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MONS

J-SOX Implementation within a Company

Case of Fujitsu Belgium-Luxemburg

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Abstract

The year 2002 had seen the disclosure in the public place of one of the most notorious scandals of American history, the collapse of Enron; but this year marks also the enactment of a financial legislation which has been a turning point in the financial industry, the controversial Sarbanes-Oxley Act, also known as SOX, which was the direct response to the Enron drama.

Mandatory for all companies listed in the United States, the Sarbanes-Oxley Act has inspired many other legislations around the world. In Japan, the same type of legislation is officially called the “Financial Instruments and Exchange Law (FIEL). This Japanese Version of SOX is so close to the US one, in terms of requirements expressed by its provision; that is why it is commonly called J-SOX (Japanese Sarbanes-Oxley).

Realized with the collaboration of the finance department of Fujitsu BeLux, a subsidiary member of the very known Japanese group “Fujitsu”, this Thesis aims at providing the cited company a model of implementation of J-SOX regulation for its Luxemburgian entity, based on what has already been done in Belgium; since the Belgian entity is already J-SOX compliant. The Luxemburgian entity needs J-SOX to be implemented to enhance its internal control system and reinforce its credibility toward local requirements.

The approach pursued to reach the objective set by the company relies on a deep analysis of the Belgian entity’s J-SOX structure, a diagnostic of the likely hosting structure in Luxemburg and the elaboration of a model taking into account all those aspects for an optimal implementation of J-SOX.

This Thesis is the result of a very practical and rewarding project undertaken during 4 months as an internship within the Fujitsu BeLux finance department; 4 months of getting to know and understanding J-SOX as a law, analysing its implementation within a company, studying how the regulation is structured in the Belgian entity through internal documentation and contact with the local Fujitsu’s J-SOX team.

The work proposes a solution to reach the company objectives by taking into account the “J-SOX culture” already set by the Fujitsu Headquarter located in Germany but also not ignoring local parameters of Luxemburg.

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Abbreviations used in the text

SOX: Sarbanes-Oxley

J-SOX: Japanese Sarbanes-Oxley

CSOX: Canadian Sarbanes-Oxley

LSF: Loi de la Sécurité Financière

CCCG: Combined Code of Corporate Governance

CLERP: Corporate Law Economic Reform Program

SEC: Securities and Exchange Commission

PCAOB: Public Company Accounting Oversight Board

FSA: Financial Services Agency

FIEL: Financial Instruments and Exchange Law

CSSF: Commission de Surveillance du Secteur Financier

PSF: Professionnel du Secteur Financier

COSO: Committee of Sponsoring Organization of Treadway Commission

COBIT: Control Objectives for Information and Related to Technologies

ISACA: Information Systems Audit and Control Association

CFA: Chartered Financial Analyst

ICOFR: Internal Control Over Financial Reporting

DRC: Disciplinary Review Committee

PCP: Professional Conduct Program

SOP: Standards Operating Procedures

EAGLE: Enterprise-wide Approach for Global Efficiency

ELC: Entity Level Control

PLC: Process Level Control

CLC: Company Level Control

FCRP: Financial Closing and Reporting Process

ITGC: IT General Control

ITAC: IT Application Control

HQ: Headquarter

WIP: Work In Progress

FTS: Fujitsu Technology Solutions

CEMEA & I: Central Europe, Middle East, Africa and India

PCB: Project Control Board

BeLux: Belgium –Luxemburg

BeNeLux: Belgium- Netherlands- Luxemburg

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General Introduction

Nowadays the issue of regulation, especially in the field of finance, has a growing meaning with the current economic crisis which has hit all developed countries and the rest of the world. The necessity of regulating banks and financial industry is an issue which has been and is still present in many debates today, but regulation is not only a bank or financial matter; it is something often present in all domains of our societies.

Many business companies face this topic every day. Compliance, accounting rules, internal control, audit, corporate responsibility and corporate governance are such vocabulary that we can easily hear from the business world. The legislator is requiring that with the purpose to protect investors and sustain their confidence in the corporate world but also to increase companies' responsibilities regarding information they disclose and destined to the public and their shareholders. There is an urgent necessity for business companies to comply with existing corporate laws for a fair and healthy business environment.

In 2002, the US Congress, confronted to many financial frauds and collapses, voted the "Sarbanes Oxley Act", a controversial law which became mandatory for all companies listed in United States. This law requires companies to systematically evaluate their internal control systems for a reliable financial reporting therefore companies are responsible for all financial report figures disclosed.

After the release of SOX Act, many countries in different region of the world adopted measures in the same direction. We, therefore, have Bill 198, also known as CSOX (Canadian SOX) in Canada, CLERP (Corporate Law Economic Reform Program) in Australia, LSF (Loi de Sécurité Financière) in France, CCCG (Combined code of corporate governance) in England and in Japan we have the financial instruments and exchange law also known as J-SOX (Japanese SOX). They're all almost built on the same basis but are, of course, different according to business culture established in their respective countries.

The J-SOX standard compliance is required and mandatory for all companies listed in Japan (Tokyo stock exchange), along with their foreign subsidiaries. Its implementation must be a part of companies' corporate governance.

SOX topic covers a wide range of things to discuss on, but this thesis focuses on the Japanese SOX standard implementation process and procedures within a company and especially in a specific one, Fujitsu Belgium-Luxemburg (Fujitsu BeLux). The core of the work is going to rely on a project carried out during an internship done within the company from January to April 2012. As a “project-thesis”, the purpose, here, is to:

- Analyze the J-SOX structure already in place in Belgium
- Identify pre-requisites and gaps for a possible J-SOX implementation in terms of processes and methods within Fujitsu Luxembourg
- Propose an implementation model and planning of J-SOX catalog and design the concrete controls that will be put in place.

For that reason, the first part is largely dealing with everything related to the law. The content of the Act, it causes and origins, its consequences and so forth. It is a literature review on the topic helping the reader to deeply understand what the law is about, especially its impact on corporate governance but also its impact in terms of organization. Then, there is a specific chapter which is a comparative analysis between what recommends, in terms of ethics, Sarbanes Oxley as legislation, especially the Section 406 and what CFA Code of ethics suggests, in order to analyze the evolution of ethical principles and legislations after the Enron collapse and to point out what have really changed for companies. Briefly, this first part is the general theoretical review about the SOX legislation

The following part will focus on the core task of the thesis, the applied part related to the project carried out within Fujitsu BeLux. We are going to outline the methodology, the J-SOX implementation structure and milestones within the company, the evaluation of the structure and at the end, the project results and the system which have been setup.

And the last part will be a conclusion, general recommendations to the company related to what should really be done for an optimal, effective and efficient internal control system.

Part 1. Literature Review

J-SOX compliance is mandatory for all companies listed in Japan including their significant subsidiaries around the world. The legislation, even though a little bit, less stringent than the American SOX, is not spared from critics. The most important point that matters, in this part, is to understand why is it, that, important to comply with this legislation?

To find some possible answers to this critical question, it is necessary to discuss the real origins and reasons of J-SOX and its specifications compared to the American SOX legislation, the evolution of the Act from its enactment to today and to describe reactions of principals stakeholders, we means companies, to this mandatory law and at the end, trying to figure out advantages and disadvantages of compliance with the legislation.

Chapter 1. Reasons and origins of financial instrument and exchange Law

In 2001, the American business world had been shocked by the announcement of many collapses and accounting scandals in big companies; especially when Enron filed for bankruptcy.

Enron, an energy, commodities and services company based in Houston, was the seventh largest company by revenues in the United States. It was a large, highly visible company which employed around 25 000 people worldwide. It was one of the most admired companies (Hamilton, 2003), a model of performance for energy industry companies. Its performance had been the subject of news articles and praised in the media; its success has been studied as a case study in business schools through the world.

Indeed, the consulting firm McKinsey had frequently cited Enron as an example of how innovative companies can outperform more than traditional rival (Hamilton, 2003). Its collapse was a real thunder in the business world, a real fall from its glory.

As more and more facts emerged, everything was clear according to the SEC (US Security and Exchange Commission) investigation that the company had disclosed false information in its financial statements to meet and satisfy various requirements of stakeholders and the company

was charged of fraud, despite various audit reports from Arthur Andersen, one of the largest audit and accountancy Corporation in the world at that time.

Arthur Andersen took also bankruptcy and had ceased existing. Enron case was attributed as the biggest audit failure (Bratton, 2002). The company was worth less than what reported, income was overstated and many company's debt and losses were excluded from financial reports. Many executives at Enron were indicted for different types of charges and were later sentenced to prison.

A Real media frenzy was surrounding the Enron affair and many press investigations were conducted. With Enron in the lead, many others companies like WorldCom, Adelphia, Xerox... were charged of similar frauds. All these scandals have called into question the credibility of the markets and reduce investors' confidence; the effect of these scandals on the equity markets has been dramatic. The Standard and Poors 500 index (S&P500) fell by 200points, over 20% in the month after WorldCom announced it was restating its earnings (Poretz and Bogle, 2002) and obviously in response, these concern led the American legislation to react with several measures but especially by adopting the "Sarbanes Oxley Act" which has been overwhelmingly voted by the congress, both in the Senate and in the House. President Bush signed it into law on July 30th, 2002.

The bill known by the names of its initial sponsors, Senator Paul Sarbanes (Maryland) and Representative Michael Oxley (Ohio) is also simply called SOX. This law, which is one of the most important reforms the US has ever known since the 1930's crisis, sets strict rules affecting every business profession, organization and agency. SOX contains 11 titles and 69 sections and each of them is crammed with detailed requirements directly affecting public accounting firms (Verschoor, 2005).The purpose of the law is to protect investors and sustain their confidence in the corporate world, increase the basic trust of shareowners, creditors, and the public in the reliability of material corporate disclosure of financial and operating performance by public corporation but also to increase companies' responsibilities. "The law prohibits also personal loans to corporate directors and executive officers. It requires CEOs and CFOs to certify financial statements and finally it provides tougher criminal penalties for fraud (Poretz, Bogle, 2002)

After the US SOX, many SOX versions have been released in every world region trying to comply with this standard. From Europeans SOX to Bill 198 in Canada, one of the versions of SOX is the Japanese one called J-SOX or Japanese Sarbanes Oxley Act

The legislation containing J-SOX provisions is, indeed, called Financial Instruments and Exchange Law. The law was passed in June 2006. These provisions are very similar in content to the US SOX. As with US SOX, J-SOX was passed in large part as a response to a number of corporate frauds that has occurred in Japan and represents also significant reform of previous securities legislation.

Indeed, Japan has also been touched by the false information's disclosure in financial statement reports. Like Enron and WorldCom, Livedoor which is a Japanese major internet service provider has been charged of financial fraud. The country which is culturally different from the western and European view was also concerned by financials scandals. Consequently the Financial Services Agency (FSA), the Japanese financial system monitoring (equivalent of the US SEC) issued compulsory rules related to financial report and its reliability. Those rules are almost the same than the US ones and there are not big differences. That is the reason why it is called the Japanese Sarbanes Oxley or simply J-SOX. Actually, J-SOX is the informal name for the legislative framework of Internal Controls over Financial Reporting (ICOFR) that falls within the scope of the Japanese financial instruments and Exchange Law, which reforms public company accounting and protect investors. It is the main statute codifying securities Law and regulating Securities Company in Japan

The legislation which is applied to all companies listed in Japan including their significant subsidiaries and affiliates, calls for the establishment of internal control rules to ensure proper disclosure and reporting on internal accounting procedures. It also requires company management to verify that these rules are complied with, and for auditing to conduct the relevant audits (Kumar and Taneja, 2008)

As a conclusion, it is obvious to notice that SOX requirements have forever changed the auditing practices and financial reporting procedures for thousands of corporations worldwide but let's mention that both J-SOX and US SOX but also others SOX versions around the world are post Enron scandal Laws; they are not the first legislations concerned with corporate governance.

There have been other initiatives in the United States and abroad but the current global regulatory environment is, definitely, one that demands that enterprises take every step to ensure the integrity of their finances, their data, their processes and their employees.

Chapter 2. Japanese Specifications of Sarbanes Oxley

Seizing Japanese specifications compared to US Sarbanes Oxley Act, needs a clear understanding of US SOX Act content first, because it is almost the reference framework for the other similar legislations around the world. Then it is possible to really understand and dissect the Japanese version of the same act.

The aim of this chapter is to outline the differences in terms of content and scope between J-SOX and US SOX and then to focus on the Japanese specifications of the Act

2.1. The US Sarbanes Oxley Act content overview

As it has been said some lines above, the “Sarbanes Oxley Act”, the US one, has been signed into law on July 2002 in the context that the congress was under the pressure to restore public confidence. The Act was voted by the House by a vote of 423 in favor, 3 opposed, and 8 abstaining and by the Senate with a vote of 99 in favor, 1 abstaining; as it can be noticed the Act was approved in an overwhelmingly majority in both chamber. *It was the most securities law change since passage of the original federal securities laws in 1933 and 1934* (Svenson, 2008). It is, therefore, mandatory for all organization listed in United States, large or small to comply with. It has many provisions that affect accounting as well as non-accounting business professions.

The Sarbanes-Oxley Act of 2002 contains 11 titles and 69 sections that treat various issues, from additional corporate board responsibilities to criminal penalties. The titles describe specific requirements for financial reporting.

Here are all the titles of the Act:

Title1. Public Company Accounting Oversight Board

This title contains nine sections which consist on the establishment of the Public Company Accounting Oversight Board, a system of oversight of public accountants newly created to regulate the accounting profession. A private, independent, nonprofit corporate entity, the

PCAOB is constituted of members, certified public accountant and appointed by the Securities and Exchange Commission (SEC) for five years terms¹.

The PCAOB:

- Adopt auditing standards
- Conduct disciplinary proceedings against public accounting firms and their personnel
- Require public accounting firms to register with the board
- Is funded by fees on public companies based on their market capitalization

Title2. Auditor independence

The second title consists in nine sections too which strengthen the independence character of public companies auditors to avoid any conflict of interest but in reverse, restrict auditors from providing the same client with non-audit services.

This title also addresses new auditor approval requirements, audit partner rotation requirements and auditor reporting requirements

Title3. Corporate responsibility

Title 3 talks about senior executives' responsibilities; it requires them to certify that financial reports do not contain any material misstatement, so they're accurate and complete. They must also certify their individual responsibility related to the design, the evaluation of effectiveness of internal control within the company.

It enumerates specific limits on the behaviors of corporate officers and describes specific cost of benefits and civil penalties for non-compliance

It requires also that audit committee to be composed of independent directors, not officers of the company and people who do not accept any consulting or advisory fees from the company issuer. The interaction of external auditors and audit committee is defined within this title.

Title 3 consists of eight sections

¹ Congress acts to stop corporate abuse

Title4. Enhanced financial disclosure

The title described requirements of enhanced reporting regarding financial transaction including “off-balance sheet” transaction, obligations, arrangements and others elements related to unconsolidated entities that might have a significant impact in the financial statements and requires them to be disclosed.

It requires internal controls for the production of accurate financial reports and disclosures and an evaluation of effectiveness of internal control over financial report by the management. Audits must be done on this internal control and also timely reporting of significant changes in the financial condition and review by the SEC.

Let’s mention that section 404 is one of the most controversial of the Act; it has been subject of lots of debates and critics. Further analysis of this section is scheduled in the third chapter.

The title has nine sections

The section 404 is one of the most important of the Act; it is subject to a lot of critics and debates. Briefly, it requires management to assess and report on the effectiveness of internal controls over financial reporting and includes a requirement for the external financial statement auditors to attest to management’s assertion

Title5. Analyst conflict of interest

This title contains one section that discusses measures to help restore investor confidence in the reporting of securities analysts and defines the codes of conduct for securities analysts and finally requires disclosure of knowable conflicts of interest.

Title6. Commission resources and authorities

It consists of 4 sections and defines practices to restore investor confidence in securities analysts. It also introduces and defines the Security Exchange Commission (SEC) as the governing body to manage financial standards and policy in the industry but also to censure securities professionals from practice and defines conditions under which a person can be barred from practicing as a broker, advisor, or dealer.

Title7. Studies and reports

The title requires the SEC to perform researches on various subjects with the purpose to protect the investor and to report its findings. The report includes the effect of consolidation of public accounting firms, the role of credit rating agencies in the securities markets, securities violations and enforcement actions. This title consists of five sections.

Title8. Corporate and criminal fraud accountability

It describes specific criminal penalties for manipulation, destruction or alteration of financial records or other interference with investigations. But one of the well-known sections of the SOX act is contained here because it provides safety for people who report their company also known as “whistleblower”

Briefly, this title outlines illegal practices for corporate fraud; the penalties associating with various fraudulent practices are also contained among the seven sections it have.

Title9. White-collar crime penalty enhancements

This area of the Act outlines the behavior associated with “white collar crime” and increases therefore, the associated criminal penalties and conspiracies. Stronger sentencing guidelines are recommended and specifically failure to certify corporate financial reports as a criminal offense is added. Title 9 has six sections

Tilte10. Corporate tax returns

This other one section title is very brief and clear, it just require CEO’s to review and sign the tax return generated by the company.

