

A Draft Framework for Inspection/Supervision of Foreign Audit Firms, etc.

1. Requirement to Submit Information

The Certified Public Accountants and Auditing Oversight Board (hereafter referred to as the “CPAAOB”) will require foreign audit firms, etc. (hereafter referred to as “firms” (Note 1)) to report or submit the following information based upon the Certified Public Accountants Act (hereafter referred to as the “CPA Act”), in addition to the information submitted through notification documents (Note 2), once every three years after the CPAAOB notifies their home jurisdictions’ competent authorities (hereafter referred to as “foreign competent authorities”) of its action in principle.

- (1) All the firms: an overview of the firms, including their businesses, and results of inspection/audit quality review conducted by foreign administrative agencies or similar organizations (Note 3)
- (2) The firms which provide services corresponding to audit and attestation services for the issuers of securities listed in financial instruments exchanges in Japan: in addition to information in 1(1) , an overview of the issues related to the above services and information on operation control systems of the firms, including rules for quality control systems

(Note 1) A person who makes notification stipulated in Article 34-35 (1) of the CPA Act

(Note 2) A notification document stipulated in Article 34-36 (1) of the CPA Act, including a notification stipulated in Article 34-37(1), and attachments stipulated in Article 34-36(2) of the act

(Note 3) Foreign administrative agencies or similar organizations stipulated in Article 5 (1) of the Cabinet Office Ordinance regarding Notification Requirements for Foreign Audit Firms, etc.

If firms do not provide the required reports or relevant documents without any legitimate reason, the Financial Services Agency (hereafter referred to as the “FSA”) will give necessary instruction to them after giving notification to the foreign competent authorities in principle. Instead of giving such an instruction, however, the FSA may ask the foreign competent authorities to take necessary action against the firms.

Furthermore, the CPAAOB will request the firms to submit the above information on a

voluntary basis when deemed necessary and appropriate.

2. Selection of Firms To Be Inspected

The CPAAOB will analyze the submitted information mentioned in **1** together with other information and examine aspects, including whether firms properly conduct services corresponding to audit and attestation services, and whether their operation control systems are functioning effectively. If it is deemed necessary to examine them by conducting inspection, such firms will be selected as those to be inspected.

Furthermore, when deemed necessary and appropriate in light of the public interest or investor protection, including in cases where a firm has made fraudulent or inappropriate attestation, inspection of the firm may be conducted without going through process **1**. In this case also, the foreign competent authorities will be notified of the intention of inspection before the firm is notified, in principle.

3. Reliance on Foreign Competent Authorities

In principle, the FSA/CPAAOB will rely on the foreign competent authorities without requiring the information in **1** and/or the inspection in **4**, where (a) a home jurisdiction's audit system and public oversight system are equivalent to those of Japan, (b) sufficient cooperation, such as the timely provision of necessary information, can be obtained from the foreign competent authorities through appropriate arrangements of information exchanges, and (c) reciprocity is ensured. Furthermore, it is prerequisite for entering into an arrangement of information exchange that the staffs of the foreign competent authorities are subject to a level of professional confidentiality obligations equivalent to that of the staff of the FSA/CPAAOB and are prohibited from using the information for any objective other than the administrative one.

In the case where information cannot be continuously obtained from the foreign competent authorities, or where such authorities' provision of the necessary information closely related to a judgment of specific administrative actions cannot be ensured, such information may be directly gathered from firms; thus, the extent to which the FSA/CPAAOB can rely upon foreign competent authorities will be subject to the home jurisdiction's audit system and public oversight system, as well as the extent of cooperation received from the foreign competent authorities.

4. Implementation of Inspection

The CPAAOB, in principle, will notify the foreign competent authorities of the intention of inspection before it notifies the firms. Also, the CPAAOB will make efforts to coordinate with the foreign competent authorities so that they will be able to conduct inspection simultaneously as much as possible.

The CPAAOB will limit the scope of inspection of audit engagements to those relevant to the financial statements (Note 4) required to be disclosed under the provisions of the Financial Instruments and Exchange Act in Japan. With respect to the operation control systems, the CPAAOB will strive to seek the efficiency of inspections and lessen the burden on firms.

(Note 4) Financial statements to be submitted under the Financial Instruments and Exchange Act by the issuers of securities stipulated in Article 30 of the Order for Enforcement of the CPA Act.

5. Provision of Inspection Report and Follow-up

As a result of inspection, the CPAAOB will provide an inspected firm with an inspection report of which the original will be written in Japanese, and a provisional translation in English as an attachment for reference.

Furthermore, the FSA basically requires the inspected firm to submit an operational improvement plan concerning issues pointed out in the inspection report. Nonetheless, in the case where inspection is conducted in cooperation with foreign competent authorities and collection of the firm's improvement plan by such authorities is considered to be more effective in light of the public interest or investor protection by Japanese authorities, the FSA may ask the foreign competent authorities to make such collection.

Additionally, based on the above-mentioned improvement plan, the FSA will examine the status of progress and give instruction to the firm when necessary and appropriate ("follow-up"). In the case where a follow-up conducted by the foreign competent authorities is considered to be more effective in light of the public interest or investor protection by Japanese authorities, the FSA may ask the foreign competent authorities to conduct such a follow-up.

When conducting the next inspection of the firm, the CPAAOB will examine the state of the said improvement.

6. Administrative Actions

In the case where firms' services corresponding to audit and attestation services in Japan are found to be significantly inappropriate, including based on a recommendation by the CPAAOB, the FSA gives necessary instruction to the firms, after notifying the foreign competent authorities in principle. Furthermore, in the case where firms do not respond to the FSA's requirement to provide reports on the improvement plan without any legitimate reason, or in the case where a poor implementation or a non-implementation of the improvement plan is revealed via inspection, etc., the FSA gives necessary instruction to the firms, after notifying the foreign competent authorities in principle.

In the above case, the FSA may request the foreign competent authorities to give the firms necessary instruction for the firms' operational improvement, instead of directly giving such instruction to them, when it is considered to be more effective in light of the public interest or investor protection by Japanese authorities.

When the firms fail to follow the instructions that they have received, the FSA may publicize such failure and the contents of those instructions. After that, until the FSA publicizes that the matters pertaining to the instruction have been rectified, the firms' assurance corresponding to audit and attestation will not be considered valid in the Japanese market under the Financial Instruments and Exchange Act.