition. However, a criminal investigation revealed that Kanebo was insolvent from 1995 through 2004.



The former president ordered Kanebo's accounting staff to **falsify the company's accounting records** by threatening that the company would fail and they would lose their jobs.



They were told to record **fictitious sales** and to **understate various expenses** to improve operating results and make the company look solvent.



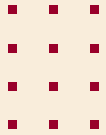
In March 2006, they pleaded guilty to falsifying the financial statements.



THE WORK OF ChuoAoyama

1. Audit firm of Kanebo Ltd.
2. Three auditors were charged for fraud.
3. They worked on its annual audits for more 15 years.
4. They had been aware of the company's true financial condition and also had recommended methods to conceal its financial health.
5. "Deconsolidating" certain Kanebo subsidiaries that were posting large operating losses each year was the main method.
6. The defendants never admitted but the prosecutors assumed they learned from the Enron case in U.S.

- In 2006, the case went to trial.
- It was the first time in the country's history that auditors from a major CPA firm had faced criminal charges for falsifying a client's financial statements.



- The defendants testified that before Kanebo fraud was discovered by authorities, they had pleaded with the suspects to correct the entries in the accounting records. According to them, the client executives refused to make those entries.



- In 2006, the ChuoAoyama were convicted of the charges filed against them. Their sentences ranged from one year to 18 months.
- The judge pointed out that the Kanebo's executives were primarily responsible for the scheme.
- The auditors had their CPA qualifications revoked and ChuoAoyama would be forced to suspend its operations for two months.



EPILOGUE

Kanebo Ltd



The government put Kanebo Ltd under IRCJ.

- IRCJ was created in 2003 to help financially distressed companies obtain the capital they needed to survive and provide them with advice from professional business consultants.
- Kanebo sold off its large cosmetics subsidiary and received more than \$1 billion in government loans and waivers of outstanding loans.
- In 2006, a large investment fund purchased a majority of Kanebo's stock and took control of the company.

ChuoAoyama



Lost one-third of its audit clients during the two-month suspension, including Sony Corporation and Toyota Motor Corporation.

- It changed its name to Misuzu Audit Corporation.
- PricewaterhouseCoopers created a new Japanese accounting firm named Aarata which started on July 2006.
- It acquired dozens of ChuoAoyama's former clients, including Sony and Toyota.
- Also, one-fourth of ChuoAoyama's employees left the firm and joined Aarata.

QUESTION 1



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



- More Japanese companies are adopting IFRS.
- Japan’s Financial Services Agency will create a team to regulate audit firms in fiscal 2023 .
- Nearly 70% of listed companies in Japan have not changed auditing firms for more than a decade.



QUESTION 2



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.



- + Only the most qualified candidates will be able to work in a company.
- + Less competition for the current professionals.
- Lower interest from people who want to work in the profession.
- Higher costs for individuals who are trying to enter the job market.



QUESTION 3



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.



- +Higher payment for the audit services.
- Higher possibility of having a close relationship between auditor and client.
- Higher chance for false unqualified audit opinion.



QUESTION 4



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?



- Stronger penalties for not respecting the law
- Higher salaries or bonuses
- Audit firm rotation



THANK YOU FOR YOUR ATTENTION!