Title11. Corporate fraud and accountability

The last title consists of seven sections mainly focuses on the identification of corporate fraud and considers tampering as a criminal offense; it links those offenses with specific penalties, so more accountability is necessary.

The Sarbanes-Oxley Act was written at a time when the United States House and Senate both felt there was an urgent need to set stringent financial laws to help restore investor confidence in businesses and companies.

As far as compliance is concerned, the most important sections or key sections within these are often considered to be:

- 201: about prohibited auditors activities
- 302: describes CEO's and CFO's new responsibilities
- 404: the management assessment of internal controls
- 409: outlines real time disclosure
- 802: describes criminal penalties for altering documents
- 806: describes whistleblower protection
- 807: describes Criminal penalties for fraud

2.2. The Japanese financial instrument and exchange Act content overview

In recent years, the Japan's financial and capital markets environment has been changing drastically. This law is the amendment of the former Security Exchange Law.

With the development of financial technologies, some financial products not covered in the previous regulations for user protection have appeared, and there have been also cases of users suffering damages. It was, definitely, necessary to compile comprehensive and cross-sectional rules for users' protection and to develop an environment where users can invest in confidence. In others words, more flexible rules to entry into the financial instruments businesses according to the type of business (new legislative framework for investor protection).

So the name of the Securities and Exchange Law has been amended to the Financial Instruments and Exchange Law; with the abolition of four laws (financial trading law, law concerning foreign securities firms, law concerning the regulation of mortgage business and law concerning the

regulation of investment advisory services relating to securities) to be consolidated into the new Law. In total 89 laws have been amended.

In the Financial Instruments and Exchange Law, the legal name for a firm subject to the regulation is changed to "financial instruments firm" and the legal name for an exchange is changed to "financial instruments exchange." Such amendments, modifications and changes as these ones have been made into the new legislation.

The law aims at: responding, obviously, to changes in the financial and capital markets environment; promote full compliance with focus on investor protection rules and improving investor convenience; ensure market functions to promote the trend “from savings to investment”; and adapting to the internationalization of the financial and capital markets².

The amendment largely consists of the following pillars³:

- Establishing a cross-sectional legislative framework for investor protection covering financial products with strong investment characteristics (the so-called legal framework for investor services)
- Enhancing disclosure requirements
- Ensuring appropriate management of self-regulatory operations by exchanges
- Strict countermeasures against unfair trading

The law contains nine chapters, forty-two sections and many subsections and divisions. Here are the titles of different chapters:

- Chapter 1. General provisions
- Chapter 2. Disclosure of corporate affairs and other related matters
- Chapter 3. Financial instrument and operators matters
- Chapter 4. Financial instruments firms association
- Chapter 5. Financial instrument exchange
- Chapter 6. Regulation on transactions of securities
- Chapter 7. Miscellaneous provisions

² www.fsa.go.jp

³ www.fsa.jp

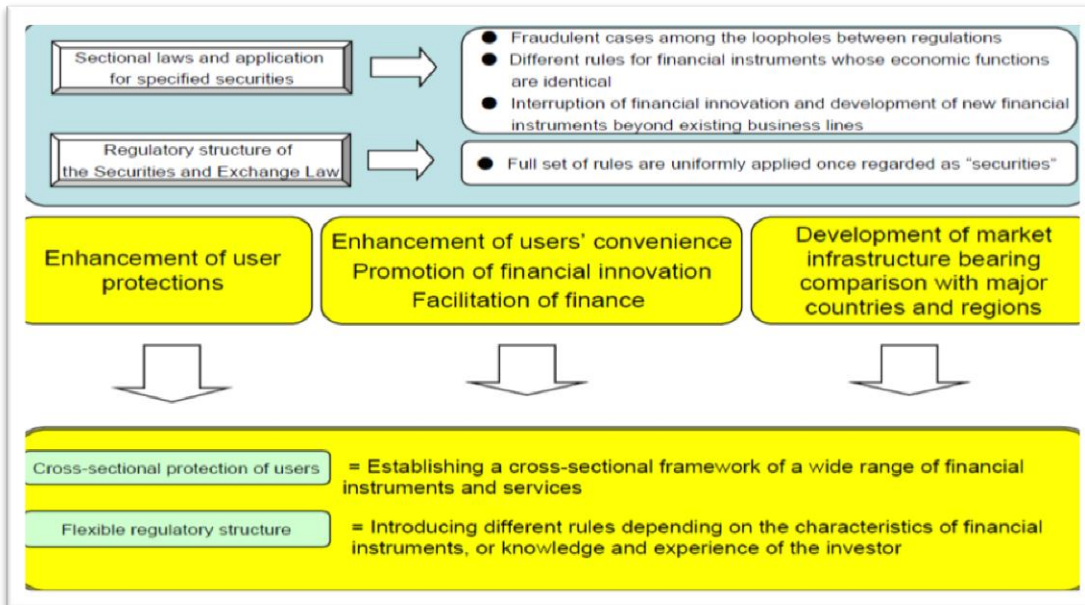
- Chapter 8. Penal provisions
- Chapter 9. Investigation into criminal case

There is another point called supplementary provisions.

The basic content of the Act can be summarized in four principals' points:

- Establishment of cross sectional framework of a wide range of financial instruments and services which consist in comprehensive definition of collective investment scheme and wide ranging definition of derivatives
- Enhancements of disclosure with an enhancement of internal control over financial reporting; review of regulations on tender offers and large shareholders reports
- Increase the maximum penalties against various market frauds and expansion of the scope of penalties. It is about penalties against such frauds as false annual reports and market manipulation.
- Provision of organization structures for self-regulatory functions of exchanges in the form of stock corporations or self-regulatory committee

Chart 1. Purport and objective of the financial instrument and exchange law



Source: bills for a new legislative framework for investor protection, financial service agency, Japan, March 2006, p5

As we can see on the diagram above, the content of the law focuses a lot on the investors' protection.

J-SOX is the informal name for the legislative framework of internal controls over financial reporting (ICOFR) that falls within the scope of the Financial Instruments and Stock Exchange Law. It is the main statute codifying securities law and regulating securities companies in Japan.

According to Shinji Hata, a professor of auditing at the Graduate School of Professional Accountancy at Ayoma Gakuin University in Tokyo, "J-SOX is a broad framework encompassing all the efforts to improve confidence in the Japanese securities market through enhancement of internal controls in Japanese-listed companies". He thinks that it is misleading to consider J-SOX as equal to the articles relating to the Internal Control Report System of the Financial Instruments and Exchange Law; especially because Section 404 of the U.S. SOX has tended to give a negative impression due to cost increases for U.S.-listed companies, so, the term J-SOX could give a biased image to Japanese-listed companies and other participants in the market.

However, Japan is no exception to the global trend of renewing corporate governance. Inspired by recent corporate scandals such as the Kanebo, Livedoor, and Murakami Fund (similar to the Enron collapse in United States) which have accelerated the movement towards corporate control enhancements, J-SOX, like in US, represents a significant reform of previous securities legislation. The legislation requires management to (Client connection, 2006):

- Document internal processes and control procedures
- Evaluate the design of internal processes and control procedures of test effectiveness
- Issue a report on the design and effectiveness of internal controls and certify as to the accuracy of the report

The legislation requires also external auditors to audit the management reports on internal controls as part of annual audit.

It is mandatory for all companies listed in Japan and has been in force for all the fiscal years starting after April, 2008. It is important to mention that most Japanese companies have a fiscal year ending on March 31. There are approximately, 3,800 listed Japanese companies, including their significant subsidiaries and affiliates; the law extends to business units that comprise two-

thirds of consolidated revenue. Their first filing of a management evaluation report on internal control had been March 31, 2009

In summary, J-SOX (and SOX) are not just compliance programs that a corporation needs to adopt and follow but they are supposed to be compliance programs that will help corporations to avoid losses and may, more importantly, restore investors' and shareholders' confidence.

2.3. Japanese specifications: differences between J-SOX and US SOX

Even though both of legislations, Japanese and American, are called SOX, there are some differences between them. First of all, Japan, the country, is very different from United States in term of cultures, including business cultures; and legislation structures are obviously not the same in the two countries.

However, let's focus first on what the two legislations have in common. First of all, J-SOX and US SOX are both of them a response to several corporate collapses occurred in their respective countries; the purpose for the legislator, in each country, was to protect investors, maintain their confidence to the markets an increase financial transparency; and then, we are going to discuss the real Japanese specifications. We are going to consider US SOX as the reference act and from there, trying to find out the difference, what is new in the Japanese version compared to the previous American version.

Similarities

In general, J-SOX requirements are similar to the US SOX section 302 "Corporate responsibility" and section 404 "Management assessment of internal control"; those sections are aimed to evaluate internal control related to financial reporting, therefore ensure disclosure of accurate and reliable financial information and prevent the recurrence of investor deception. The stipulations in section 404 of title 4 of US SOX are similar in content to the provisions and stipulations contained in article 24, section 4, Paragraph 4 of Japan's financial instruments and exchange law. While the remaining parts of the document are different from the content of US SOX, these specific requirements are referred to as J-SOX.

Extract of Sarbanes Oxley act (one hundred seventh congress session of the United States of America: the second session)

“Sec. 404. Management assessment of internal controls.

(a) RULES REQUIRED.—The Commission shall prescribe rules requiring each annual report required by section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)) to contain an internal control report, which shall—

(1) State the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting; and (2) contain an assessment, as of the end of the most recent fiscal year of the issuer, of the effectiveness of the internal control structure and procedures of the issuer for financial reporting.

(b) INTERNAL CONTROL EVALUATION AND REPORTING.—With respect to the internal control assessment required by subsection (a), each registered public accounting firm that prepares or issues the audit report for the issuer shall attest to, and report on, the assessment made by the management of the issuer. An attestation made under this subsection shall be made in accordance with standards for attestation engagements issued or adopted by the Board.

Any such attestation shall not be the subject of a separate engagement...”.

Extract of Financial instruments and exchange act

“Article 24-4-4 (System for Ensuring Appropriateness of Statements on Finance and Accounting and Other Information)

(1) A company which is required to submit Annual Securities Reports under Article 24(1) (including companies which have submitted Annual Securities Reports under Article 23-3(4); the same shall apply in the following paragraph) shall, if the Securities issued by the company are those listed in Article 24(1)(i) or the company is otherwise required by a Cabinet Order, submit a report in which evaluation pursuant to the provisions of a Cabinet. Office Ordinance is made with regard to its system specified by a Cabinet Office Ordinance as necessary for ensuring appropriateness of statements on finance and accounting and other information concerning the Corporate Group to which the company belongs and concerning the company (hereinafter referred to as an "Internal Control Report") to the Prime Minister together with an Annual

Securities Report (or a Foreign Company Report in cases where Foreign Company Reports are submitted instead of Annual Securities Reports, etc. as defined in Article 24(8) under Article 24(8)) for each business year.

(2) A company which is required to submit Annual Securities Reports set forth in Article 24(1) may, even if the company is not a company which is required to submit Internal Control Reports together with Annual Securities Reports under the preceding paragraph (except those specified by a Cabinet Order), voluntarily submit Internal Control Reports provided for in the preceding paragraph.

(3) The provisions of the preceding two paragraphs shall apply mutatis mutandis to a company which is required to submit Annual Securities Reports under Article 24(1) as applied mutatis mutandis pursuant to Article 24(5) (including companies which have submitted Annual Securities Reports under Article 23-3(4)) and is specified by a Cabinet Order. In this case, the term "or the company is otherwise required by a Cabinet Order" in paragraph (1) shall be deemed to be replaced with "or the company is otherwise required by a Cabinet Order (limited to the Issuer of Regulated Securities (meaning Regulated Securities as defined in Article 5(1); hereinafter the same shall apply in this paragraph)); the term "business year" in paragraph (1) shall be deemed to be replaced with "Specified Period (meaning Specified Period as defined in Article 24(1) as applied mutatis mutandis pursuant to Article 24(5)) designated for the Regulated Securities"; the term "the Corporate Group to which the company belongs" in paragraph (1) shall be deemed to be replaced with "asset investment or other similar businesses conducted by the company"; and any other necessary technical replacement of terms shall be specified by a Cabinet Order. ...”

Finally, let's mention that for those Japanese companies who have undergone and passed U.S. SOX, the Japanese government was considering granting exemption to J-SOX due to its similarities to U.S. SOX, thus avoiding duplication of efforts.

Differences

J-SOX have been enacted couples of years after SOX, so Japanese financial authorities had taken their time to avoid burden, confusion and imperfection surrounding the American legislation; unlike to United States, where SOX have been enacted in a short period of time, the FSA didn't

have a sense of urgency . During the process of devising J-SOX, the events that occurred in the U.S. after the SOX introduction were taken into account, which has resulted in a number of differences between the two laws. That's why J-SOX requirements have been designed to require a broader initiative than US SOX. The differences found are based on the applicability, the origins, the framework, the adoption, the approach and the internal control procedures.

Difference in applicability

The first difference between the two legislation lies on their applicability scope.

J-SOX rules are applied to all listed companies from the first year onwards whereas under the US-SOX, the application time and the content have been divided by the accelerated company and the non-accelerated company (Yazawa, 2010)

Difference in the origin and intent

The origin and intent of J-SOX was at first, a little bit different from what happened in United States even though finally, the purpose and background of both laws are almost the same. However, the idea of so called J-SOX was driven by FSA authorities who wanted to crack down on pro- North Korean interests and criminal groups who have been engaged in fraud and stocks manipulation.

Indeed, corporate scandals that have been occurred, happened to companies alleged to have backing from Koreans living in Japan who are sympathetic to North Korea, specifically Livedoor and Murakami Fund (Toshio, 2006).

Difference in the economies

One of the important differences between J-SOX and the American Sarbanes Oxley lies also in the economy organization of respective countries.

The Japanese economy rests on a structure of “Kereitstu” which is a group of companies with interlocking business relationships and shareholdings; it is a type of business group which dominates the economy for the greater half of the twentieth century instead of standalone corporations as it is organized in the United States.

Difference in the framework

The SEC in United States and the FSA in Japan recommend to use a recognized internal control framework and specifically the “Committee of Sponsoring Organization of the Treadway Commission (COSO) framework for an optimal SOX implementation.

COSO provides a comprehensive framework for defining and evaluating internal controls. The framework identifies five essential components of effective internal control – (1) control environment, (2) risk assessment, (3) control activities, (4) information and communication, and (5) monitoring but also three objectives- (1) Efficiency and effectiveness of business, (2) Reliability of financial reporting, (3) Compliance with related laws and regulations (Kost, 2006).

The COSO framework defines internal control as a process; it consists in five interrelated components derived from the way management runs a business and helps the organization to achieve objectives of internal control described above. It is a very important framework in documenting and testing the effectiveness of internal controls

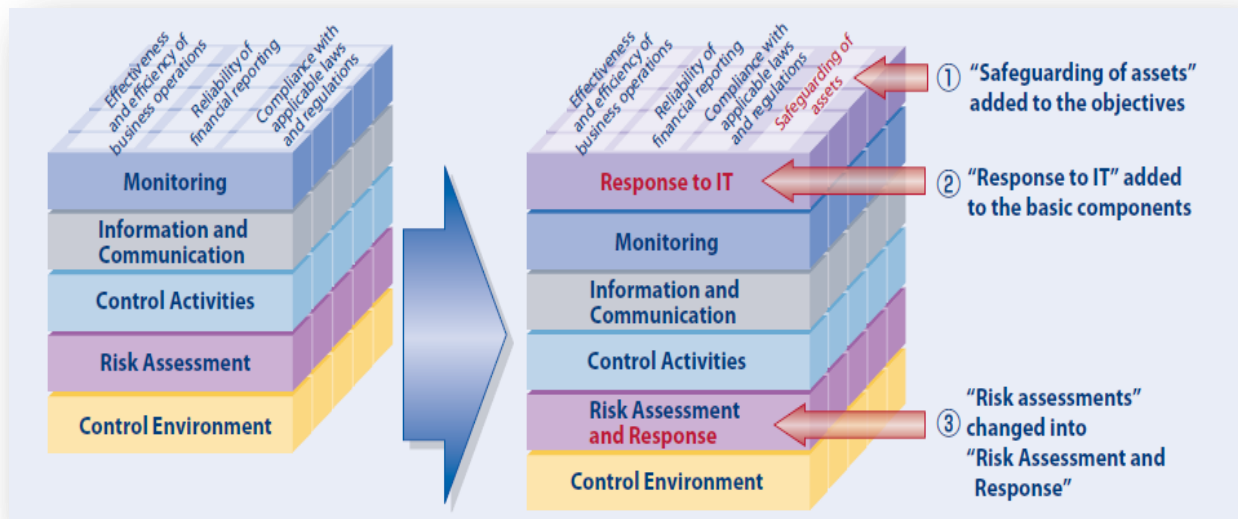
The J-SOX Standard was generally built upon the COSO framework” as well as the US SOX and others similar legislation all over the world but to better reflect the business practices in Japan, the framework was modified to include “custody of assets” as the fourth control objective to emphasize the importance of using reasonable procedures and approval for the acquisition, use and disposition of asset and introduced a sixth component of control, “response to information and technology,” since IT has become critical in the current business environment and deeply penetrates companies, therefore has a significant impact on the financial reporting process. The component “Risk Assessment” in the COSO framework changed into “Risk Assessment and Response” in the new standard practice, because it is important to include in the framework the responses made after Risk assessment. This new Japanese framework is called “practice standard” (Uehara, et al., 2008)

As the following diagram is showing us, there is therefore the additional component and objective to form the Japanese practice standard.

