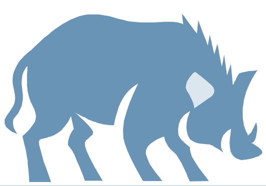
KAKIMOTO & NAGASHIMA LLP

CERTIFIED PUBLIC ACCOUNTANTS
CONSULTANTS

NEWSLETTER

Volume 5, Issue 1 January 2007

Inside this issue:



Summary of Articles

Release of J-SOX (Japanese version of the U.S. Sarbanes-Oxley Act) Exposure Draft

An exposure draft of the "Implementation Standards for Evaluation and Audit of Internal Control over Financial Reporting" was issued by the Committee on Internal Control of the Business Accounting Council on November 21, 2006. The draft has received wide attention because it presents the detailed standards for internal control required under the Japanese version of SOX. This includes the establishment, assessment and audit of internal control. We introduce the fundamentals of the exposure draft in this newsletter.

The Tax Relief and Health Care Act of 2006

You've probably heard that Congress passed another tax cut package. President Bush made it official by signing it with only two weeks left in 2006. The new law retroactively restores some popular tax cuts to the beginning of 2006. What are some of the changes? How much tax relief does this law create? Our current article discusses some of the changes affecting individuals and corporations.

Electronic Filing Cabinet – Paper Files a Thing of the Past?

Many speculated that going to work would be like working on the Starship Enterprise. All work would be done on computers and laptops and the paper hard-copy would be a thing of the past. Roughly 15 years have passed since then. Have we come any closer to realizing this fantasy? We could be, maybe sooner than you think.

The Internal Revenue Service and Treasury Department have announced that the 2007 optional standard mileage rate has been changed to 48.5 cents a mile for all business miles driven. This is an increase of 4 cents from the 44.5 cent rate put in last year.

Any Questions?

We are committed to providing our clients with quality and excellent services. If you have any questions or comments, please let us know by either e-mail or phone. Our company profile is available on the internet at:

http://www.knllp.com

Los Angeles Office:
Tel: (213) 439-6800
E-mail: laoffice@knllp.com

South Bay Office:
Tel: (310) 715-9100
E-mail: sboffice@knllp.com

Release of J-SOX (Japanese version of the U.S. Sarbanes-Oxley Act) Exposure Draft

Summary of "Implementation Standards for Evaluation and Audit of Internal Control over Financial Reporting"

The Committee on Internal Control of the Business Accounting Council of Japan published an exposure draft of the "Implementation Standards for Evaluation and Audit of Internal Control over Financial Reporting" on November 21, 2006. The exposure draft fleshed out the abstract objectives presented in the draft of the "Standards for Evaluation and Audit of Internal Control over Financial Reporting" published by the same committee on December 8, 2005; the recently released exposure draft contains helpful detailed guidelines. This exposure draft was subject to public comment until December 20, 2006; the final version of the standards will be issued by the Financial Services Agency during January 2007. The standards are expected to apply to all listed companies with fiscal years beginning in April 2008, and will subject listed companies to prepare and file internal control audit reports. These companies must evaluate internal control, prepare an internal control report, obtain attestation of the report and file the report and attestation in accordance with the new standards.

The exposure draft consists of the following three parts, which had appeared in the draft standards published in December 2005.

Part I. Basic structure of internal control.

1. Definition and objectives of internal control.
2. Primary elements of internal control.
3. Limitations of internal control.
4. Roles and responsibilities of persons involved in internal control.
5. Establishment of internal control over financial reporting.

Part II. Assessment of and report on internal control over financial reporting.

1. Objectives of assessment of internal control over financial reporting.
2. Assessment of internal control over financial reporting and the scope of the assessment.
3. Methods of assessment of internal control over financial reporting.

Part III. Audit of internal control over financial reporting.

