

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

### **I. Basic Framework**

With respect to information gathering and inspections regarding foreign audit firms, etc. (hereafter referred to as “firms” (Note 1)), the Financial Services Agency (hereafter referred to as the “FSA”) and the Certified Public Accountants and Auditing Oversight Board (hereafter referred to as the “CPAAOB”) will, in principle, rely on such actions by the competent authorities of the firms’ home jurisdictions (hereafter referred to as “foreign competent authorities”), instead of seeking to obtain information from or conducting inspections on firms themselves, provided that (a) audit and public oversight systems in the firms’ home jurisdictions are equivalent to those of Japan (Note2), (b) necessary information can be provided from the foreign competent authorities through appropriate arrangements of information exchange, and (c) reciprocity is ensured. It is a prerequisite for entering into an arrangement of information exchange that the staffs of the foreign competent authorities are subject to professional confidentiality obligations and are prohibited from using the information beyond predetermined purposes.

In cases where any of the above conditions cannot be met and thus the framework of mutual reliance cannot work, the FSA/CPAAOB will seek to obtain information from or conduct inspections on firms on their own. Also, even if all the conditions are met, in cases where the above arrangements of information exchange cannot be fully fulfilled, including when information cannot be obtained from the foreign competent authorities in a sustained manner, or necessary information, such as those closely related to the judgment of a specific administrative action, cannot be provided despite the arrangements, such information may be directly gathered from firms.

(Note 1) A person who has notified the authority according to Article 34-35 (1) of the Certified Public Accountants Act (hereafter referred to as the “CPA Act”)

(Note 2) Equivalence of the audit and public oversight systems will be assessed in a comprehensive manner, based on principle-based criteria which will be published separately.

## **II. Operation of Inspection/Supervision**

The FSA/CPAAOB will require firms to submit information and inspect/supervise firms basically following the lines outlined below. In implementing this framework, however, the FSA/CPAAOB will give due consideration to specific circumstances surrounding each jurisdiction, including its legal system.

### **1. Information Submission**

The CPAAOB will require following firms to report or submit respective information based upon the CPA Act once every three years in principle, in addition to the information submitted through notification documents (Note 3). The CPAAOB will, in principle, notify foreign competent authorities prior to taking such actions.

- (1) All firms: overview of the firms, their businesses, and results of inspection/audit quality review conducted by foreign administrative agencies or similar organizations (Note 4).
- (2) 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 II.1(1), overview of the issues related to the above services and information on the firms' operation control systems, including rules for quality control systems

(Note 3) A notification document stipulated in Article 34-36 (1) of the CPA Act, including a notification of changes stipulated in Article 34-37(1), and attachments stipulated in Article 34-36(2) of the Act

(Note 4) 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 reasons, the FSA will issue business improvement instructions, upon notifying, in principle, the foreign competent authorities in advance. Instead of issuing such instructions, however, the FSA may request the foreign competent authorities to take necessary actions 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 information submitted following the process mentioned in II.1 together with other information and make assessment on the need for further examination on aspects including whether firms properly conduct services corresponding to audit and attestation services, and whether their operation control systems are functioning effectively. Inspections will be conducted to the firms selected as the result of such assessment.

Furthermore, when deemed necessary and appropriate in light of the public interest or investor protection, such as in cases where firms have allegedly made fraudulent or inappropriate attestation, the CPAAOB may conduct inspections of the firms without going through the process described in II.1. The CPAAOB will, in principle, notify the foreign competent authorities prior to taking such actions.

## **3. Implementation of Inspection**

The CPAAOB will, in principle, notify the foreign competent authorities when it intends to conduct inspections, before it notifies the firms. Also, the CPAAOB will make utmost efforts to coordinate with the foreign competent authorities so that they will be able to conduct inspections simultaneously.

With regard to specific audit engagements, the CPAAOB will limit the scope of inspection to those related to the financial statements (Note 5) required for disclosure under the provisions of the Financial Instruments and Exchange Act in Japan. With respect to operation control systems, the CPAAOB will strive to pursue efficiency of inspections and lessen the burden on firms.

(Note 5) Financial statements to be disclosed under the Financial Instruments and Exchange Act by the issuers of securities stipulated in Article 30 of the Cabinet Order for Enforcement of the CPA Act.

## **4. Provision of Inspection Report and Follow-up**

The CPAAOB will communicate inspection results to inspected firms by providing inspection reports in Japanese, together with provisional English translation for reference.

Following the inspection, the FSA will basically require the inspected firms to submit business improvement plans concerning issues pointed out in the inspection reports. Nonetheless, in the cases where inspections are conducted in cooperation with foreign competent authorities and collection of the firms' improvement plans by such authorities are considered to be more effective in light of public interest or investor protection by Japanese authorities, the FSA may request the foreign competent authorities to assume the task.

Furthermore, based on the above-mentioned improvement plans, the FSA will monitor the progress and give instructions to the firms when necessary and appropriate (hereafter referred to as "follow-up"). In the cases where follow-up actions taken by the foreign competent authorities are considered to be more effective in light of public interest or investor protection by Japanese authorities, the FSA may request the foreign competent authorities to assume the task.

The CPAAOB will directly examine the state of improvement in following inspections, if conducted.

## **5. Administrative Actions**

In the cases where firms' services corresponding to audit and attestation services in Japan are found to be significantly inappropriate, including based on recommendations by the CPAAOB, the FSA will basically issue business improvement instruction to the firms. Furthermore, in the cases where firms do not respond to the FSA's requirement to submit improvement plans without any legitimate reasons, or in the cases where poor- or non-implementation of improvement plans are revealed via inspections, etc., the FSA will issue business improvement instruction to the firms as well. The FSA will, in principle, notify the foreign competent authorities prior to taking any of such actions.

In the above cases, the FSA may request the foreign competent authorities to take actions to ensure the firms' operational improvement instead of directly issuing business improvement instructions, when it is considered to be more effective in light of 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 the instructions. Once such publications are

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made, the firms' assurance corresponding to audit and attestation will not be considered valid in the Japanese market under the Financial Instruments and Exchange Act until the FSA publicizes that the matters pertaining to the instructions have been rectified.