It is also important to mention that most of the time, different corporations develop an IT control framework that supports their internal control program. The most widely recognized is COBIT

(Control Objectives for Information and related Technologies), an IT control framework developed by the ISACA (information System Audit and Control Association). Many companies have adopted COBIT as their standard IT control framework for SOX as well as J-SOX compliance.

Chart 2. From COSO Framework to J-SOX



Source: Present, Past and Future of internal control, a survey of J-SOX compliance

Difference in the adoption

J-SOX is, actually, a nickname by Japanese media, for expediency, to indicate a number of provisions included in the Financial Instrument and Exchange Law (FIEL) and which seems to be very similar to US Sarbanes Oxley but J-SOX is not a copy of US SOX, there is a lot of differences between them.

The biggest difference between Japan and United states lies in the methodology employed by outside auditors. In US, the main method used is direct reporting whereas in Japan, auditors mainly conduct indirect inspections.

The major burden of SOX compliance is documentation of all activities within the company; it has been proven that it constitutes additional cost for companies and its stringent rules do not help management teams in their process ; that's one of the reasons why Japanese authorities hadn't design J-SOX to follow US SOX as it is, J-SOX is much simpler. Business process and

business rules are handed down from person to person. They're not documented in details. While the focus in United States is on documentation, in Japan there are very few manuals and Standard Operating Procedures (SOP).

Difference in the approach

Another difference is that the FSA recommends for J-SOX a top down, risk-based approach whereas for US SOX a bottom up approach is recommended.

The top down and risk-based approach encourages management to focus its efforts on the accounts, business process and location that can be a high risk of material error and to spend less time on the lower risk areas. A risk based approach is the one that focus on financial statements accounts and related process which are significant, either quantitatively or qualitatively to the financial statements and the top-down aspect simply means that the parent company will begin evaluation by an Entity Level Control (ELC), and will work down to specific processes and financial statements accounts (Client connection, 2006)

Difference in the internal control procedures

Under J-SOX, we classify internal control deficiencies in two categories: Control deficiencies and Material weakness, whereas under US SOX, the classification is made in three categories: control deficiency, significant deficiency and material weakness.

J-SOX is softer in some ways than the US Sarbanes Oxley , it requires businesses to publicly disclose governance related errors that would be deemed to change group pre-tax income by more than 5 percent, that's much lighter than US SOX's requirements that any "material error be disclosed" (Aritake, 2006).

The J-SOX Practice Standard focuses on the responsibilities of Executive Management rather than the ones of auditors, so "direct reporting" by the auditor is not a priority; it is the contrary in United States with the audit of management's assessment. Management is required to prepare an "Internal Control Report," on its assessment of the effectiveness of internal control over financial reporting.

In another register, under J-SOX, auditors will only audit the management's assessment of internal controls and not directly audit and report on the effectiveness of internal control. They will express an opinion on management's assessment on the effectiveness of internal control over financial reporting.

Internal control audits can be performed by the same auditors and the same engagement partner responsible for auditing the company's financial statements, with certain limitations, which are still being discussed. Unlike U.S. SOX, internal control audits must be performed by a party independent of the external financial auditor, such as management, internal auditors, or a designated third-party provider.

Table 1 below describes a summary of the breakdown of US Sarbanes Oxley and J-SOX

To conclude, we can say that it is obvious that Japanese SOX has been inspired by US SOX but Japanese authorities have adapted it to the local business culture and environment, paying attention to avoid American mistakes, dysfunctions or critics, and focus directly to most important issues outlined by the regulation. These are different points set by the Japanese authorities to improve flexibility or enhance J-SOX compared to the equal US legislation (Abeam Consulting, 2009):

- Using top down/ risk based approach
- Classifications of deficiencies of internal control
- Not adopting direct reporting
- Integration of internal control audit with financial statement audit
- Preparation of internal control audit report and financial statement audit report
- Coordination of external auditors and corporate auditors (audit committee)

Table 1. Breakdown of US SOX and J-SOX

	US SOX	J SOX
Governing Laws	Sarbanes Oxley Act 2002 (signed by president, July 2002)	Financial Instrument and Exchange Law (passed by Diet, June 2006)
Organizations subjected to rules	All public companies listed on a US Stock Exchange	All public companies listed on a stock exchange in Japan and other companies requested by ministerial ordinance
Type of control subjected to the rules	<ul style="list-style-type: none"> - Disclosure control and procedures (Section 302) - Internal control over financial reporting (Section 404) 	<ul style="list-style-type: none"> - Disclosure control and procedures (Section 24-4-22) - Internal control over financial reporting (Section 24-4-4)
Type of information subjected to the rules	<ul style="list-style-type: none"> - Significant disclosures in quarterly and annual reports (Section 302) - Financial Statements and footnotes includes in 10K, 10KSB, 10Q, 10QSB, 20F, 40F (Section 404) 	<ul style="list-style-type: none"> - Disclosure included in the securities report (Section 24-4-22) - (consolidated) Financial statements and their footnotes in the financial section of the securities report (Section 24-4-4) - Disclosures that have the significant impact on the reliability of financial statements in other sections of the securities report
Evaluation of IT Control	Relevant application and general IT control based upon risk-based approach	The following control should be evaluated: <ul style="list-style-type: none"> - IT General controls - IT Application controls

	US SOX	J-SOX
IT General controls	Consider: <ul style="list-style-type: none"> - Program development - Program change - Computer operations - Access to program and data 	Consider: <ul style="list-style-type: none"> - Management of development and maintenance of system - System operation and management - System security management, such as access controls - Contract management related to service organizations
Definition of deficiencies	<ul style="list-style-type: none"> - Deficiency - Significant deficiency - Material weakness 	Two types based on qualitative and quantitative factors: <ul style="list-style-type: none"> - Deficiency - Material deficiency Five percent of consolidate pretax income is provided as an example of a materiality threshold; however, consideration should be given to the materiality for the financial statement audit
Subject of audit	Audit of internal control over financial reporting	Audit of effectiveness of management's assessments of internal control over financial reporting
Definition of financial statement	Consolidated statement only	Consolidated and parent company only statements
Suggested overall approach	Top down risk-based approach heavily influenced by Auditing standard no.2	Top down risk-based approach

	- US SOX	- J-SOX
Internal control framework	<ul style="list-style-type: none"> - No specific framework - SEC rule regards COSO as one of the recognized framework - Equivalent foreign framework generally adopted for foreign corporations 	<ul style="list-style-type: none"> - An original framework (J-SOX framework) is suggested - J-SOX framework was developed based on COSO framework (it includes an objective of safeguarding of assets in addition to three COSO objectives and an element of response to IT in addition to five COSO elements)
Auditor oversight	Public Company Accounting Oversight Board (PCAOB) --> issue Audit standard	Financial Services Agency (FSA) FSA Business accounting Council--> issue Audit standard
Foreign issuers	Must comply on a delayed basis	Must comply
Smaller companies	Delayed compliance and reporting dates	No specific provision for smaller companies
Type of control subjected to the rules	Disclosures control and procedures (section 302) Internal control over financial reporting (section 404)	Disclosures control and procedures (section 24-4-2) Internal control over financial reporting (section 24-4-4)
Subject of audit	Audit of the effectiveness of management' assessment of ICFR	Audit of effectiveness of management' assessment of ICFR

Source: Uehara, K et al (2008) J-SOX Challenge: efforts to comply with the new legislation ; ISACA (www.isaca .org)

Chapter 3. J-SOX evaluation since its enactment

Since its enactment in 2006, J-SOX, as well as other similar legislations around the world have been subject to a lot of critics. In most of the time, those critics turn around the stringent side of the legislation and its cost when it comes to implementation.

This chapter is precisely devoted to reactions of the business world to the Financial Instruments and Exchange Law or the so-called Japanese Sarbanes-Oxley Act (J-SOX), which was enacted in order to reinforce corporate accountability and responsibility after several corporate and accounting scandals in Japan. The chapter is going to discuss and figure out consequences of the Act on companies, what changes it brings and how companies have been dealing with that mandatory law; how the law itself has evolved through time, and at the end, in an objective way, tries to classify advantages and drawbacks of this act for companies.

3.1. Business world's reactions to J-SOX

Stock market reaction

By the day the Congress passed the Sarbanes-Oxley Act in United States, stock market indices of large capitalization stocks had fallen 40 percent over the preceding 30 months; According to a study by a researcher at the Wharton Business School, the number of American companies deregistering from public stock exchanges almost tripled year after Sarbanes–Oxley became law, while the New York Stock Exchange had only 10 new foreign listings in all of 2004.

The reluctance of small businesses and foreign firms to register on American stock exchanges is easily understood when one considers the costs and stringent rules that Sarbanes–Oxley imposes on businesses. This trend illustrates very well the impact of SOX enactment on the business world in US.

On the Japanese side, the announcements leading to the passage of the J-SOX raised stock prices of firms listed on the first Section of the Tokyo Stock Exchange and it has been noticed that firms with high ratio of foreign shareholders or leverage experienced more positive stock price reactions, perhaps because these firms were more prepared for J-SOX compliance, with a better governance structure.

In addition, large firms tended to have more negative stock price reactions than small firms, perhaps due to the high costs of the J-SOX compliance (Seino and Takeda, 2009). However it is important to mention that J-SOX was enacted Four years after US SOX and in different circumstances

Corporate reaction

The US SOX was a real revolution; a brutal, quick, rough reaction, groundbreaking new rules adopted in a rush from the American legislator toward companies, whereas in Japan, all the companies had an idea of what could be expected within the Financial Instruments and Exchange Law, they already had a reference.

The lesson learned from US companies difficulties related to SOX compliance led the Japanese Financial Services Agency (FSA) to soften J-SOX requirements. The fact that J-SOX was expected to be a more flexible adjustment of some Sarbanes Oxley requirement in the US, even though nobody knew the specific requirement at that time, helped to ensure that the Japanese legislation wouldn't be excessive for Businesses (Hoffman, 2007)

However, from the Americans, Japanese could find out 3 categories of companies' profiles facing SOX since it is mandatory (Watkin and Levick, 2007):

- Companies that accept the necessity of a better internal controls and put them in place
- Companies that spend massive money and time on system that do not change their culture
- Companies that already practice the highest standard. They do not balk at SOX requirement and welcome the new provision from a competitive standpoint.

The main message for Japanese authorities was to emphasize first that J-SOX does not represent a systemic correction but represents a reaffirmation of current corporate values and second, J-SOX does not impose any additional burden on corporate practice

Similarities expectancy between J-SOX and US SOX, especially similarities with the section 302 and section 404 of Us Act, led a lot of companies to get ready to be the early adopter of the regulation, because most of finance officers were already familiar with that. So, we can say that despite the fact that J-SOX was a significant reform of previous Japanese financial regulation, it was not a real surprise to Japanese companies.

In Japan, the response to J-SOX varies, as some companies viewed it merely as another set of legal requirements; seeking to complete the procedure with minimum costs while some other companies regard it as a good opportunity to improve their management quality. In any case however, the companies seem to be struggling in designing internal control as they were partially unclear about how they should interpret what the law requires (Abeam Consulting, 2009)

In 2009, according to the Abeam Consulting survey conducted, a large number of corporation were still in the process of designing and establishing internal control even after the start of the inaugural year; It seems like at the time the survey was conducted, corporation were not making enough effort to penetrate internal control but as for the methodology in design and establishment, companies seems to be faithfully complying with the practice standard framework (Abeam Consulting, 2009)

3.2. Critics on the Act

Among SOX' criticism, we can easily hear high cost, government intrusion into corporate management, destruction of capital market, killer of small businesses... etc. Opponents contend that compliance imposes too great a burden on publicly traded firms, particularly on small firms, which face higher average costs and derive lower average benefits as a result of new regulations (Kauffman rand institute for Entrepreneurship for public policy survey, 2007)

One of the rough critics made on Sarbanes Oxley Act is related to the requirements of Section 404. Regarding the number of critics made on this section, it is obviously interesting to focus on its content and figure out and understand all the critics made on it.

This section came about as a direct result of corporate failures of the past decade in which there were significant internal control failures associated with fraudulent financial statements. It has been subject of a lot of debates, press papers and it is one of the most controversial aspects of the Act. It is considered as “the most expensive and time-consuming SOX effort”. In this part, we are going to consider both US SOX and J-SOX because the same section 404, with almost the same main requirements, is contained within the two laws

To really understand all the critics, it is important to find out what this famous section 404 really says. Briefly, the section 404 which was adopted by the SEC on May 2003 requires management

and independent auditors to annually evaluate a firm's internal controls over financial reporting controls. We are not going to see the entire section here but this is the main requirements:

- Management's assessment of the effectiveness of the system of internal control over financial reporting as at the company year-end; together with
- The company's external auditors opinion on management's assessment and
- The company's external auditors' own assessment

According to a lot of managers, these requirements come to burden companies with huge implementation costs as armies of auditors check every corner of their operations; the average of first year implementation within large companies had reached upward \$ 35 million. Apart from that, the section is charged to come with a significant workload. Some 60% of companies with revenues greater than \$ 20 billion each invested more than 100,000 man hours in section 404 compliance-activities, even before taking in account external auditor's hours (*Verschoor, 2005*)

Another accusation about the section 404 lies on the fact that it drains IPO abroad; it is a discouragement for companies from listing on SOX-countries stock exchange.

So, critics on SOX can be summarized in two points:

First, corporate managers are complaining about the implementation cost and Second, Stock markets claim that the Act and especially section 404 is destroying different centers of financial world by pushing companies abroad.

Anyway, since, finance officers faced the compliance challenge of finding a way to reduce the cost of compliance while ensuring that the business process control operates and works effectively to mitigate and minimize financial reporting risks.

Thanks to all the complaints related to the cost of compliance, the PCAOB in United states found the necessity to revise the auditing standard which set out procedures required of external auditors for their control assessment (Auditing standard 2) and the SEC issued guidance for management on the work required of them, to help companies implementing section 404.

3.3. Consequences of the Act over companies

As said before, J-SOX was a revolution in the field of regulation; it couldn't remain without any consequences because it has changed some details of corporate governance or how companies should do business.

Many companies are claiming that the costs of implementing the reforms are much higher than the benefits they produce, especially small companies. One thing is certain; it creates a huge increase of internal costs and external audit fees, a real need for additional staff and expertise as well as a need for new and more sophisticated processes automation

Studies of compliance costs provide ample evidence that SOX increased public firms' accounting and auditing expenditures, regardless of company size; that audit costs were disproportionately higher for small firms even before SOX had passed; and that this disparity increased after SOX enactment, especially for small firms subject to the section 404 (Kauffman-Rand Institute for Entrepreneurship Public Policy, 2007).

On the table below, this is an example of the cost impact implied by SOX compliance. The table show median audit costs before and after SOX for all firms.

Table 2: Median audit fees as a percentage of revenues

Market capitalization (\$ millions)	Median audit fees as a percentage of 2003 revenues	Median audit fee as a percentage of 2004 revenues	Median audit fee as a percentage of 2004 revenues
		Firms not filling internal control reports	Firms filling internal control reports
0-75	0.64	0.79	1.14
75-250	0.29	0.35	0.56
250-500	0.18	0.26	0.40
500-700	0.15	0.20	0.30
700-1,000	0.13	0.12	0.25
➤ 1,000	0.07	0.07	0.13

Firms with less than \$75 million in market capitalization, already spending the highest portion of revenues on audit fees in 2003, saw these costs increase significantly after SOX, rising to 1.14% of 2004 revenues for firms filing internal-control reports (0.79% for non-reporting firms).

It is not possible to discuss about SOX consequences without saying a word about how it affects small businesses and foreign companies listed in a SOX country stock exchange.

This issue is by itself an entire topic because there is a lot to discuss on but, the purpose here is just to highlight that the first victims, if it could be said so, in terms of cost and burden, are small businesses. Indeed, Small businesses must develop and implement internal controls to safeguard their operational and financial information. Setting up internal controls requires the use of a public accounting firm or professional accountant. This represents an initial upfront cost for creating internal controls. They may also need to conduct periodic internal audits on business operations but when they're unable to conduct an internal audit by themselves; they have to hire an outside accountant to complete this function. So, SOX legislation with all its additional requirements implies higher fees and additional time and people dedicated to the compliance issue.

SOX legislations are also reported to make companies too much risk-averse. With the strict regulations some companies do not jump at new opportunities as easily as they used to do (Young, 2008)

In response, the SEC in United States had extended the compliance deadline twice because it has acknowledged that the cost of compliance for smaller companies greatly exceeded estimates.

However, apart from cost implication for a company, SOX consequences must be expected in the field of internal control. It is important to keep in mind that the purpose of the SEC in United States and FSA in Japan is to make sure that companies implement necessary processes for collecting, analyzing and disclosing information which have to be included in the financial reporting. So, for the sake of the financial reporting certification, according to the section 302 of the Act, companies should take into account the adoption of appropriate process to deliver the required certification.