1. The objectives of the audit of internal control.
2. Relationship between the audit of internal control and the audit of financial reporting.
3. Review of the audit plan and the scope of assessment.
4. Implementation of the audit of internal control.
5. Reports by auditors.

According to the exposure draft, overseas/foreign subsidiaries of Japanese listed companies may be within the scope of the assessment of internal control. However, if there is a proper internal control reporting system in the country where the subsidiary is located, the local system can be used. In addition, even if the country has no internal control reporting system, there is a possibility that a proper internal control system of another country other than Japan has been used because of historical or geographical circumstances, and in such cases, the system can be used. Consequently, the internal control reporting system under SOX in the U.S. may be used for the "subsidiary outside Japan" when the Japan parent company prepares the internal control report on a consolidated basis.

Management, if necessary, should consult with the organization's audit committee and auditors after the determination of the scope of assessment of its internal control is performed. Primarily, communication between all persons involved is crucial and is encouraged throughout the entire process.

In the attached supplement, we introduce the fundamentals of "4. Roles and responsibilities of persons involved in internal control" and "5. Establishment of internal control over financial reporting" of "Part I. Basic structure of internal control", and "Part II. Assessment of and report on internal control over financial reporting" of the exposure draft. These sections provide helpful guidance on operations of Japanese companies or subsidiaries of Japanese companies in the U.S.

If you should have any question about the contents of this article, please do not hesitate to contact us.♦

The Tax Relief and Health Care Act of 2006

President Bush signed the new tax law on December 20, 2006, with less than two weeks left in the 2006 year. The new law renews temporary tax incentives known as "tax extenders." These are temporary tax breaks that Congress has been extending every year instead of making them permanent.

The new law is the last tax bill of the 109th Congress which enacted major tax legislation over the past two years. The new law retroactively restores to the beginning of 2006 some popular tax cuts and credits that expired at the end of 2005. In addition, the law enhances some important tax incentives and makes technical corrections to existing tax law. The total cost of the new law is $45.1 billion in tax breaks for individuals and businesses spanning over 10 years.

Changes Affecting Individual Taxpayers

The late enactment and the retroactive application may cause some challenges for the estimated 18.5 million individual taxpayers affected by the change. The 2006 tax return forms and instructions were printed prior to the passage of the law and the Internal Revenue Service (IRS) has no plans on reprinting the forms incorporating the changes. The IRS has announced that they will not process individual returns containing the extended provisions until early February. Some of the changes affecting individual taxpayers are as follows:

Deduction for State and Local Sales Taxes

The new law extends to the end of 2007, the opportunity for taxpayers to deduct either state and local income taxes or state and local general sales taxes as an itemized deduction. This deduction originally scheduled to expire in 2005, was extended due to popularity, especially among residents of states with no or low income tax.

Higher Education Tuition Deduction

Originally scheduled to expire in 2005, the new law extends the higher education tuition deduction as a deduction in arriving at adjusted gross income (AGI) for qualifying taxpayers through the end of 2007. Depending on the filing status and income level, taxpayers may be eligible to claim a deduction of $2,000 or $4,000 in arriving at AGI.

Teacher's Classroom Expense Deduction

The deduction of $250 for certain out-of-pocket classroom expenses by teachers and educators which expired in 2005 is now extended to 2007.

Changes Affecting Corporate Taxpayers

The changes made by the new act are targeted to many types of businesses, but for the most part are temporary. The popular extenders were moved from one bill to another during 2006 until it finally passed at the end of the year, nearly a year after the original expiration date. This created compliance headaches for corporations with fiscal year ends that needed to file the tax returns based on existing law. As many of the provisions are expected to expire at the end of 2007, we will be faced with the same issues next year unless Congress can act on the expiring tax cuts earlier in the year. Listed below are some of the changes affecting corporate taxpayers:

Research Tax Credit

The research tax credit which expired in 2005 has been extended for amounts paid or incurred in 2006 and 2007. This provision is the biggest tax break in the new law, estimated at $16.5 billion over 10 years. Due to the long-term planning required for research, many businesses would like to make this credit permanent and it is likely that the businesses will apply pressure on Congress to do so.

