

5 March 2007

Mr. Pierre Delsaux  
Director of Directorate-F  
Directorate General for Internal Market and Services  
The European Commission  
B-1049 Bruxelles  
Belgium

Re: Consultation on Articles 45 - 47 of the Directive on Statutory Audit

Dear Mr. Delsaux,

The Financial Services Agency of Japan (JFSA), together with the Certified Public Accountants and Auditing Oversight Board of Japan (CPAAOB), welcomes the opportunity to comment on the “*Consultation on Implementation of Articles 45 - 47 of the Directive on Statutory Audit (January 2007)*”, and highly commends the European Commission for its efforts towards improving the implementation of the Directive in a transparent manner. We believe that many of the issues identified in the consultation document are critical to the future of cooperation between Japan and the European Union (EU) in the areas of accounting and auditing, and thus we would highly appreciate the Commission for giving due consideration to our comments in finalizing the implementation measures.

Please find our general comments in the main body of this letter; and the specific comments to the questions, in the appendix.

#### Approach towards equivalence assessment

JFSA and CPAAOB share with the Commission and European regulators the goal to protect the interest of investors, while ensuring the fairness and efficiency of markets, and enhancing capital movements. Particularly in the context of EU, it is in the best interest of both sides to maintain the openness of European markets.

For the European equivalence assessment exercise on auditing, a recommended approach consistent with this goal would be a market-wise (or market-sensitive) approach focused on the most critical elements of a foreign auditor oversight system, rather than a heavy-handed approach involving extensive scrutiny of all conceivable aspects of the oversight regime, including, inter alia, audit standards and independence rules.

We understand that the consultation document suggests a two-track approach, which consists of the two workstreams - one under Article 46 (1), focused on the three critical elements of the oversight system (i.e. quality assurance; investigation and penalties; and public oversight) and the other under Article 45, comprising a full scope scrutiny. It is highly crucial for the success of the equivalence exercise to maintain the first track as the mainstream option, while reserving the excessively burdensome second workstream strictly for very exceptional cases. It would appear very difficult, if not impossible, to complete by next June assessments of the 30-plus third countries by relying on the second workstream. Besides, the costs associated with such excessive requirements to auditors would ultimately be passed on to investors through issuers, significantly diminishing the attractiveness of European capital markets for both investors and issuers.

#### Unified application throughout EU

The Commission suggests adopting an EU-wide consistent approach. To achieve the objectives of the Directive, we believe this single European approach should be applied consistently throughout the entire process of equivalence assessment by the Commission and registrations at the Member States. The three benefits identified in the page 7 of the document (i.e. reduce market fragmentation; simplification; and focus on audit quality in third countries) are all persuasive, and are also consistent with our earlier suggestion for a market-wise approach. We would strongly advise against allowing individual Member States to exercise their discretion to “*modify*” the registration requirements, which could have detrimental impacts on the European single market.

#### Japanese oversight regime

The Japanese authorities believe that high quality audits are an indispensable element of capital market integrity, and thus have maintained and improved the Japanese auditing system through seamless efforts. We are confident that the current Japanese auditor oversight regime is no less effective and comprehensive than those in European countries. The JFSA and CPAAOB believe that, in accordance with Article 46(1), the Japanese auditor oversight system satisfies all the conditions set out in Articles 29, 30, and 32 of the Directive, and thus Japanese auditors and audit firms are well qualified for a full exemption from the registration requirements. We would like to express our intention to seek a full exemption from the registration requirements.

Finally, the Japanese government is currently contemplating further improvements to its auditor oversight regime. A bill amending the CPA law is to be submitted to the Diet shortly, which aims at enhancing the governance and transparency of audit firms; solidifying auditor independence; and reinforcing disciplinary measures (including financial penalties). The bill will also propose introducing a notification requirement for foreign auditors and audit firms that produce audit attestation for foreign issuers whose securities are publicly traded in Japanese markets. Such foreign auditors and audit firms would be required to notify the Japanese authorities of their identities and be subject to Japanese oversight, unless they are already subject to foreign auditor oversight systems which are considered appropriate by Japanese authorities.

We sincerely thank you again for the opportunity to comment on your consultation document. Should you have any questions, please do not hesitate to contact us.

With our best regards,

Sincerely yours,

Junichi MARUYAMA  
Deputy Commissioner for International Affairs  
Financial Services Agency  
Government of Japan

Hideyuki FURIKADO  
Secretary General  
Certified Public Accountants and Auditing  
Oversight Board  
Government of Japan

## Appendix

<b>Question 1: Do you have further comments, or concerns to share, on the equivalence?</b>
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### **Need for the definition of “equivalence”**

We would like to recommend that the Commission further clarify the term “*equivalence*”, since it could be critical to reaching the final decision of the assessment. We are aware that the Commission is revisiting the definition of “*equivalence*” for the equivalence assessment on accounting standards, developed based on the proposal of CESR. The Commission might wish to align the two definitions with a view to achieving consistency.

### **Ability to co-operate with the public oversight bodies of the EU Member States**

We think mutual co-operation is important in the area of auditing. The consultation document makes a notable statement at the end of page 7: “*In addition, they should have the ability to co-operate with the public oversight bodies in the EU Member States on sensitive issues*”.