3.4. Advantages and drawbacks of the Act

The Financial Instruments and Exchange law was passed in Japan, like in the US in order to prevent companies from engaging in accounting fraud. While J-SOX increased the accuracy and validity of financial information for outside stakeholders, it created some challenges for Business in attempting to comply with its guidelines. However, compared to US SOX, J-SOX has the advantage to be much looser. This part of the text outlines what can be advantages or drawbacks for a company to be J-SOX compliant.

Advantages

Very few studies have been focusing on the advantages of SOX regulation because most of the time, studies have indicated that the cost of implementation have been very high, so SOX regulation got the reputation to be heavy, stringent and obviously expensive for companies to implement. However, there are some advantages for companies to compliant with this legislation.

There are a lot of advantages for a company to be SOX compliant. The overall advantage of SOX regulation is the improvement in transparency and disclosure, with heightened monitoring providing better control of costs. However, being SOX compliant allows to:

- enhance internal controls management productivity and reduce disclosing process cost
- detect fraudulent financial reporting earlier and minimize its adverse effects
- Avoid higher penalties, since it is mandatory for all listed companies
- Decreases the risk of financial fraud, errors and improve the accuracy of financial reports

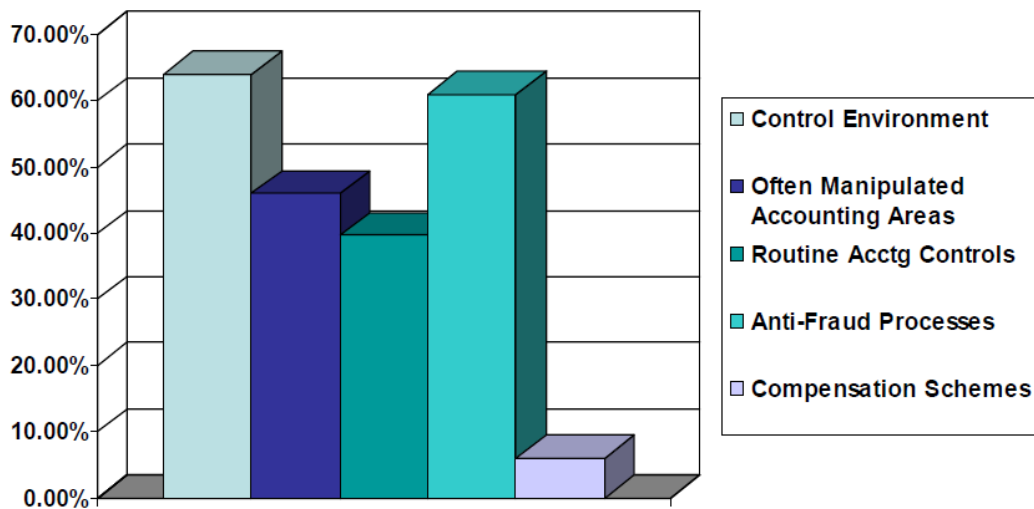
A study conducted by Rittenberg and Miller (2005), respectively an Ernst & young professor of accounting at the university of Wisconsin and Deloitte and Touche LLP vice-chairman, which shows that control improvement is directly associated with section 404 of SOX act. They asked participants to identify the controls that were improved directly as a result of 404work in their respective organization. The participants ranked the controls on a 5-point scale, with a 4 indicating agreement with a statement that the controls had improved directly as a result of the work and a 5 indicating strong agreement. They categorized their responses in four categories:

- Control environment
- Often-manipulated account areas
- Routines accounting controls
- Anti-fraud activities

And the results are displayed in the chart below.

As it can be noticed, the two biggest improvements have been made on the control environment area and anti-fraud process areas. It seems to be normal because weaknesses in the control environment have often been associated with business failure or financial frauds but the most important thing to keep in mind here, which is the point, is that the respondents to this survey were saying that improvements would not have been identified, or taken place, without the systematic review, documentation, testing, and analysis of controls that took place as a direct result of Section 404 work (Rittenberg and Miller, 2005). So there is no doubt of the beneficial impact of SOX regulation on companies' internal control.

Graph1. Agree or strongly agree control due to section 404 Work



Source: Sarbanes oxley section 404 Work, Looking at the benefits, p6

Others obvious advantages of the legislation are related to the investors. With SOX, they can evaluate the process and performance of the management, but also the reliability of a company's financial statements, so their confidence is increasing.

Drawbacks

It is very easy to talk about SOX legislation disadvantages because a lot of criticisms have been made on it. SOX is perceived as an extra task which creates extra processing time and delayed financial reporting preparation. It requires more personnel and increases number of audits, finally the cost of implementation is very high. So:

- Smaller public companies can't afford all these account burden and most of the time they get taken private and become less accountable than they were prior SOX.
- Companies that do not report accurately, do not do it on time which means less information for the public
- In a certain way, the legislation makes some companies less competitive than other international companies

Another disadvantage is that SOX is perceived as an intrusion of Governments into corporate law.

To close this section of disadvantages, it is important to mention that despite its enactment in 2002 in United States, in 2006 in Japan, and elsewhere in the world, SOX is charged to not have been able to prevent financial collapses of the world economy, starting in 2008; Specifically, in the United States, the provisions of the Act were inefficient in preventing, or at least allowing regulators to uncover, the multibillion dollar financial fraud occurring at Lehman Brothers and AIG as well as the Madoff affair.

Chapter 4. CFA Code of Ethics and Standards of professional Conduct VS Sarbanes Oxley's section 406

The adherence of investments professionals to ethical practices always benefits all markets stakeholders and increases investor's confidence in global financial markets. This chapter's purpose is to come up with a comparative analysis between what recommends, in terms of Ethics, Sarbanes Oxley as legislation, especially the Section 406 and what CFA Code of ethics suggests. It is important to mention here, that the CFA's Code of Ethics and standard of professional conduct created in 1960, indeed existed before the 2002 financial scandals which gave birth to Sarbanes Oxley Act.

The point of this chapter is also to analyze the evolution of Ethical principles and legislations after the Enron collapse and to point out what have really changed for companies. Do companies are more regarding of Ethical issues than before? Or Ethical issues are just used like marketing arguments and implemented only for the compliance purposes.

First, both Sarbanes Oxley's Section 406 and the Ethical responsibility required by the CFA Institute code of Ethics and standards of professional conduct will be exposed to really seize and understand what they require, then, they are going to be confronted, to bring out their similarities and differences, then finally the chapter ends with an analyze of what companies really apply in their business regarding those Ethical standards and how they react.

4.1. Sarbanes Oxley Section 406

In 2002, outrage over ethical and financial misconduct by the senior management of public companies led to the passage of historic legislation redefining the roles and responsibilities of corporations and those who serve them.

Through the Sarbanes Oxley Act, US Congress and the Securities and Exchange Commission (SEC) had made, at that time, significant changes in the oversight of public companies. They also have asked public companies to disclose the fundamental values by which they operate, and by which the conduct of executives may be measured. Senior management and directors are

challenged to examine the "tone at the top" of their organizations, and to emphasize ethics and integrity in business decisions.

Many were aware that the collapse of Enron was preceded by the unwise decision of the company's directors to specifically waive provisions of the company's code of ethics. That decision allowed Enron's chief financial officer to benefit from transactions involving the company. The precise facts of the directors' decision, reported extensively in the media (but only after the fact), led to proposed reforms by the New York Stock Exchange that were modified and incorporated in Section 406 of Sarbanes-Oxley (Navran and Pittman, 2003)

The enactment of Sarbanes Oxley was perceived as a new era of transparency and accountability for corporate financial reporting; but this couldn't be possible without serious ethics requirements. Section 406 of Sarbanes Oxley Act outlines code of Ethics requirements for senior financial officers. It requires a company subject to the reporting requirement to disclose whether it has adopted a code of ethics that applies to the company's principal executive officer, principal accounting officer or controller or persons performing similar functions. If a company does not have adopted a code of conduct, it must disclose this fact and explain why they do not have such code. Companies have also to disclose amendments to the code of ethics. A company may file its code as an exhibit to the annual report, post the code on the company's Web site, or agree to provide a copy of the code upon request and without charge.

Sarbanes Oxley Act attempts to improve organizational ethics by defining code of ethics as including the promotion of "honest and ethical conduct" requiring disclosure on the codes that apply to senior financial officers, and including provisions to encourage whistle blowing (Hess, 2006)

By doing so, the SEC encourages companies to apply the code of ethics to as broad as possible of personnel and affiliates as practicable and accordingly the Code affects a wider group of senior employees than is specified by Sarbanes-Oxley. Those to whom this Code applies are required to adhere to its provisions completely and to address any perceived conflict with the Company's Business Principles with the Company Secretary.

4.2. CFA Institute Code of Ethics and Standards of professional conduct

It is important to start by explaining what CFA is. The Chartered Financial Analyst (CFA) is a professional credential offered by CFA Institute (formerly AIMR) to investment and financial professionals. A candidate who successfully completes the program and meets other professional requirements is awarded a "CFA charter" and becomes a "CFA charter holder."

CFA Institute is a not-for-profit organization that is heavily dependent on the expertise and intellectual contributions of member volunteers. Members devote their time as they share a mutual interest in the organization's mission to promote and achieve ethical practice in the investment profession. CFA Institute owes much to the volunteers' generosity and energy in extending ethical integrity.

CFA program curriculum is grounded in the practice of the investment profession. CFA Institute performs a continuous practice analysis with investment professionals around the world to determine the knowledge, the skills, and abilities that are relevant to the profession.

With a six-decade history of maintaining a rigorous focus on globally relevant investment knowledge, CFA Program is the widely known and respected investment credential in the world.

Candidates for CFA Program includes students entering the investment field, professionals increasing their expertise and marketability, and people making a career change into the investment profession from other disciplines.

The curriculum for CFA program comprises several topics divided in 3 levels and for each level there is a preparation book. CFA book is composed of different readings and the first reading of each book is always "Code of Ethics and Standards of professional conduct".

The purpose of this Code and Standards is to provide guidance to the people who grapple with real ethical dilemmas in the investment profession on a daily basis. The code and standards are increasingly being adopted, in whole or in part, by firms and regulatory authorities. Their relevance goes well beyond CFA Institute members and candidates.

Once a firm ensures its code of ethics meets the principles of the code and standards, that party should make the following statement:

“[The firm] claims compliance with the CFA Institute Code of Ethics and Standards of Professional Conduct. This claim has not been verified by CFA Institute”

The CFA Institute Board of Governors maintains oversight and responsibility for the Professional Conduct Program (PCP), which in conjunction with the Disciplinary Review Committee (DRC) is responsible for enforcement of the code and Standards.

An important goal of CFA Institute is to ensure that the organization and its members develop, promote and follow the highest ethical standards in the investment industry. The code is a set of principles that define the professional conduct CFA Institute expects from its members and it works in tandem with the standards, which outline conduct that constitutes fair and ethical business practices.

CFA Institute encourages all members to consider in their investment decision-making process the promotion and protection of the global financial markets as an aspect of the broader context of the application of the code and standards (CFA Institute, 2012)

Briefly CFA code of ethics is summarized as followed by the CFA Institute website. The CFA members and candidates must:

- Place the integrity of the profession and the interests of clients above their own interest
- Act with integrity, competence and respect
- Maintain and develop their professional competence

And the Standards professional Conduct covers:

- Professionalism and integrity of the capital market
- Duties to clients and employees
- Investment analysis and recommendations
- Conflict of interest and responsibilities of CFA Institute members

The CFA Institute code of ethics and Standards of Professional Conduct are essential to achieve the mission of leading the investment profession globally by setting high standard of education,

integrity, and professional excellence. High ethical standards are critical to maintain the public's trust in financial markets and in the investment profession (CFA Institute, 2012)

4.3. Similarities and differences

Similarities

The main similarity of the 2 requirements is the attempt to restore and reinforce the public trust in the markets and improve the image of the investment industry. Indeed, one of the reasons why Sarbanes Oxley Act was born was the fact that the financial scandals could affect the confidence of investors to the markets and could weaken the US economy. In the same wavelength, the CFA Institute since its creation has worked hard and keeps on doing so to promote and rebuild trust in the investment industry community. In a certain way, Sarbanes Oxley, stimulated by the Enron scandals, had subscribed to the approach already undertaken by the CFA Institute.

Obviously, the both CFA and SOX encourages companies to apply the code of ethics

Differences

Differences between them rely on specificities. Sarbanes Oxley Act' section 406 is focused on the senior financial officers and senior employees in general, especially those ones whose jobs affect the company's financial statements reporting. Its purpose is to make them accountable of any misstatements from the company and the section emphasize on the disclosure of existence of any code of ethics which applies specifically to them; whereas the CFA Code of Ethics and Standards of Professional Conduct are general principles for all investment industry members. It focuses on values like integrity, competence, professionalism. Once again, the purpose of CFA Institute is to promote and achieve ethical practice in the investment profession.

Here is in the table below a SWOT analysis of the 2 requirements which highlights other important differences regarding their strengths, weaknesses, opportunities and threat. The perception from the 2 requirements could lead to say that Sarbanes Oxley is a compliance based program and CFA Code of Ethics and Standards of Professional Conduct is an integrity based program.

Table 3. SWOT Analysis of SOX Section 406 and CFA Code of Ethics

	SOX section 406	CFA Code of ethics
Strengths	<ul style="list-style-type: none"> - Increase of officers accountability - Disclosure of existing Code of ethics specific for officers 	<ul style="list-style-type: none"> - Promotion of important business values - Encourages the application of the code of ethics for all business areas
Weaknesses	<ul style="list-style-type: none"> - Focused on deference through threat of punishment for non-compliance - Perceived as a burden for the management - Could be a mechanical implementation only for compliance purposes 	Only effective for members and candidates of CFA Institute
Opportunities	<ul style="list-style-type: none"> - Reinforce credibility and transparency of companies' statements - Have the pretention to make all direct stakeholders accountant of their actions - Avoid companies' misstatements 	<ul style="list-style-type: none"> - Contribution to a better investment industry - Have the pretention to be the ethical benchmark for all investment professionals
Threats	<ul style="list-style-type: none"> - Ineffective disclosure preparation process 	<ul style="list-style-type: none"> - Individual unethical behaviors

Source : Personal production

4.4. Evolution and Consequences on companies

As a conclusion of this chapter, it is important to mention that companies behaviors regarding ethics issues depend on the ethical program chosen. A firm using a compliance-based approach focuses its efforts on deterrence through threat of detection and punishment for violation of the code of conduct, employees are trained on the code they must comply whereas a firm using an

integrity-based approach focuses more on integrating ethics into employee's decision making and inspiring them to have ethical ideal in mind every day in the business life (Hess, 2006)

Companies should continuously act having the ethical ideal in mind, in this way, ethical practices will not be a burden or a constraint imposed by external authorities to their business but a positive aspect of the organizational life. In fact, ethics issues have always been present when it comes to talk business but its importance and weight in the business world have grown with scandals and different frauds through years. Nowadays, companies have to deal, seriously with code of ethics and professional standards, good governance principles, corporate social responsibility and all kind of fair rules.

But in another side, those standards achievements are used by many corporations as a communication or marketing tool. Achieving these standards could influence investors and consumers choices and preferences. So the race in the compliance topic could be focused on the communication or marketing aspect of the disclosure requirement instead of the effective compliance achievement.

The mandatory aspect of many regulations has come with different violation of transparency requirements. It is a shift from a "what-you-don't-know-can't-hurt-you" attitude at management level to an "honesty-is-the-best-policy" imperative (Bisoux, 2005).

However, it is clear that CFA Institute vocation relies on the building of a much better investment industry. Its objectives are more professional than other things; so its code of ethics even though applies to its members and candidates, it has a general scope on the investment industry stakeholders; whereas SOX section 406 is mandatory for all companies listed in the US no matter what they do.

It is also important to mention that Sarbanes Oxley Act enactment in 2002 was a direct consequence of abuses which led to the Enron collapse; even though, meanwhile, CFA Code of ethics and Standard of Professional Conduct has been subject of different evolutions through years, it has treated the same principles several years before with the purpose of building a reliable investment industry

Conclusion

Before the Enron collapse and others unprecedented corporate frauds, the subject of internal control has never been known to inspire much passion or heated discussions. And then, arrived also unprecedented legislation called Sarbanes Oxley, which is the result of a senator and representative works on how to protect investors and make them confident looking at the market. Paul Sarbanes and Mike Oxley maybe didn't suspect that their legislation would be followed and duplicated all around the world and be the principal subject of all kind of articles and even thesis.

This first part of this thesis aimed at understanding and seizing the content of the Sarbanes Oxley legislation, especially the Financial Instrument and Exchange Act, commonly called J-SOX (Japanese Sarbanes Oxley). It is important to have this theoretical knowledge to really understand what's going to happen then in the next part since it is a focus on the implementation within a company, a real practical case.

It has been a critical regulation in the corporate business history in Japan as well as it correspondents in United States and all around the world. As a reaction to different corporate accounting scandals, the legislation has a significant impact on companies. It required companies to implement stringent rules for a better, safer and more confident financial market.