Leasehold and Restaurant Improvements

The new law extends through 2007 the 15-year recovery period for certain leasehold and restaurant improvements.

Other Business Incentives

Many employers, whether large or small, benefit from the Welfare-to-Work and Work Opportunity credits which reward employers who hire new employees from economically challenged groups.

Businesses are also eligible for energy tax breaks for certain energy improvements and domestic production of alternative fuels.

We have highlighted some of the provisions of the Tax Relief and Health Care Act of 2006. If you have any questions about the new tax law, please do not hesitate to contact us.♦

Paperless Office

Way back in the 80's and early 90's many experts were predicting an entire office devoid of paper files. The technological boom that was occurring seemed to have guaranteed that the olden days of filing cabinets and file rooms would be a thing of the past. Captain Kirk and Mr. Spock were never seen working with any sort of paper in their hands, so why can't we?

Flash-forward now to the twenty-first century and what was supposed to be a paperless office, has become exactly the opposite. The previously mentioned technological boom not only brought high speed computers and large electronic data storage capabilities but also highly efficient and cost effective laser printers. Instead of doing away with printing cash receipt reports and legal briefs these printers enabled corporate firms to print even more documents than ever before. Mountains of paper files continued to clutter offices everywhere.

And here we are today. The paperless office clearly remains a hot topic in today's corporate world, appearing on the AICPA's Top 10 Technologies survey for several years running. Advancements in technology have allowed several companies to offer software packages that create an "electronic filing cabinet" on your computer or file-server. Microsoft SharePoint Server 2007 (http://www.microsoft.com) and Cabinet NG (http://www.cabinetng.com) are two such software products that deliver these capabilities. These types of software can manage the full range of documents found in any type of business – from purchase authorizations to client correspondence, to employee records and e-mail – reducing the costs associated with creating and storing paper documents and resulting in an environment where employees work together more efficiently. Professional organizations can now store all electronic copies of their Windows-based documents, whether it is a portable document format (.pdf), a Microsoft word document (.doc), or Microsoft excel spreadsheet (.xls), among many others, all to be viewed and maintained on the computer screen. A high-speed, high-quality document scanner and a centralized server can now be used instead of large file rooms filled with manila folders. What they do is help your company's entire workflow become paperless and more efficient.

Cost Effectiveness

If you ever calculated how much time, money, and effort go into storing, managing, and retrieving documents for your clients or customers, you would be amazed. In fact, it is estimated that a typical firm serving 500 clients could easily spend more than $28,000 annually on paper filing, printing, storage, and retrieval. And this estimate doesn't even include postage and courier costs to distribute paper documents, storage resources needed for previous years' documents, time spent tracking down missing files, or the potential cost of disaster recovery.

When you think about how much time, money, and effort you would save by reducing the amount of paper in your company, an electronic filing cabinet can pay for itself many times over.

Besides the increased efficiencies and cost savings, an electronic filing cabinet can also provide you with the risk mitigation you need for document storage and retention. Sarbanes-Oxley and other regulatory compliance rules have changed the way you do business. An electronic filing cabinet will help you meet those standards, all in the background of your day-to-day work.

Although it may be impossible to entirely rid your office of a paper workflow, what electronic filing cabinets can do is reduce the amount significantly. Perhaps our grandchildren will someday be asking us what a pencil and paper are used for? Perhaps.♦

Questions or comments about this issue or inquiries about our newsletter by e-mail subscription service can be sent to:

newsletter@knllp.com

Release of J-SOX (Japanese version of the U.S. Sarbanes-Oxley Act) Exposure Draft

Summary of "Implementation Standards for Evaluation and Audit of Internal Control over Financial Reporting" Supplement

The Committee on Internal Control of the Business Accounting Council of Japan published an exposure draft of the "Implementation Standards for Evaluation and Audit of Internal Control over Financial Reporting" on November 21, 2006. The exposure draft fleshed out the abstract objectives presented in the draft of the "Standards for Evaluation and Audit of Internal Control over Financial Reporting" published by the same committee on December 8, 2005; the recently released exposure draft contains helpful detailed guidelines. This exposure draft was subject to public comment until December 20, 2006; the final version of the standards will be issued by the Financial Services Agency during January 2007. The standards are expected to apply to all listed companies for fiscal years beginning in April 2008, and will subject listed companies to prepare and file internal control audit reports.

A bill which drastically amends the Securities and Exchange Act, and will rename the Act as the "the Financial Instruments and Exchanges Act", was submitted to the diet in March 2006, and passed in June 2006. The new act requires filing of internal control reports for the purpose of evaluating the internal control structure to ensure the accuracy of financial statements and related information. The requirement applies to the reporting companies which are listed on a "financial instruments exchange" (currently known as a "stock exchange") and other reporting companies that are designated by the relevant cabinet order. The reports must be filed annually with the Financial Service Agency together with an annual securities reports. It must contain an assessment of the internal control system necessary to ensure the accuracy of financial statements and related information of the reporting company and the group in which the company belongs to. The internal control reports must be attested to by a certified public accountant or an audit firm.

As a result, such companies must evaluate internal control, prepare an internal control report, obtain and file the attestation of the report in accordance with the standards to be finalized in January 2007.

The exposure draft consists of the following three parts, which had appeared in the draft standards published in December 2005.

Part I. Basic structure of internal control.

1. Definition and objectives of internal control.
2. Primary elements of internal control.
3. Limitations of internal control.
4. Roles and responsibilities of persons involved in internal control.
5. Establishment of internal control over financial reporting.

Part II. Assessment of and report on internal control over financial reporting.

1. Objectives of the assessment of internal control over financial reporting.
2. Assessment of internal control over financial reporting and the scope of the assessment.
3. Methods of assessment of internal control over financial reporting.

Part III. Audit of internal control over financial reporting.

1. The objectives of the audit of internal control.
2. Relationship between the audit of internal control and the audit of financial reporting.
3. Review of the audit plan and the scope of assessment.
4. Implementation of the audit of internal control.
5. Reports by auditors.

In this supplement, we introduce the fundamentals of "4. Roles and responsibilities of persons involved in internal control" and "5. Establishment of internal control over financial reporting" of "Part I. Basic structure of internal control", and "Part II. Assessment of and report on internal control over financial reporting" of the exposure draft. These sections provide helpful guidance on operations of Japanese companies or subsidiaries of Japanese companies in the U.S. The complete exposure draft in Japanese is available at http://www.fsa.go.jp/news/18/singi/20061121-2.pdf.

Roles and responsibilities of persons involved in internal control

According to the definition of internal control, control activities are explained as follows:

> "Control activities are the policies and procedures for ensuring the proper implementation of orders and instructions by management. Control activities include extensive policies and procedures of the assignment of authorities and responsibilities, segregation of duties and the like. Such policies and procedures should be integrated into operation processes and will not work without being complied and performed by all people in the organization."

In short, the effectiveness of control activities is assessed by whether or not the activities are properly performed by all the members in an organization. Members of an organization are classified into the following five categories.

(1) Management

Management is ultimately responsible for any and all activities in the organization. This responsibility includes duties to set up and implement internal control in accordance with the basic principles adopted by the board of directors. Management is expected to set up and implement internal control (including monitoring of internal control) through internal organization. Management has greater impact on the environment of an organization which affects various elements of the control environment and other primary components of internal control than any other person in an organization.

(2) Board of directors

The board of directors is expected to determine the basic principles for the setup and implementation of internal control. Additionally, the board is expected to supervise management's setup and implementation of internal control, as the board has the obligation to supervise management performance. A board of directors which functions properly is a part of the "internal control over operation process" as well as being an essential part of "company-wide internal control".