Since its enactment, the legislation have been subject of a lot of criticism related to its cost and the strict side of its requirements; however, despite of all those criticisms, companies recognized and approved that the regulation has proven to be very useful for a better internal control. Indeed, a better internal control leads to more or less the accuracy of financial reporting which, in its turn leads to a reliable financial information towards investors and then, strengthen their confidence into the business market.

The SOX legislation can be efficient but professionals of financial area have to develop always vigilance about their operations and actions for a better, reliable and safer market. So investors could benefit from reliable financial reporting and keep on being confident to it.

Part 2. Implementation of J-SOX within a company: Specific case of Fujitsu Luxemburg

This second part of the thesis is going to focus on the applied side of the work, the project undertaken within the Luxemburgian affiliate of Fujitsu, a Japanese multinational and corporation, spread all around the world.

The purpose of the three months project, from January to April 2012, which has been conducted within Fujitsu, aimed at setting an implementation plan for J-SOX within the Luxemburgian branch of the company since Fujitsu Belgium has been already J-SOX compliant for two years now.

Since Luxemburg is a very special country with specific regulations for companies like the PSF (Professionnel du Secteur Financier = Professional of financial Sector) Status required by the CSSF (Commission de Surveillance du secteur Financier), the oversight organism for the financial sector in Luxemburg, allowing Fujitsu Luxemburg, which has its main customers from the financial sector and therefore is a PSF company, to be SOX compliant will reinforce its compliance with CSSF requirements for all PSF companies but also reinforce the internal control in general. That explains why compliance with J-SOX is so important for the company as well as why is this project so important.

Chapter 1. Methodology

This first chapter presents the different options for gathering and processing information used in the whole work, difficulties encountered when collecting information and the chapter is concluded by a point on the reliability of information used.

It is important to notice that unlike a research paper which aims at verifying a hypothesis, the methodology here does not consist on collecting primary data for instance or design a research questionnaire; the methodology here consists on tools or means which could help to achieve the objectives pursued and set by the company at the beginning.

1.1. Collection and procession of information

A clear methodology has been defined to complete the project, no sophisticated tools or special approaches have been used but only a simple analysis of facts within the company and deep examination of all items that are related to J-SOX Compliance within Fujitu BeLux.

When the thesis subject (which is, actually, a project) had been submitted by the company, a literature reading was mandatory to get in touch with the subject and to really deeply understand what the subject was about. The research period was about to collect all reading materials (books, journals, articles, statements, internet files, videos, etc) that could contain information about J-SOX and SOX legislation in general.

The next step was the contact with the company. Through company's internal documentation, it was possible to understand the structure of the company itself but particularly the finance division where the project was led. That documentation helped to figure out the J-SOX structure existing within Fujitsu Belgium, to make a sort of diagnosis and to have an idea of what should be done in Luxemburg, let's mention that both Belgian and Luxemburgian entities depend on a general Head Quarter which outlines directions for the implementation.

As said above, no specific digital tool was used for the project; the main tool used was Excel spreadsheets to collect, analyze and monitor information, processes and procedures needed for J-SOX compliance but also to set up the project plan.

For the sake of continuity, an Excel file called “How to proceed with J-SOX in Luxemburg” has been created; the document indicates for each question related to the J-SOX Checklist, what evidences are to be uploaded, its availability within the Luxemburgian entity and who is supposed to be in charge of that.

Finally, an Excel Dashboard was necessary to follow up the evolution of the project; it indicated which level or objective has been achieved.

Microsoft PowerPoint was also often used to present and explain to the personnel whose functions were related to the project, what were the purpose and the evolution of the project, what should be added or changed.

However, reading company’s documentation was not enough to get all the information needed for the project. It was necessary to talk to people in charge of functions related to J-SOX to get necessary additional information. So, many interviews have been made with different employees to understand how they do their job and how their functions are connected to the project and to figure out how their implication could get the project evolved.

It was also necessary to attend some business meetings to catch all the connection regarding internal control and J-SOX.

Finally a deep analysis of the J-SOX structure in Belgium was done to really seize what should be really done in Luxemburg for an optimal implementation of the regulation.

Understanding the real need for Fujitsu Luxemburg to be compliant couldn’t be possible without an analysis of the structure ready to host the legislation. It was so important to detect the pre-requisite and then to point out the gaps that could be a problem to the project. Besides of what have been done for Belgium, attending to the session of Fujitsu Luxemburg internal audit helped to catch general problems of the company but also to seize what could be an obstacle to an optimal implementation of J-SOX.

1.2. Difficulties encountered

The first and most important difficulty encountered was the scarcity of documentation about the Japanese Sarbanes Oxley. This is due to relative recent topic and because it is very easy to find documentations (books, papers or articles) about US SOX rather than the Japanese one. Moreover the work is done in a French-Dutch speaking country (Belgium) and a French-German-Luxemburgian speaking country (Luxemburg) while most of books and material on the topic are in English. So, the focus was made on online documents; internet through different scientific portal was the main source for collecting information about the Japanese Legislation and its differences from the US one. However, J-SOX and US SOX appear to have almost the same requirements for companies, a part from some differences.

The second difficulty encountered was the confidential character of previous work on the topic. Almost all theses which were treating about implementing the SOX legislation within a company are confidential for at least ten years. Thus, it was not possible to consult them as part of the literature review and be in the continuity of these anterior researches. The focus of the work was to reach targets set by the project and the plan was established according to those objectives.

1.3. Reliability of information

Regarding the literature review, all documents used here are mentioned in the bibliographical part with all details of their sources. And then, for the applied part, concerning what has been done in the core part of the project, exclusively internal documents have been used. They can easily be found on the intranet network of the company or they are specific to the finance division where the project has been led; once more, everything is mentioned in the bibliographical part. So the reliability of information could be checked and guaranteed. The system of referencing in the Bibliography is the Harvard referencing system.

The annexes part shows also some documents used in the applied part, especially examples of checklists.

Chapter 2. Corporate Governance within Fujitsu

Fujitsu is the leading Japanese information and communication technology (ICT) company offering a full range of technology products, solutions and services. Over 170,000 Fujitsu people support customers in more than 100 countries⁴. That's the reason why it is so important to have a look on the corporate governance of such a multinational. The concept of good governance is so important nowadays and its scope is very broad. Each level mentioned above is concerned.

2.1. History of the company

Since it was founded back in 1923, Fujitsu has been innovating information and communication technologies (ICT) the world over. A long line of landmark achievements and product milestones have made Fujitsu what it is today – a leading company in the ICT space. Computers are the first thing that comes to mind for many people when they think of Fujitsu. But since its foundation, Fujitsu has striven to strengthen the very fabric of society with its innovative information and communications technologies.

Over the years, Fujitsu has gone from strength to strength, preempting and pioneering defining moments in the history of information and communication technologies. It has inspired many of the enabling breakthroughs in information and communication technologies over the last century.

Among the company's milestones, it is important to mention 6 significant periods:

- 1923-1949: development of telecommunication with the delivery of the first self-developed the US step-by-step automatic switching system to Ministry of communication and transportation by Fuji Electrics in 1933 and the listing at the Tokyo Stock Exchange in 1949
- 1950-1958: the dawn of Fujitsu's computer business with the beginning of the manufactures of radio communication equipment in 1953 and the delivery of first multiplex radio device (2GHz/FM) to Nippon Telegraph and Telephone Public Corporation in 1957

⁴ www.fujitsu.com

- 1959-1969: A decade of bold moves with the beginning of mass production of integrated circuits at Kawasaki Plant and the establishment of New York representative office as first office outside of Japan in 1967
- 1970-1979: A wave of international standardization with the establishment of the Japan America Institute of Management Science in Hawaii with the aim of developing business leaders, the conclusion of Joint-venture agreement with Siemens AG in computing product field in 1978
- 1980-1991: A decade of personalization with the listing in London Stock Exchange and on the Zurich, Basel, and Geneva Stock Exchange (merged now as the Swiss Exchange), the release of world 's first commercial ISDN service in Seoul in 1988, running on Fujitsu FETEX-150 digital switching System in Singapore.
- 1992-today: A shift to solutions and services with the announcement of Fujitsu Siemens computers, a joint venture with the Germany-based Siemens AG in 1999, the announcement of “everything on the internet” business direction , a new era I broadband internet , the expansion of global partnership in services area with SAP AG

2.2. The Integrated Management System

Implementation of good governance within an organization implies a good management structure. Within Fujitsu, there is a management system whose purpose is the realization of entrepreneurial targets. In order to facilitate synergies, Fujitsu in CEMEA&I (Central Europe, Middle East, Africa and India) has consolidated various management systems into one integrated management system. This Integrated Management System supports employees and management in the transformation of legal requirements and verbalized guidelines derived from their vision and the corresponding company’s objectives (Fujitsu, 2010). This management system gives to employees the direction on:

- Where they want to go
- Who is responsible
- How targets are precisely met
- How improvements are systematically transformed

Table 4. Fujitsu Integrated Management System

Fujitsu Integrated Management System				
Quality Management <ul style="list-style-type: none"> • Fulfilment of customer requirement 	Environmental Management <ul style="list-style-type: none"> • Reduction of environmental impact 	IT Service management <ul style="list-style-type: none"> • Efficiency by IT Service Management 	Information Security Management <ul style="list-style-type: none"> • Effective risk reduction/constant fulfilment of requirements 	Additional Management System

Source: Management System Manual Fujitsu in CEMEA&I

The objectives of the integrated Management System are:

- The improvement of process performance including additional requirement from spheres activities, especially quality management, environmental management, IT service management, information security and additional management systems
- Reduction of risks due to ambiguous organization, structures and workflow
- Retention of conformance to laws by compliance with corresponding legal requirements and contractual agreements
- Optimization of interfaces.

Governance and specific control mechanisms are a prerequisite to manage and operate the IMS for the certified systems. Fujitsu products and services for customers are based on globally valid guidelines and laws, including the relevant standards. Governance and specific control mechanism are prerequisite to managing and operating IMS for the certified system.

Good governance goes also along with compliance with different rules, laws, treaties government regulations and statutes, the respect of human rights, acting with fairness in business dealing, respect and protection of intellectual property, the maintenance of confidentiality and loyalty, conformity with socially accepted business practices as it is stipulated in the Fujitsu Way, an internal document that embodies the Corporate Values, corporate vision, corporate principles, the code of conduct and the business policy ; integrity within Fujitsu Group is a key factor of sustainable business success and the backbone of the good corporate governance.

2.3. Corporate governance framework and Organizational structure

There is an internal document called “Fujitsu Way” which states the company’s corporate vision, corporate values, principles and code of conduct. The Fujitsu Way aims at enhancing the value of the company through the ongoing growth and development of Fujitsu group.

In order to continually raise the Fujitsu Group's corporate values, along with pursuing management efficiency it is also necessary to control the risks that arise from business activities. Recognizing that strengthening corporate governance is essential to achieve that, the Board of Directors has articulated the Basic Stance on the Internal Control Framework, and these measures are continuously implemented.

To accelerate decision-making process and clarify management responsibilities, it was necessary to separate management oversight and operational execution functions. The constructive tension created between oversight and execution functions by proactively appointing outside directors, contributes to the enhancement of the transparency and effectiveness of management.

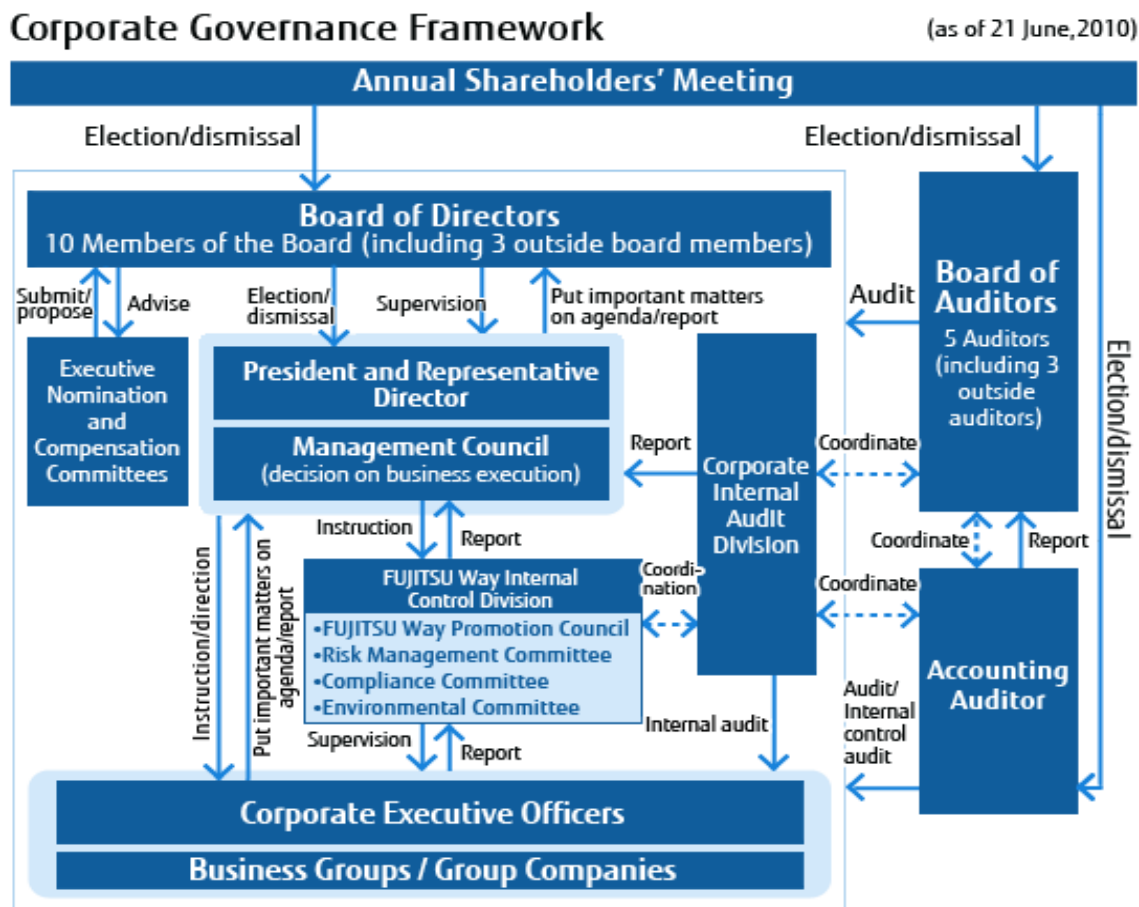
With respect to group companies, the total optimization is pursued for the Fujitsu Group by clarifying each group company's role and position in the process of generating value for the group as a whole and managing the group to continuously enhance its corporate values.

Fujitsu has established Executive Nomination and Compensation Committees in order to ensure the transparency and objectivity of the process for choosing candidates for the Board of Directors, determining their compensation, and ensuring that the compensation system and levels are appropriate. The committees act as a consultative body to the Board of Directors and include outside members of the board. Taking into consideration the current business climate and anticipated trends, the Executive Nomination Committee makes recommendations of candidates for the Board of Directors, choosing candidates having objectivity in making management decisions, foresight and perceptiveness, and a superior character. The Compensation Committee is tasked with making recommendations on executive salaries and methods of calculating bonuses linked to business performance, taking into consideration compensation levels at competitors and other factors. The aim of this activity is to retain superior management talent,

ensure that the oversight function operates properly, and provide effective incentives to, improve the company's business performance.

In addition, the company has adopted the processes in place, in accordance with laws and regulations, to ensure that conflicts of interest are avoided, including but not limited to obtaining approval from the Board of Directors⁵

Chart 3. Fujitsu's Corporate Governance Framework



Source: www.fujitsu.com

The Company, through a resolution by the Board of Directors, has adopted the following basic stance on the framework for internal control (resolved on May 25, 2006, and revised on April 28, 2008). In terms of putting an internal control system in place, an organization with executive responsibility for internal control has been established. The Company is, moreover, pursuing

⁵ www.fujitsu.com

initiatives to implement an even more robust operational execution structure by reviewing and revising its regulations and business operations.

To accelerate the penetration and implementation of the Fujitsu Way and ensure the appropriateness of business operations, four Committees were established directly under the Management Council and tasked with pursuing more robust and efficient business execution: the Fujitsu Way Promotion Council, the Risk Management Committee, the Compliance Committee, and the Environmental Committee.

Chapter 3. The J-SOX Implementation in theory

The mandatory side of J-SOX legislation pushed business companies' stakeholders to be compliant with its requirements, but the question is how to implement it properly, in the right way. Some companies hire experts in the domain to do the job, so they can dedicate their entire time to focus on their usual activities, because SOX implementation is pointed out to be a very time consuming process, to have an additional workloads for internal staff and to have high external consulting/audit fees but there is a cost for hiring consultants to do that job.

Indeed, there is a general theory about J-SOX implementation that has been developed and spread by the Financial Services Agency (FSA) itself and many financial audit and accounting firms, in order to help companies to respect the implementation process in the right way. When some people criticized US SOX on its lack of directions around compliance, the Japanese legislator provide guidance around what kind of control should be done by giving accurate information on how evaluation should be like, what auditors are looking for, what constitutes a control deficiencies... etc. the Japanese oversight board have just learned from US approach to compliance that if something is left open, it becomes harder to handle (Lau K, 2007). The general J-SOX theory describes different steps of a process to follow for reaching the compliance status.