(3) Corporate auditors or audit committee
Corporate auditors or audit committees are expected to independently supervise and examine the setup and implementation of internal control as a part of the audit on operations of an organization.

(4) Internal auditors
For purposes of more effective internal control, internal auditors are expected to examine and assess the setup and implementation of internal control as a part of the monitoring function, which is one of the essential components of internal control. In addition, internal auditors are to provide suggestions to improve upon the internal control process.

(5) Other people in the organization
Other people in the organization have certain responsibilities for the setup and implementation of internal control over their assigned areas, as internal control is a process that should be performed by all people in an organization.

Establishment of internal control over financial reporting

According to the exposure draft, "An internal control reporting system is created for ensuring the reliability of financial reporting, and, thus, deficiencies in internal control over financial reporting are expected to be properly handled and corrected before the reporting on internal control. Management is expected to make improvements to ensure that the internal control becomes effective before the enactment of the internal control reporting requirements."

Brought forward from the basic structure of internal control mentioned above, the exposure draft lists several points important for the establishment of internal control. As stated previously, when certain deficiencies come to light, they must be corrected as necessary. Following are points to be considered when establishing internal control policies and procedures:

- Presentation, proper setup and implementation of company-wide policies and procedures to ensure proper financial reporting;
- Proper assessment of, and action against, the risk of material misstatements in financial reporting;
- Proper establishment and implementation of the system for reducing the risk of material misstatements in financial reporting;
- Establishment and implementation of the system for identification, understanding and processing of true and fair information, and communication of such information to the person in charge;
- Establishment and proper implementation of a system for monitoring of the internal control over financial reporting;
- Proper handling of IT regarding internal control over financial reporting.

The exposure draft also present examples that an organization can refer to while establishing its internal control over financial reporting. These examples should prove helpful and are cited below.

(1) Determination of basic plans and principles.
It is important that the establishment of internal control be made under a consistent policy presented by management. According to the Company Code of Japan, the basic policy for internal control is to be adopted by the board of directors. Management must establish basic plans and policies to implement internal control at a company-wide level and at the individual operation process level based on resolutions furnished by the board of the directors.

Basic plans and policies to be established by management may include, for example:

- Principles for the establishment of internal control, its scope and level to ensure proper financial reporting.
- Management and other personnel who are responsible for the establishment of internal control and its operation on a company-wide basis.
- Procedures and schedules for the establishment of internal control.
- Personnel who are involved in individual procedures for the establishment of internal control, organization of staff, and the method of advance training given to staff.

(2) Monitoring the establishment of internal control.
After the establishment of the basic plans and principles, the establishment of subordinate rules should be monitored and recorded. It is advisable that this task be performed as a company-wide project under the instruction of management and other officers who are in charge of the establishment of internal control.

As for the company-wide internal control over financial reporting, it is advisable to understand and document the current internal control process including existing rules and practices relating to internal control and compliance thereof. It is important to put implied rules and the like in written form.

For a better understanding of the company's internal control, it is helpful to refer to items listed in “Reference 1, Examples of items regarding the assessment of company-wide internal control” in “Part II. Assessment of and report on internal control over financial reporting” of the exposure draft.

For internal control over the business operation processes relevant to financial reporting, the current status of internal control over important business processes should also be documented, for example, following these procedures:

a. With regard to important operation processes in the organization, understand the process of the relevant transactions and the relevant account processing, by using, if necessary, flowcharts and diagrams.
b. Identify the risk of misstatements regarding these operation processes, associate the risk with items in financial reporting or accounts, and examine whether the identified risk can be sufficiently reduced by an internal control which is incorporated into the operation, by using, if necessary, flowcharts and diagrams.

“Reference 2, Operation flowchart/description of operation” and “Reference 3, Relationship between risk and control” in “Part II. Assessment of and report on internal control over financial reporting” provide examples of flowcharts and diagrams mentioned in a. and b. above.

Recording and visualizing the status of internal control facilitates the assessment of the effectiveness of internal control.

(3) Response to, and remediation of, identified deficiencies.
Proper action must be taken regarding the deficiencies which come to light during the examination of the current status of internal control. Management and officers in charge of the establishment of internal control must correct the deficiencies in accordance with the basic plans and principles of internal control.

As for company-wide internal control concerns, "Reference 1, Examples of items regarding the assessment of company-wide internal control" in "Part II. Assessment of and report on internal control over financial reporting" of the exposure draft is helpful in identifying problems to be corrected.

For addressing problems with internal control over business operation processes, corrective actions can be applied as follows:

a. If an internal control incorporated into the operation is insufficient to adequately reduce the risk of misstatement, additional actions to improve the internal control should be taken.
b. If a new flow of transactions or accounting processes are created by the actions mentioned in a. above, the flowchart or diagram mentioned in (2) a. and b. must be updated accordingly.

Assessment of and report on internal control over financial reporting

"Part II. Assessment of and report on internal control over financial reporting" is composed of the following three sections:

1. Objectives of the assessment of internal control over financial reporting;
2. Assessment of internal control over financial reporting, and the scope of the assessment;
3. Methods of assessment of internal control over financial reporting.

First, the exposure draft requires the preparation of a report for external purposes which contains a self-evaluation of an organization's internal control over financial reporting "to ensure the reliability of financial reporting" based on generally accepted standards for assessments of internal control.

The exposure draft provides commentaries on (1) the scope of financial reporting and (2) a guideline for the determination of materiality.

(1) The scope of financial reporting
The scope of financial reporting contains the setup, implementation and evaluation of internal control not only for ensuring accuracy of financial statements themselves, but also for ensuring the accuracy of those items subject to disclosure which materially affect the reliability of financial statements. These disclosure items contain the following:

a. Disclosure items that are the summary, abstract or breakdown of the amounts, numbers or notes in the financial statements, or items that are otherwise derived from such amounts, numbers or notes. For example, the disclosure items in annual securities reports, which is obtained from information in the financial statements, including:

- “transition of the major management index …” in the “Overview of the company” section,
- “Status of business” in the “Overview of performance …” section,
- “Production, received orders and sales”, “Research and development activities” and “Analysis on financial conditions and results of operations” in the “Overview of business” section,
- “Facilities”,
- “Stocks …”, “Treasury stocks ...”, “Dividend policy” and “Corporate governance” in the “Status of the reporting company” section,
- “Major assets and liabilities” and “Others” in the “Accounting” section,
- “Guaranteed bonds” in the “Companies which offer guarantees” section,
- “Index ...”.

b. Items that are closely related to the preparation of financial statements, such as the determination of the scope of affiliated companies, the scope of consolidation, application of the equity method, the scope of related parties (which is broader than “affiliate company”). For example:

- “Business” and “Affiliate companies” in the “Overview of the company” section,
- Descriptions related to affiliate companies, related parties and major shareholders in the subsection “Status of major shareholder ...” in the “Status of the reporting company” section.

(2) Guideline for the determination of materiality
"Internal control deficiencies” and “material weakness” are respectively defined as follows:

Internal control deficiencies are composed of (i) deficiencies of the setup of internal control where, for example, there is no internal control, or the control is not properly designed in meeting the control objectives, and (ii) deficiencies of implementation where, for example, a control is not complied with, or the persons performing the control have no authority or the ability necessary to implement/perform the control.

An internal control deficiency may, by itself or together with another deficiency, impair the initiation, recording, processing, or reporting of transactions in conformity with the generally accepted standards of corporate accounting and laws applicable to financial reporting, and as a result, may rise to the level of a “material weakness” of internal control.