3.1. General theory about the implementation

The implementation guidance published by the Japanese Financial Services Agency (FSA) explains in details for Japanese corporations how to implement a management assessment of Internal Control over Financial Reporting as required by J-SOX. The FSA suggests a risk based, top down approach to J-SOX implementation, which focuses on financial statement accounts and related processes that are significant to the financial statements but also the parent company will begin by evaluating entity level controls (ELC) and will work down to specific processes and financial statement accounts (Greenback alan LLP, 2007)

The theory recommends that management have to prepare an internal control report and states the results of an assessment on the effectiveness of the company's internal controls as of the company's year-end. The scope of the internal control over financial reporting should include

financial reporting and footnotes and other disclosed financial information (RSM Mc Gladrey, 2010)

Implementation standards (or standard practice) on the assessment and audit of internal controls over financial reporting is composed of four parts according to the FSA guidance for Japanese companies:

1. *Internal control framework* which is basically the COSO framework evolved in the Japanese way with additional components or J-SOX framework and has been developed on pages above, with its components:
 - Control environment
 - Risk assessment
 - Control activities
 - Information and communication
 - Monitoring
 - And IT response

2. *Management assessment of internal control over financial reporting:*
 - a. Evaluation of company level internal control
 - b. Evaluation of process level internal control
 - c. Evaluation of process level internal control over closing and financial reporting
 - d. Evaluation of process level internal control other than closing and financial reporting processes
 - i. Selection of significant entities subject to evaluation
 - ii. Identification of business processes subject to evaluation
 - iii. Evaluation of the business processes subject to evaluation
 - iv. Report on overall results of managements evaluation

3. *Management reporting of internal control:* it is the management conclusion on design and operating effectiveness of ICFR done on the two first step above

4. *Auditing of internal control*: it is the audit of effectiveness of management's assessment of ICFR. The audit part consists on evaluation of appropriateness of the scope of management assessment and evaluation of each level of control

The second part, management evaluation of internal control is one of the heavy parts of the implementation process because of all the documentation and the time, it implies. Among the control level mandatory to do, there is:

- The entity level control (ELC): it consists on list of question to answer and the questions are designed in order to rely on J SOX framework objectives and elements (or COSO + Japanese specifications framework)
- The process level control over financial closing and financial reporting: it is divided into company level control and process level control
- Process level control other than closing and financial reporting: it consists of :
 - o The selection of financial reporting elements
 - o The selection of entities
 - o Non-consolidated entities
 - o Selection of business processes
 - o Outsourced processes

Accounts are determined based on both quantitative and qualitative factors; most of the time accounts with significant relationship with the primary objectives of the business, generally sales, account receivables and inventories are listed as example of such accounts. The entity is chosen according the 2/3 coverage on revenue rule.

Processes as well are selected according the way it affects accounts that have significant relationship with the primary objectives of the business on significant entities subject to evaluation and result of evaluation of company level control;

- o Evaluation of IT controls: it contains the IT application control (ITAC) and the IT general control (ITGC).

ITGC Consider the management of development and maintenance of system, system operation and management, system security management like access controls, contract management related to services organizations.

A typical plan for J-SOX implementation has 5 steps:

- The development of implementation of a project plan which consists in:
 - o clarification of project objective and scope
 - o the development of an effective and realistic plan
 - o securing requiring resources internally and/or from outside
- Documentation of processes, risks and correction of gaps consists in:
 - o Obtaining the understanding of company control environment
 - o Identifying significant financial reporting risks and existing controls for business processes
 - o IT process and financial reporting process.

In practice it consist on filling in different checklist, especially the company level one, the IT checklist and the IT general control; preparing the documentation of business processes, flow chart, risk control matrix (RCM) for business processes.

- Evaluation of control design and correction of gaps: it is about identifying effectiveness of internal control, to determine whether internal control mitigates identified risks. The point here is to identify the key controls for each significant financial reporting risk, to evaluate if those key control really mitigate risks, develop a plan to correct identified control design gaps
- Test control operation and correction of gaps which consists on checking that controls are operational
- Support of external auditor to perform audit of management assessment of internal control over financial reporting

These are typical steps for a company and especially a subsidiary company like Fujitsu BeLux.

The parent company should just:

- Determine the scope and the approach
- Support subsidiaries activities related to the evaluation process
- Compile results and prepare reports
- Supports external audits

For the sake of efficiency in methods, the FSA provided guidance to simplify and clarify its standards. One area the FSA addressed was the scope of entity level controls (ELC) evaluation.

To clarify treatment of out-of-scope entities that are “business items with insignificant impact on

financial reporting,” the FSA noted that those consolidating entities that do not meet the “95% of the total revenue” rule need to be disclosed in management’s assessment report. And, to simplify the ELC evaluation, the FSA asserts that it is possible to use again the previous year’s assessment of operating effectiveness in instances when that year’s operating assessment was effective and there have been no major changes in controls design at the entity level. However, this approach towards simplification excludes those controls that have a significant impact or reliance on financial statements (Protiviti, 2011)

At the business process level, the FSA recommends to reduce the scope of design and operating effectiveness assessments. Specifically, items deemed previous year as “significant” may be excluded from current year’s significant items when previous year’s assessment of controls operation resulted in a conclusion that controls were operating effectively and there have been no major changes in control design. In instances where items are excluded in accordance with this guidance, the FSA acknowledged that a company may not meet the “two thirds of revenue” coverage rule. However, the FSA outlined that this approach towards simplification excludes those items that are core to the company, i.e., the most significant item for the company overall. Obviously, significant judgment must be applied in these matters.

Regarding material weaknesses, the FSA notes that the appropriate amount of historical data or exclusion of special factors is permitted to determine financial materiality. To illustrate, in terms of financial materiality, it is necessary to assess the industry, size and complexity of the business before determining the materiality percentage of consolidated assets, revenue and Earnings Before Income Taxes (EBIT). We also should note that the materiality threshold should not be determined based on the audited year’s results only, but should be considered with the average amount of historical data of certain periods. For example, while in general 5 percent of EBIT is used as a materiality threshold, the threshold used should be determined based on the significance of qualitative and other factors in the audited financial statements. In addition, when EBIT is extremely small or becomes a loss, the percentage of materiality should be adjusted or certain accounts related to EBIT should be excluded. Once again, these matters involve significant judgment and should be undertaken after discussion with the auditor and other advisors.

With respect to evaluating new entities acquired as a result of a merger or acquisition, when there have been what the FSA refers to as “unavoidable circumstances,” management may assess the effectiveness of internal control over financial reporting excluding areas where assessment procedures could not be performed. According to the FSA, “unavoidable circumstances” are those where it is deemed difficult to perform assessment procedures in accordance with its guidance within the period of time normally required for financial statements (Protiviti, 2011)

On October, 2007, the FSA and the Securities and Exchange surveillance Commission has published a document called “Our Answers to your questions about the Financial Instruments and Exchange Law” which is responding to Frequently Asked Questions about the FIEL and which purpose is to give detailed information about the legislation charged to be very complex.

All the efforts that the Japanese Legislator is doing aim at making the implementation process more optimal and easier even though the legislation itself is already stringent and not easy to comply with. So, companies’ internal staffs have direction on how to apply the implementation process and can, therefore feel confident when implementing it.

3.2. The revised standards on ICOFR

The Reporting System on Financial Instruments and Exchange Law aim at strengthening internal control over financial reporting within listed companies and ensuring the reliability of financial reports disclosures to the public.

Since J-SOX became effective, the FSA has received many requests and comments from public companies, particularly small and mid-sized firms and it has been noticed that auditors do not often accept company’s own internal control approach; in response to these requests and concerns, the FSA reevaluated the standards and, in March 2011, issued revised Standards on ICFR (Protiviti, 2011). The revised Standards on ICFR are applicable to assessments and audits of internal control over financial reporting from fiscal years beginning on or after April 1, 2011.

Internal control audits conducted by auditors needs to be based on the content and purpose of the Standards and Practice Standards of internal control, and an understanding of management assessment approaches that were developed based on conditions of the Company. Auditors must understand that the management assessment approaches should be different from their own standard procedures and techniques, and must not force management to follow these methods.

The audit firm should begin its assessment with a complete understanding of management's assessment approach and then plan the nature, extent and timing of the procedures needed to conduct their audit.

Small businesses could have resource constraints when operating their internal controls. Accordingly, advices from auditors are very important to them. In this situation, it is often believed that auditors could not provide consultation due to their lack of independence. However, the FSA confirmed that it is appropriate for auditors to provide guidance to management. Note that the FSA stated that its intention is for auditors to provide advice to maintain the effectiveness of internal control while companies maintain the effectiveness of their internal controls. There is no specific guidance as to how these provisions are to be applied in a manner that will preserve the auditor's independence. Given the FSA's intent, it can be presumed that auditors should advise on matters such as examples of best control practices and how to build efficient test plans but should refrain from the actual design of controls or testing of controls on behalf of their clients.

Concerning the scope of entity level controls (ELC) evaluation, the FSA noted that those consolidating entities that do not meet the "95% of the total revenue" rule need to be disclosed in management's assessment report for a clear treatment of out-of-scope entities that are "business locations with insignificant impact on financial reporting".

In addition, to simplify the ELC evaluation, the FSA asserts that it is possible to utilize the previous year's assessment of operating effectiveness in instances when that year's operating assessment was effective and without major changes in controls design at the entity level. However, this approach excludes those controls that have a significant impact or reliance on financial statements (Protiviti, 2011)

On the business processes' side, the FSA provided a suggestion to reduce the scope of design and operating effectiveness assessments. Specifically, items deemed on the previous year as "significant" may be excluded from the current year's significant items when last year's assessment of controls operation resulted in a conclusion that controls were operating effectively and there have been no major changes in control design. In instances where locations are excluded in accordance with this guidance, the FSA acknowledged that a company may not meet

the “two thirds of revenue” coverage rule. However, the FSA pointed out that this approach to simplification excludes those items that are core to the company, i.e., the most significant items for the company overall.

In addition, for an internal control assessments simplification at the business process level, the FSA noted that it is possible to utilize the results of the previous year’s assessment of operating effectiveness when the current year’s ELC assessment was effective and there have been no major changes in business process controls design. However, the FSA reiterated that business processes having a significant impact on reliable financial statements are excluded from this guidance, i.e., their operating effectiveness must be assessed annually.

When considering the determination of a material weakness, the FSA notes that the appropriate amount of historical data or exclusion of special factors is permitted to determine financial materiality. To illustrate, in terms of financial materiality, it is necessary to assess the industry, size and complexity of the business before determining the materiality percentage of consolidated assets, revenue and earnings before interest and taxes (EBIT). It should be noted that the materiality threshold should not be determined based on the audited year’s results only, but should be considered with the average amount of historical data of certain periods. For example, while in general 5 percent of EBIT is used as a materiality threshold, the threshold used should be determined based on the significance of qualitative and other factors in the audited financial statements. In addition, when EBIT is extremely small or becomes a loss, the percentage of materiality should be adjusted or certain accounts related to EBIT should be excluded. Once again, these matters involve significant judgment and should be undertaken after discussion with the auditor and other advisors (Protiviti, 2011)

Concerning evaluation of new entities acquired as a result of a merger or acquisition, when there has been what the FSA refers to as “unavoidable circumstances,” management may assess the effectiveness of internal control over financial reporting excluding areas where assessment procedures could not be performed. According to the FSA, “unavoidable circumstances” are those where it is deemed difficult to perform assessment procedures in accordance with its guidance within the period of time normally required for financial statements to be prepared and approved by the board of directors. Prior to the issuance of the revised guidance, “unavoidable

circumstances” must have happened immediately prior to the year end. With the revised guidance, this standard has been changed to the last half of the fiscal year

It is important to mention that, since J-SOX enactment, the key goal of FSA has been to minimize the cost burden to public companies listed in Japan. The revised standard which purpose is to make the business stakeholders feel confident about the implementation process, makes clear some provision that has been subject of misunderstanding for many people and draw a path for implementation stakeholders to act in the right way concerning J-SOX provisions.

Chapter 4. J-SOX Implementation within Fujitsu Luxembourg

Being a J-SOX compliant company can be a status that could bring a lot of advantages in term of improvement of internal control even though the legislation is charged to be expensive and complex to implement, but most of the companies do not have choices because it is a mandatory legislation.

J-SOX has been implemented within the Belgian entity of Fujitsu for two years now. However, having Fujitsu Luxembourg compliant with J-SOX is not mandatory according to the internal rules of Fujitsu Group because the Luxembourgian entity is not big enough in term of revenue to be compliant with this regulation (the revenue is below 60 Million Euros) but the objectives by looking forward to submit Fujitsu Luxembourg to J-SOX compliance are the reinforcement of its internal control and the setting of specific internal control regular checking actions, the need for a best level of internal control to face and respond to CSSF (Commission de Surveillance du Secteur Financier) requirements, since Fujitsu is classified as a Support PSF, a local Luxembourgian status for a category of companies which will be developed further in this chapter.

4.1. J-SOX Structure present in Fujitsu Belgium

Implementation of J-SOX within Fujitsu group is controlled and guided by the Fujitsu Way Unit in Tokyo. As compliance with all laws and regulations is one of Fujitsu's corporate behaviors it is clearly outlined in the company philosophy "The Fujitsu Way", which also encompasses the company's code of conduct and business policy.

After the enactment of the Financial Instrument and Exchange Law, the Fujitsu Group had initiated "Project EAGLE" (Enterprise-wide Approach for Global Efficiency) as company-wide activity for the preparation of the new laws and requirements. And The Fujitsu Way Unit has the initiative to evolve this project. Highlighting internal control over financial reporting is strongly influenced by J-SOX provision included in that new law.

The financial reporting is carried out effectively and efficiently in order to ensure reliability of the Fujitsu financial statements.

There is a policy called Fujitsu J-SOX Master Policy which helps the company to have an internal control framework, compatible with International Financial Reporting Standards (IFRS) and company law including the Japanese Financial Instrument and Exchange law (FIEL), it is important to remind again that Fujitsu is a Japanese company listed in the Tokyo Stock Exchange. These master policies describe the mandatory principles for design, operation and evaluation of internal control over financial reporting. So, Evaluation of Internal Control over Financial Reporting (ICOFR) must be carried out in accordance with the Japanese practice standard for J-SOX described in chapter 3, by means of appropriate methods to ensure that financial reporting is accurate in all material respects (Fujitsu, 2010)

4.1.1. The Framework

Fujitsu's J-SOX Framework is based on the selection of the Fujitsu Group companies by revenue importance. The official scoping for mandatory controls within the Fujitsu Group for Fiscal Year 2011 (FY11) states that all companies that fall into the top 2/3 of the total group revenue are required to implement the full control set, whereas the companies with a planned revenue of more than € 60 million are required to conduct the ELC set only (see Annex 3). So, not all Fujitsu legal entities in Continental Europe, Middle East, Africa & India (CEMEA&I) will need to implement the same level of internal controls under J-SOX. Notwithstanding, a minimum control level (ELC – Entity Level Controls) is mandatory for the following Fujitsu's entities: Austria, Belgium, Czech Republic, France, Germany, Italy, Netherlands, Poland, Spain and Switzerland (see Annex 2)

The full control implementation set includes 3 levels of control which are the Entity Level Control (ELC), Process Level Control (PLC) and Information Technology General Control (ITGC).

The EAGLE Team which is the Internal Control Evaluation unit and whose scope covers the establishment of internal control for reliability of financial reporting (which J-SOX requires), the evaluation of countermeasures to business risk and the introduction of business process renovation to improve the efficiency of the business operation; performs the evaluation of design and operation of ICOFR. The head of EAGLE team is also responsible for reporting deficiencies and remediation progress to the internal auditor (Fujitsu way Unit, 2006)

4.1.2. The Entity Level Control (ELC)

The Entity Level Control is composed of Company Level Control (CLC) and Financial Closing and Reporting Process Control (FCRP). This control level aims to mitigate company level risks of misstatement in financial reporting. The operability of this Control Level influences the effectiveness of the next step which is the Process Control Level.

The CLC and FCRP consist on different checklist (see Annex 4) with a number of questions to answer. Those checklists (CLC-checklist, CLC-IT-checklist and FCRP-checklist) are provided by Fujitsu Head Quarter or “Fujitsu Limited”. They are designed in line with the generally accepted internal control and take into account the J-SOX framework described in the previous part. They evaluate and analyze corporate policy and culture that give much effect on employees’ behavior. They include not only internal control over company but rules or culture of each division, which affect employees in local group (Fujitsu way Unit, 2006)

The CLC affect the basic way of thinking and behavior of the employees, especially when they encounter the events which are not stipulated in manuals in their day-to-day operation. The purpose is to measure the understanding of employees who receive instructions. The behavior of the staff who executes business processes affects the financial reports.

Fujitsu Belgium just implements the process as it has been instructed by the Head Quarter; the finance department has a J-SOX team which through the CFO supervision, answers and carry evidences to each checklist question and then send them back to the Head Quarter. That’s the most important work related to J-SOX

4.1.3. The Process Level Control (PLC)

This control level is composed of business process level and IT Application Control (ITAC), it affects the business processes which are sequential business activities including the development, procurement, production, sales and distribution/delivery of products or services. It also includes control activities to ensure that the recording of financial reporting information is accurate and complies with relevant legal framework.