Material weakness is defined as a control deficiency in which there is a likelihood that it will lead to a quantitative and/or qualitative material misstatement. Management must review both the quantitative and qualitative aspects when determining whether an internal control deficiency constitutes a material weakness. As a general rule, the determination of materiality must be made on a consolidated basis in which the standard of materiality for consolidated financial statements is used. The exposure draft also presents the following criteria for the determination of materiality:

a. Determination of quantitative materiality
Quantitative materiality would be determined upon the basis of the ratio to consolidated assets, consolidated sales, consolidated earning before tax and the like. There is no fixed ratio applicable to all companies; instead, the company's industry, size and characteristics, etc. must be considered when determining the ratio. As for the ratio to consolidated earnings before tax, an acceptable threshold is about five percent, but the materiality level of the overall financial statements should be also considered.
b. Determination of qualitative materiality.
Qualitative materiality is determined upon the basis of the materiality of the impact on inventors such as the consideration of standards for delisting of listed companies, items relating to financial covenants, and items regarding transactions with related parties and major shareholders.

Assessment of internal control and its scope

According to the exposure draft, the following are subject to evaluation on a consolidated basis:

a. Consolidated subsidiaries, etc. (including partnerships)
b. Equity method affiliates
c. Subsidiaries outside of Japan

"Subsidiaries outside Japan" is explained as follows:

> "Subsidiaries, etc. outside Japan may be within the scope of the assessment. However, if there is a proper internal control reporting system in the country where the subsidiary is located, the local system can be used. In addition, even if the country has no internal control reporting system, there is a possibility that a proper internal control system of another country other than Japan has been used because of historical or geographical circumstances, and in such cases, that system can be used."

Consequently, the internal control reporting system under SOX in the U.S. may be used for the "subsidiary outside Japan" when the Japan parent company prepares the internal control report on a consolidated basis.

According to the exposure draft, although a company may outsource a process to a third party professional, the company's internal control over the approval, performance, calculation, counting and/or the recording of such process, which is the basis of the financial statements or preparation of disclosure items, is within the scope of assessment. Therefore, if a company outsources the calculation of payroll, etc. to a third party service provider, the internal control over the provider is within the scope of assessment.

Determination of scope of assessment of operation processes

According to the exposure draft, management must evaluate internal control on a company-wide basis. The assessment of the effectiveness of internal control is not necessary for all operation processes of the company; instead, the scope (including location and type of processes) should be reasonably determined using materiality (quantitative and qualitative) based on the financial statements and associated reporting/disclosures.

The exposure draft presents a method for the selection/inclusion of significant business units. If a company has two or more business units, the units subject to assessment could be determined by using a measure such as revenue. Generally, if the results of the company-wide internal control assessment are positive, a ratio of two-thirds can be used to determine the business units to be subjected to assessment. For example, revenues of the largest business units that make-up two-thirds of total consolidated revenues would be included in the scope of assessment. However, it should be noted that two-thirds is a general rule of thumb; the ultimate ratio will be dependent on the characteristics of the business. A company can use another or additional criteria depending on the company's environment.

As for the operation processes subject to assessment, as a general rule, the scope of the assessment includes operation processes associated with accounts that are materially related to the business of the company (such as sales, account receivable and inventory).

Furthermore, irrespective of whether or not it is performed for the core units of the business, an operation process which has material impact on financial reporting will also be subject to assessment. Matters to be considered when identifying such operation processes include the following:

a. Operation process of business which involves high risk transactions;
b. Operation process of important accounts which includes a high level of estimation by management;
c. Operating process of transactions which involve high misstatement risk, such as atypical or irregular transactions.

Management, if necessary, should consult with the organization's auditing firms after the determination of the scope of assessment of its internal control is performed. Primarily, communication between all persons involved is crucial and is encouraged throughout the entire process.

If you should have any questions about the contents of this supplement, please do not hesitate to contact us.