Basically, accounts that have significant impact on the business objectives are: sales, receivables and inventory, important item of the balance sheet that affects the profit and loss account (P&L)

in term of revenues and charges; each of those accounts have relevant processes. Those work processes related to the principal account usually have potential risks of error or fraud, and at the same time they should be controlled to mitigate and prevent these risks.

For this control level it is better to exclude processes that have low materiality on the financial reporting. Generally, are considered as non-material item, all processes that have in total less than 5 % of quantitative impact of the amount on each account title present in the balance.

Fujitsu is at first an IT company, it provides IT Solutions, so, the implication of IT in the work process is very significant. The control in charge of IT application at this level is called IT Application Control (ITAC). IT Application it is really involved in the financial reporting process because most of the accounting figures are managed by IT System, that's all the importance of the precise processing of IT system for the reliability of financial reporting. So IT System that is related to generating financial reports must be examined carefully in term of its accuracy of journal entry and aggression process. IT application manages also the security side of financial information.

Fujitsu Belgium has an IT division which manages IT Application for both countries, Belgium and Luxembourg. The division provides all the authorization accesses to information network of the company and even authorization access to the company buildings but it contributes also a lot with the partnership of related division to the documentation of different processes. Many processes documentation are from the Headquarter as well but some other processes are documented locally in Belgium adapted to local parameters of the country.

The PLC Evaluation method of effectiveness consists in preparation and updates by the company of flow chart, function list and Risk control Matrix documents and for PLC utilizing IT, the IT evaluation unit is required to identify relevant automated controls in each relevant IT system.

The flow chart and business function list will help to extract misstatement risks. If major business processes are outsourced and the mitigation of material risks of misstatement in financial reporting relies on the internal control of the outsourcing company, the internal control related to the outsourced processes will be also in scope for evaluation. The effectiveness of design of internal control related to the outsourced processes shall be evaluated directly by Fujitsu on a sampling basis, however if such direct evaluation is impossible, another method such as using the evaluation report of the outsourcing company shall be considered (Notz and Knippschild, 2010)

4.1.4. The IT General Control (ITGC)

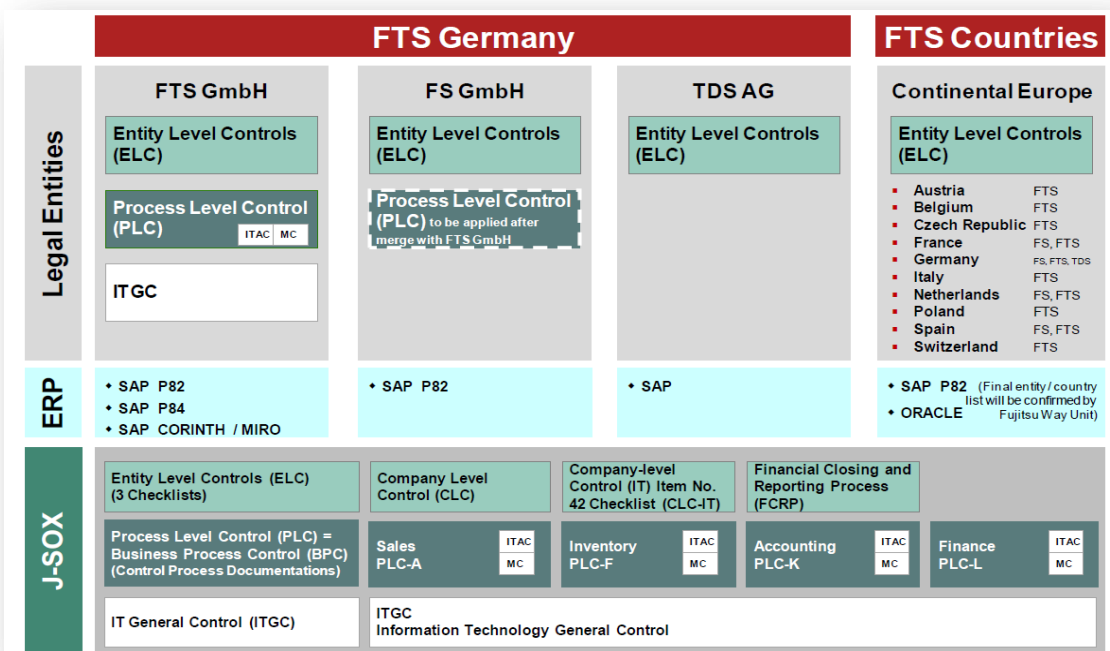
IT General Control is performed by a unit called the IT control evaluation unit. The IT control evaluation unit evaluates the design and operation of internal control and operation of internal control that is based on IT and report the result to the internal control evaluation unit.

The ITGC is designed and operated to mitigate material risks of misstatement in financial reporting.

The evaluation of effectiveness of design and operation of ITGC is conducted in accordance with the procedures for design, operation and evaluation of internal control over financial reporting.

The basic ICOFR Control framework implemented within the Fujitsu Group is outlined in the following chart

Chart 4. Fujitsu's Basic ICOFR Control Framework



Source: Project EAGLE @Fujitsu-ELC V1.0-2011

4.2. The implementation procedures

As said some lines above, only the ELC level is mandatory for Fujitsu Technology Solution Belgium. How does it work in practice?

Let's mention first that the Belgian entity is included within a geographical region called CEMEA & I which Head Quarter (HQ) is based in Germany. For the sake of centralization of Management, all the requested documentation for J-SOX are asked from and sent back to Germany.

In general and very briefly, the J-SOX implementation process for all CEMEA & I entities follows and is implemented in accordance to orders from the German HQ. The process is organized by semester or "half", so every fiscal year, the compliance process must be implemented twice, every six month. This process has 5 steps:

4.2.1. Communication and agreement with entities

At this step, all the entities receive from the German HQ the CLC, CLC-IT and FCRP Checklists (see the Appendix) for conducting the evaluation of effectiveness of design and operation to be adopted and locally adapted by Fujitsu. It is important to mention that all the checklists have been translated from Japanese to English; knowing that Japanese is not a common language, the translation has been done carefully to keep the entire and accurate meaning of requirements.

The first step of the process is the ELC communication to Managing Directors (MD's) and Finance Directors (FD's) by the J-SOX Implementation team via an email. There is a SharePoint on the intranet network containing all information concerning J-SOX, organized by country including the information status of each country.

The CLC checklist consists in a checking document of 88 questions grouped in accordance with the J-SOX framework components: control environment, risk assessment and responses, control activities, information and communication.

The FCRP-Checklist, as its name indicates, is about the financial closing and reporting processes. The checklist has 44 questions organized in 6 groups: procedures for closing of accounts, daily accounting transactions, Non-daily accounting transactions, Monitor of financial figures entered

in upstream business processes, IT application control in accounting system, Data entry to the consolidation package tool.

The CLC-IT Checklist includes the ITAC and the ITGC; it is the smallest one with Thirty-six questions grouped in accordance to different topics: System development, change and maintenance, system operation management, system security, management of outsourcing contracts.

The CLC and FCRP Checklist are designed and operated to mitigate company level risks of misstatement in financial reporting but to effectively mitigate the risk of financial misstatement, the CLC and FCRP are designed in line with the framework of generally accepted internal control and support the effective design and operation of PLC and provide appropriate framework of overall internal control of the company. They must be an adequate support to the PLC

4.2.2. Collection of checklist and evidences

After completing every checklist, gathering and providing proper evidences from all division implied in the financial reporting (finance, accounting, HR, Legal,... etc) to support answers to different questions, those checklists are sent back to the HQ where a team work on them and check that everything is well done in accordance to the principles and then, the checklists and evidences will be uploaded to the SharePoint. For this second steps, it is mandatory for countries entities to respect the calendar and the related deadline.

4.2.3. Walk through

It is a period of detailed control where everything, every action is checked to guarantee the accuracy of financial statement. Sometimes the company's documentation does not really reflect what actually happens daily. Companies which controls are only based on their documentation may face exceptional control when they discover that documentation of the information stream and related controls was not accurate

The walkthrough procedure allows the understanding of key elements of the information processing stream and related controls before auditor begin detailed test work. It can help auditor to evaluate the effectiveness of the design of internal control for each major transaction. While

performing the walkthrough, auditor also may obtain evidence about the operating effectiveness of controls.

The walkthrough is also the step where deficiencies can be reported and all changes are taken into account, so remediation action for material weaknesses can be performed.

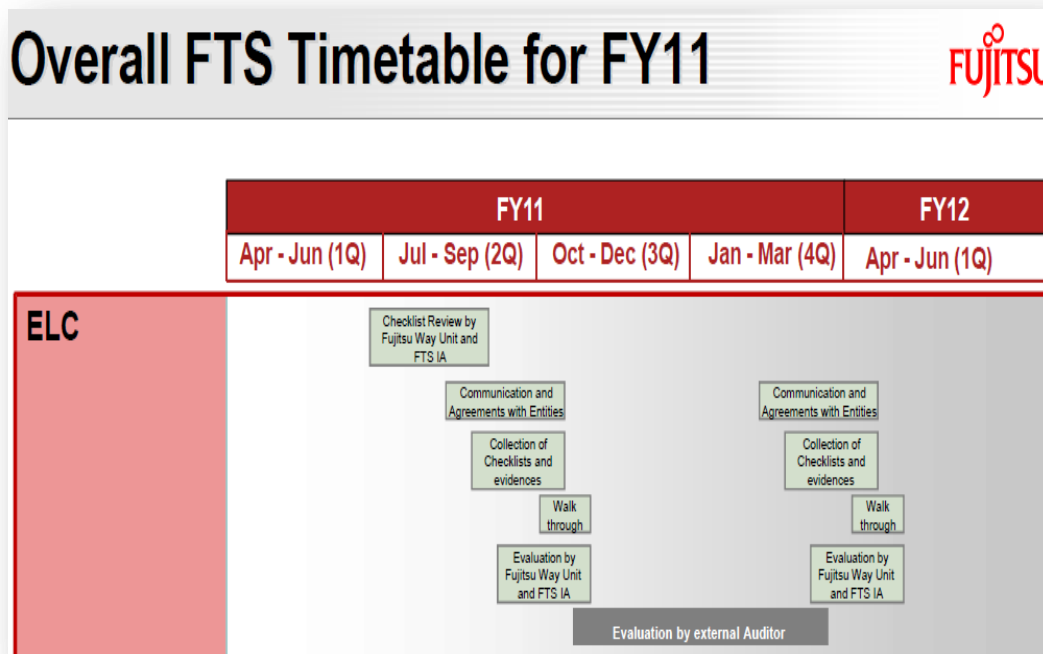
4.2.4. Checklist Review and Evaluation by Fujitsu way unit and Fujitsu Internal Audit

It is the evaluation of effectiveness of the design and operation of different checklist; CLC and FCRPC. These steps lead to the validation and the confirmation of checklists and evidences uploaded. It is the task of Fujitsu and the Fujitsu internal Auditors

5.2.5. Evaluation by external auditors

External auditors (KPMG) evaluate the effectiveness of the entire internal control over financial reporting described in the management report and also the management assessment on different control level made by the management.

Table 5. Fujitsu’ J-SOX timetable for fiscal year 2011-2012



Source: Project EAGLE @Fujitsu-ELC V1.0-2011

4.3. Analyze of the likely hosting structure within Fujitsu Luxembourg

Luxembourg is a country which has a specific local regulation monitored by the CSSF (Commission de Surveillance du Secteur Financier- Financial Sector oversight Commission) and submitted to all PSF. The CSSF with its control requires companies to meet a certain number of criteria of excellence, especially in terms of internal governance (adequate organizational structure, clear division of responsibilities, risk management processes, control mechanisms and information systems security). As a PSF, Fujitsu Luxembourg has to be compliant regarding CSSF requirements.

4.3.1. Fujitsu in Luxembourg: a bit of history⁶

Fujitsu Services PSF S.à.r.l (the company) was incorporated for an unlimited period in the grand-duchy of Luxembourg on August 28, 2006 as a private limited liability company (Société à Responsabilité Limitée).

The company acts as an operator of financial sector information technology systems and communications networks, according to 29-3 of the law dated 5 April 1993 regarding the financial sector as amended (the PSF law).

The annual account of the company was included in the consolidated financial statements of Fujitsu services Holding PLC, 22, Baker Street, London, United Kingdom.

On August 31, 2009, there has been a change on the ownership of the company's parent company. Fujitsu services Holding Ltd, the sole shareholder of the parent company, sold their shares in the company to Fujitsu Technology Solutions (Holding) BV, a private company with limited liability with registered office in Amsterdam and The Netherlands.

4.3.2. Luxembourgian legislation

As said above, the CSSF is the Luxembourgian oversight board for financial sector. It has as mission, the prudential supervision and the public oversight of the Audit profession.

⁶ Annual account of the year ended March 2009

CSSF took over the responsibilities of the Institut Monétaire Luxembourgeois (IML- Luxembourgian monetary institution) which became the Banque centrale du Luxembourg (BcL- Central bank of Luxemburg) on 1 June 1998, as well as the responsibilities of the former Commissariat aux Bourses. The recent institutional changes in the structure and the practice of prudential supervision have not in any way altered the existing legal and regulatory framework (CSSF, 2012)

The Luxembourgian oversight board is responsible for the prudential supervision of credit institutions, professionals of the financial sector (investment firms, specialized PSF, support PSF), undertakings for collective investment, pension funds, SICARs, securitization undertakings issuing securities to the public on a continuous basis, regulated markets and their operators, multilateral trading facilities, payment institutions and electronic money institutions. It also supervises the securities markets, including their operators.

For the sake of its mission of prudential supervision of companies of the financial sector, the CSSF aims at the following:

- promoting a considered and prudent business policy in compliance with the regulatory requirements
- protecting the financial stability of the supervised companies and of the financial sector as a whole
- supervising the quality of the organization and internal control systems
- strengthening the quality of risk management

The CSSF examines all applications made by undertakings or persons seeking to carry out a financial activity in the Grand Duchy of Luxembourg and requiring the authorization of the Minister responsible for the CSSF

Regarding the mission of public oversight of the audit profession the CSSF is hence responsible for granting the professional qualification of "*réviseur d'entreprises*" (statutory auditor) and "*cabinet de révision*" (audit firm), for the approval and registration of statutory auditors and audit firms which wish to perform statutory audits and other assignments which are reserved to approved auditors and audit entities, including the registration and the oversight of third-country auditors and audit entities, by the law of 18 December 2009 concerning the audit profession. It is

also responsible for the adoption of auditing standards and standards on professional ethics and internal quality control of approved audit firms and for continuing education.

4.3.3. The PSF Status

This status has been created in 1993 and regarding the trend towards increasing specialization in the financial sector, even despite of the crisis; the Luxembourg Government has progressively extended it to a range of complementary activities. By submitting all natural and legal persons professionally engaged in this type of activity to regulation and supervision by the financial supervisory authority, the CSSF, the Government seeks to facilitate the outsourcing of non-core activities by ensuring the high quality of services and professional confidentiality required in the sector. The CSSF itself has reorganized its services, in 2009, to better meet the national and European regulatory requirements. The sector plays an important role in the Luxembourg economy, employing over 10 000 professionals. Most of players come from over 20 different countries.

So, PSF entities can be defined as regulated entities offering financial services that are not reserved only to credit institutions, especially the perception of public deposit. PSFs fall into three categories related to the type of activities and the nature of services they provide, either investment firms, specialized PSF and support PSF (Cesari, S et Al., 2011)

Investment firm

These types of PSF benefit from the European passport for the distribution of their product and services. They can establish branches and act through free provision of services in other EU member states without further approval from the host countries authorities.

They can be defined as companies providing and performing repetitive investment services and activities to thirds parties (Cesari et Al., 2011)

Investment firms must participate in an investor compensation scheme set up in Luxembourg and recognized by the CSSF. Investment firms are thus required to become member of the AGDL (*Association pour la Garantie des Dépôts, Luxembourg* - Deposit Guarantee Association Luxembourg). They must comply with the organizational requirement, must set up a compliance function and must put in place a risk management function where appropriate and proportionate in view of the nature, scale and complexity of the activity as well as the nature and range of

investment services and activities provided or performed in the course of their business (CSSF, 2010)

Specialized PSF

By default, specialized PSF can be defined as companies that provide financial services without being investment companies. They do not benefit from the European passport but can perform their activities in Luxembourg. They provide financial services in various domain like investment funds, constitution, management of fund domiciliation, securities lending, specific lending operations (leasing and factoring) or debt collection (Cesari et Al., 2011)

Support PSF

Their particularity is that they do not receive Public deposit and they mainly act as subcontractor of operational function in account for other financial sector professionals. The term “support” has been defined by the market in agreement with the CSSF.

These so called support PSF have an activity which is *a priori* not of the financial sector but they provide an activity for an entity which falls under the LFS (Luxembourgian financial sector). Therefore, they are subject to an authorization (CSSF, 2010). Services provided by these types of PSF are:

- agent communicator customer
- administrative agent of the financial sector
- primary computer systems operator in financial sector
- secondary computer systems operator for financial sector

Having that in mind, it is not possible to talk about J-SOX process in Luxemburg without mentioning PSF requirements. Both PSF and J-SOX regulation are so much related to the enhancement of internal control within a company, and in the case of Fujitsu, the idea of being compliant is once more the improvement of internal control system but also make shareholders feel confident and the last but not the least is to justify in front of local state officials.

4.3.4. Pre-requisites (strengths) for a J-SOX implementation in Luxemburg

In Luxemburg, the CSSF which is the official authority for financial institution supervision has the responsibility to define financial regulations and ensure their fulfillment. It is not an easy task

because more and more international regulations are introduced such as the IFRS, the Basel accords and Sarbanes Oxley.

There is a good point in the Luxembourgian entity which can make the likely J-SOX implementation easy:

Both CSSF through PSF status and FSA through J-SOX requirements have the same and common purpose which is regulation. The fact that a company based in Luxemburg has a fair internal control practices is a good thing when it comes to implement J-SOX. But also in the other direction, being compliant with J-SOX is a good point which can in any ways reinforce the PSF status requirements.

CSSF, as the official authority, its job is to be the guarantor of Luxembourgian financial laws because the stability of financial system in Luxemburg is the core of the economic stability of the country. Its circulars most of the time specify modalities of legal provisions application, publish prudential rules specific to certain areas and makes recommendations concerning financial sector activities. There are internal rules for financial sector within Luxembourg. As a secondary computer system operator and communication network in the financial sector which means the support PSF status, Fujitsu Technology Solution has to comply with all CSSF regulation.

J-SOX focus more on the internal control processes and especially internal control related to the financial reporting. ICOFR get a little bit easier if there is already an existing hosting structure, it means that when it will come to upload evidences to different checklist questions, documents in general used for the PSF requirements will be also used for J-SOX and supplementary control that J-SOX would bring will reinforce evidences used for PSF.

Another big advantage for the Luxembourgian entity is the proximity with the Belgian one. Actually, even though Fujitsu Luxembourg is smaller than Fujitsu Belgium, it has been noticed that most of processes are the same for the two countries, the implementation process will be done close to the Belgian one since they use almost the same documents and in many cases the processes are the same. There will be only some exceptions related to the PSF status. In Luxembourg, the company faces the CSSF control and should do it best to be compliant with the financial authorities status, so many question in the checklists find their answers in processes also done for the PSF requirements. For instance, to the question “Does your company have an

internal audit function?” in the Luxembourgian answers, it has been important to mention that “it is mandatory because of the PSF, an internal auditor is appointed toward the CSSF.

So, the J-SOX checklists held in Luxembourg is definitely not the same than the one held in Belgium, even though the questions are the same since all of them come from the Fujitsu’s HQ in Germany but answers are specific to Luxemburg, taking into account the influence of PSF in the company’s internal control

It is also important to mention as a prerequisite, the small size of the company and especially the finance division. This fact is considered as a prerequisite because it allows avoiding the heaviness of the administration and the structure. This aspect could be helpful to find easily, and quickly evidences to upload but also to get them ready for J-SOX Checklists requirements.

4.3.5. Gaps (weaknesses) in the likely hosting environment for J-SOX Implementation

This section of the thesis is, in majority, from an internal audit made during the project period. Despite its small size, Fujitsu Luxembourg still has a lot to do in term of organization and operation of processes. This audit interview has pointed out many important issues to take into account for a better management. These issues could affect in one way or another quality of financial reporting.

First of all, it has been found that there can be a serious disconnection between the finance, the billing and what actually happens in reality; in another side between different services that are supposed to be very connected to serve the customers. For instance, there is a conflict potential between pre-sales and sales services and integration services who charged them to be in the hurry to sale without considering technical problems that should be also taken into account in the process since Fujitsu is an IT services provider. Both sellers and integration personal should communicate and exchange information to provide optimal services to their client but also to avoid loss and to preserve their image toward the customers.

There is SIEBEL as the CRM software which can organize information but the software is not used efficiently. Most of employees have some important documents on their computers, it can,

for example be difficult to find a template of company's official documents toward customers, and employees try to find them themselves or imagine and design them which turn out to be time consuming tasks. It is a real weakness on the side of files centralization

The maintenance service seems to be a sector that apparently has not as much interest as others sectors within the company. It is in charge of follow ups of services. There is no process to compute the maintenance costs at a project level. There are existing tools but they just need to be gathered in an optimal way. This could lead to maintenance employees ignoring what customers have ordered; missing information which can lead to a poor services quality.

All those remarks could be summarized by a weakness of processes which causes real backup problems.

Knowing all these gaps, a part from recommendations from the auditor to consider, in the scope of the project and with an active collaboration of the CFO, a new internal control set had been included in the Agenda of the project. This new project has been called "J-SOX local extension" and will be developed in a section further down in the text.

4.3.6. The implementation preparation

For a better and optimal J-SOX's ELC level implementation within Fujitsu Luxemburg, it was imperative and important to analyze the way the related checklists were treated in Belgium and then to adapt them to the Luxembourgian situation. To achieve that purpose, the first obvious thing was to take into account the PSF aspect. That element is the main difference compared to the Belgian checklists.

As it can be noticed in the checklists available in the appendix part, they are very complex and it takes time to read, understand properly all the questions and then upload relevant evidences.

In order to simplify things, it has therefore been established a panel called "How to proceed with J-SOX in Luxemburg" (see the appendix) which is an excel document based on the CLC Checklist since it is the most important and discuss all the questions contained in that checklist, the evidences to provide for each question, with a reference number assigned to each group of evidences and the person who is in charge of the evidences and finally with a green, orange and

red color, it is indicated respectively that the question was well answered and all evidences have been uploaded, or some evidences are missing and will be ready soon or again in the red color case, none of the evidences have been uploaded and are not ready yet.

The purpose of the “how to proceed with J-SOX in Luxembourg“ is to establish a baseline that will be the reference and will reduce the complexity of the checklist but also will help to save time when it will come to proceed and collect information for J-SOX.

Regarding the other Checklist, first, the CLC-IT hasn't been changed because the same checklist is valid for both Belgium and Luxemburg, so after deep analysis, it has been concluded that there was nothing to change or to add.

The FCRP checklist with a very complex structure and a lot of sub- questions has been treated without creating an additional document because a lot of questions have already been treated by the Head Quarter (HQ) in Germany and a lot of requirement inside are not applicable in Luxemburg. So, questions have been answered properly for Luxemburg and relevant evidences have been uploaded.

Basically, the complete ELC implementation level consists therefore on the treatment of the three main checklists and especially joining relevant evidences for each question. Achieving that is not that easy; once again J-SOX requirements are charged to be complex and embarrassing. The difficult thing is to get evidences ready and gathering them, at the right moment for J-SOX because people get so busy, they get focused on what they have to do for the business especially during the closing days next to the end of fiscal year.

Once the project ready, all the files containing evidences and linked to relevant checklists have been posted and launched on the Fujitsu Belgium local server. Since the project was running on the server, everything was ready to be launched in the Fujitsu's intranet J-SOX SharePoint to join the other compliant countries. To be part of Fujitsu's J-SOX compliant countries, a request has been sent for the HQ authorization to book a space and run the project program. In the appendix part, there is some screenshots which show the organization of the program files and also how the intranet J-SOX SharePoint is organized.

4.4. J-SOX Local extension

As mentioned above, this part has been added to the agenda of the project with the purpose of always improve the internal control system already in place. It aims at always doing important controls that are needed to be done.

The concept of J-SOX local extension consists in the establishment of a certain number of controls to do monthly in order to improve the health of the company's accounting and internal control in general. In this part, we are going to develop each of these controls and find out why they are so important.

Following the official J-SOX model, a local checklist has been established with question corresponding to the evidences related to each following controls:

4.4.1. Monitoring of account receivables

It affects the management of cash and treasury of the company and as its title clearly explains, it basically consists in monitoring receivables from different customers. Fujitsu set up a reminder for all customers who still owe money to the company to face their obligation as quickly as possible. This reminder plan is set up taking into account the amount of money due, the solvability of the customer, the due date...etc.

The monitoring of receivables is all about what we call the proactive cash collection management which is a way to secure payments due to the company.

Since receivables affects directly the revenue of the company as per the collectability principle of IFRS, it is really important to have a regular monitoring on that balance sheet asset.

4.4.2. Follow up of closing process

During the closing period, there are always a lot of things to do for the end of the fiscal year. From this view, the follow up of closing process has all its meaning, it, therefore, consists in a checklist with a number of actions to do, each of them assigned to departments and people that have to execute them and finally there is a due date for each action to be done. It was important to set up this checklist in order to hat should be done and not forget anything.

The most important thing to have in mind is that the respect of the checklist with the closing schedule will make the closing easier to do.

4.4.3. Cut off controls storage and servers

The concept of cut off controls lays on the well-known accounting principle of periodicity. This principle states that each accounting entry should be allocated to a given period, and split accordingly if it covers several periods. The opening balance sheet should be equal to the closing one. Basically, the balance sheet can't be modified at the beginning of a period.

The cut off controls are set to avoid that given revenue count for entirely on the date of transaction instead of being split to the entire time-span.

4.4.4. Monitoring of accruals/provisions

This control concerns:

- Bonuses that has been provisioned or paid but also any wages, it is important to take into account this provision
- Holydays: It is important to manage employee's holydays taking into account that the company should keep on having a minimum activity needed
- Legal claims: it is important to consider in the forecast any risk of any possible payment of legal claims
- Empty lease: it is about the renting of an empty building for example, it is also important to make a provision of the rents

4.4.5. Provision restructuring

It is the restructuring of the management when comes an unforeseen event for example the incurrence of costs when some employee go to retirement. This kind of event implies a lot of things like a reallocation of tasks and employees or maybe the hiring of ne collaborators.

It is therefore important to have an eye on:

- The provision calculation
- End of the month overview

4.4.6. Monitoring of bad debts

Bad debts must be provisioned; it really affects the company's revenue.

There are two sorts of bad debts:

- Generic bad debts which are bad debts in general, the general trend or index evolution of bad debts of the company
- Specific bad debts: it is the individual bad debts, it is related to the solvability or the financial ability of a customer

4.4.7. Monitoring of forecast process

The forecast process consists in the establishment of "Factuals" which is the collection of information from the sales and delivery department in order to have an idea what the company could earn within a certain period. It is about stepping back for some visibility at a time horizon.

4.4.8. Monitoring of WIPs

WIP is the acronym of Work In Progress. The monitoring of WIP consists in a reporting on WIP as well as tracking of the older ones. Actually, it is a monitoring of all the contracts in progress, the evolution of different project commitment of the company with its customers. Someone have to follow how things are going on and if be attentive if any intervention is needed. Such monitoring is made to ensure collects as much revenues as possible and within the shortest time

4.4.9. Project Control Board (PCB) and Contract Control Board (CCB)

PCB and CCB are review of all important projects. It is a monthly constant monitoring of these projects. The CCB focuses more on Local projects.

PCB and CCB contain important information very interesting for shareholders, so they can have an idea of profitability of the biggest and most visible projects (very often, long-term) of the company.

4.4.10. Management Project Reporting (MPR)

It is a template document issued by the Head Quarter to report information about important projects. The management team has to fill in this template on a regular basis and send it back to the Head Quarter.

4.4.11. Cross charges

As its denomination indicates, Cross charges are charges managed between two entities. In the BeNeLux area it could be charges related to different performance of employees from a given entity within another entity located in a foreign country. In this case, locally, the home entity must charge or invoice the hosting entity. Those charges must be monitored regularly for local revenue purposes as well as on a tax-wise basis

4.4.12. Balance sheet review

It consists in reviewing every balance sheet items

Conclusion

To close this second part, it is important to remember the purpose of this project, why does Fujitsu Luxemburg find important to implement J-SOX. First of all, let's mention that J-SOX as a mandatory regulation allows companies reinforcing internal control system, despite its burden and then finally display reliable financial reports. Within Fujitsu Luxemburg, the Necessity of reinforcing internal control system is huge as it can be noticed in the chapter 4 regarding the analysis of the hosting institution. Regarding its PSF status, the company has internal control obligations to comply with and J-SOX seems to be the right regulation to support this approach.

J-SOX with its army of controls will allow the management to:

- Not forget anything when comes the closing and reporting processes
- Always prove that necessary and mandatory controls are done in the due time
- Always report with the support of evidences

Finally, J-SOX within Fujitsu Luxemburg could, certainly, reinforce position regarding CSSF requirements.

Part 3. General Conclusion

It results from the development of this work that J-SOX is a very complex regulation which could be very heavy for implementation to a company but in another way, it has a lot of advantages in term of internal control management productivity, the disclosing process costs, confidence to the company statements.

However, through the second part of this thesis, it has been largely developed why J-SOX should be implemented within Fujitsu Luxemburg even though, official, it isn't expected to be compliant. A deep analysis of what have been done within others the CEMEA & I area and especially within Fujitsu Belgium, but also a real diagnosis of the hosting institution in terms of strengths and weaknesses for a possible J-SOX implementation. The conclusion is that J-SOX is important for the Luxemburgian entity of Fujitsu to reinforce its credibility towards CSSF requirements but also to enhance the local internal control management system. This part aims at describing the implementation model for Fujitsu Luxemburg but also what is necessary first for an optimal implementation.

Chapter 1. The prerequisites to the implementation

Since Fujitsu Luxemburg is a part of Fujitsu Group and located in the CEMEA & I geographical area, there is no doubt that the entity depends on the Head Quarter in Germany.

The first thing that Fujitsu Luxemburg management team and especially the new J-SOX team have to do is to make sure that the HQ team is aware of the project and agree with the proposed approach. This necessity had already been resolved during the development of this project period. Indeed, the agreement of the HQ had been obtained in the middle of March. The Luxemburgian must, therefore, align and comply with directives from HQ.

Apart from this administrative formality which is important, there are others significant actions to implement for an optimal implementation. The most important of them are:

- The mandatory implementation of recommendations from the internal audit: this audit, has revealed important structural and administrative problems to solve necessarily for improving the local internal control management System
- The mandatory organization of evidences required by J-SOX procedures: Since J-SOX procedure is a very complex procedures, the organizational structure of files and evidences is mandatory to make things work easier
- The respect of J-SOX Calendar: J-SOX Calendar is set by the HQ for all CEMEA & I entities and it is important not to wait for the due date to be close, to have evidences ready. Evidences should be prepared all along the fiscal year.
- The consistency of evidences to upload regarding requirements: each Checklists has at least Seventy questions, so it is important to read carefully and understand what is really needed and to upload appropriate evidences

- Taking into account the PSF Status of the Luxemburgian entity: definitely, this is what makes Fujitsu Luxemburg so special and different from Belgium and others CEMEA & I entities. There are a lot of questions within different checklist that need evidences which relay on or are directly related to the CSSF requirements documents. It is , therefore, important to pay attention on this specific local aspect
- The Fujitsu intranet platform: There is an intranet space managed by HQ and where all J-SOX evidences and filled checklists from all CEMEA & I Countries are uploaded. The access to this platform is necessary to run the J-SOX process when it is ready.

Apart from the implementation of internal audit' recommendations, all the others actions have been implemented for the Second half of Fiscal Year 2011-2012 (2H FY 11-12) since it was the period of the development of this project. Indeed, for the sake of continuity, a document called "How to proceed with J-SOX" has been established to help the new J-SOX team in Luxemburg finding easily evidences to each question of different Checklists; so the very complex process could be an easier one.

Chapter 2. The implementation Model

At the end of the project, the model resulted from 4 months of analysis is a J-SOX procedures with two branches. The “Official” branch with J-SOX requirements and directives from the HQ and the “Local” branch with all local control to do. Both of them, J-SOX Local and J-SOX Official aim at enhancing the Internal Control Management System which, finally, has an impact over the Financial Reporting.

As it has been said before, Fujitsu Luxemburg should implement J-SOX by registering in the model already implemented by other Fujitsu entities across the CEMEA & I area. It means that using the same Checklists from the HQ but the most important thing is to adapt the answers to questions and evidences to the Luxemburgian parameters, especially considering PSF particular obligations.

Briefly, the Official J-SOX implementation relays on the official Checklists and the Local one on a stack of control to implement on a regular basis.

- Official J-SOX :
 - o Will occur every 6 months (semiannually) with 2 half by Fiscal Year
 - o Will comply with HQ requirements
 - o Will comply with J-SOX governance
 - o Will be organized in different files on the CEMEA & I corporation’s intranet

And

- Local J-SOX:
 - o Will occur every Month
 - o Will comply with internal requirements (management requirements)
 - o Will be an internal duty for the management team
 - o Will formalize the company’s accounting and internal control system
 - o Will consist in answering a local checklist
 - o Will be organized in different files on the BeLux network server

Conclusion

Obviously, J-SOX is not the simplest compliance program, it really is complex but, in its complexity this regulation allows the management to monitor the main topics of a balance sheet; it reviews all aspects of management control and contributes for a large part in the enhancement of Internal Control Management System, especially, the Internal Control Over Financial Reporting.

The Local J-SOX for Luxemburg inspired from the formal model is definitely, an additional asset to reinforce the entity's credibility towards CSSF requirements but it will be efficient if all the prerequisites mentioned above are taken into account.

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