This is confusing. Neither Article 45 nor 46 explicitly imposes such obligation to any third countries. The Directive does not appear to empower the Commission or the Member States with such competence. Besides, the term “*the ability to co-operate*” is far from being unequivocal. This statement does not appear to be consistent with the Commission’s commitment to be transparent in its rule-making procedure.

Nor may this approach be workable in practical terms. Generally, “*the ability to co-operate on sensitive issues*” could be demonstrated through the conclusion of mutual cooperation arrangements, or more formally, MOUs, between the competent authorities. It is difficult to envisage all 30-plus third countries concluding such arrangements with each of the 27 Member States by next June in order to be qualified as equivalent.

More generally, as we stated earlier, the recommended approach towards equivalence assessment is a market-wise one, focused on important but realistic requirements. Making this “*the ability to co-operate*” as one of the preconditions for the assessment could risk stifling the entire flow of the process.

For these reasons, we strongly advise against including “*the ability to co-operate*” as one of the conditions in Article 46(1) assessment process under the current timeframe. This position, however, should in no way preclude Japan and EU from engaging in bilateral dialogues towards furthering our mutual co-operations, which we believe is too important and fundamental an issue to be concluded within such a very limited period of time as suggested by the consultation document.

**Question 2: Do you have any comments on the need for transitional measures?**

We are supportive of the Commission's preference for the second avenue.

**Question 3: Do you have any comments or observations on the above list of third countries? Do you have specific information on those third countries which you would like to share with the European Commission services and if so, which?**

The proposed list of 35 countries to be assessed by next June, does present a challenge for the Commission. Given the confirmed competence of the Commission, it certainly is achievable, particularly if the Commission is to relay on the market-wise, focused approach, as we suggested earlier.

We also support the Commission's proposal to draw on the existing materials to avoid the duplication of work. It is advised, however, that the Commission disclose the basis of said assessments to the subject countries before reaching the final conclusion, to ensure that the Commission is using correct and updated information.

**Question 4: Do you have any comments or observations that you wish to bring to the European Commission's attention as regards the explanation in section 3.2?**

We are not comfortable with the description stating that individual Member States may "*modify*" the registration requirements. As stated earlier, we would strongly advise against the possible modification of the registration requirements at Member State's discretion. This may result in requiring registration requirements to third country audit firms, even when their auditing system is assessed as "*equivalent*". To the success of the Statutory Audit Directive, consistency and integrity are key elements. Therefore, we encourage the Commission to ensure that there be very limited, if any, application of the modification option, in order to avoid confusion and unnecessary costs as a result of inconsistent applications.

**Question 5: Do you have comments on a concept for co-operation in registration procedures that would aim at reducing administrative burdens and cost?**

We understand this question as being not relevant to countries qualified under Article 46(1) for a full exemption from the registration requirement. As stated earlier, we believe Japan to be among such countries. Given this understanding, we would like to offer the following comments.

We support the Commission's proposal to rely on the EGAOB as a forum where Member State authorities are expected to share information to cooperate in registration procedures.

It would be highly appreciated if the Commission could enlighten us as to how the other European institutions, such as the European Parliament, would be involved in the assessment process of individual third countries.

**Question 6: Do you have comments on the use of International Standards on Auditing and US auditing standards (US GAAS) by third country audit firm for registration purposes for a limited transitional period?**

We understand this question as also being not relevant to countries qualified under Article 46(1) for a full exemption from the registration requirement. As stated earlier, we believe Japan to be among such countries. Given this understanding, we would like to offer the following comments.

The audit standards applied in Japan is ISA-based and would be qualified as “International Standards on Auditing” in the context of the assessment exercise. We, however, must express our strong opposition to the Commission’s proposal to allow only ISAs and US GAAS as a transitional arrangement. This is a matter of principle. A transitional arrangement, by definition, should maintain the current situation, without adding nor subtracting anything, let alone prejudging any future decisions. Such preemptive actions can incur serious unintended impacts to markets. As we stated earlier, the guiding principle of the equivalence assessment should be a market-sensitive approach. We would strongly recommend the Commission to design a transitional period that would allow the use of all currently accepted standards, in addition to ISAs and US GAAS.

**Question 7: Do you have any comments on independence issue under Article 45?**

We understand this question as also being not relevant to countries qualified under Article 46(1) for a full exemption from the registration requirement. As stated earlier, we believe Japan to be among such countries. Provided this understanding, we would like to offer the following comments.

The question is similar to the previous one, yet likely to present a more complexity, given the wider national discretion allowed for individual Member States. Consistent with our position on the preference for a unified EU approach, Option 1 is not our preference. Option 2 may not be a satisfactory solution either. The ethics code applied in Japan is IFAC Code-based (with many *pluses*) and would be qualified as IFAC Code in the context of the assessment exercise. This, however, could relate to the question of non-discriminatory treatment of third countries. Given the wide national discretion provided under the Directive and the recent fast developments in IFAC Code, there could well be Member States applying independence rules that are less stringent than IFAC Code. It might amount to discrimination against the third country auditors, if they were to be required to comply with IFAC Code, while auditors of these Member States were be allowed to operate under significantly less stringent national rules. In conclusion, the EU might want to introduce a more unified independence rule before embarking on any rigorous equivalence assessment on third country rules.

**Question 8: Do you have any concerns which you would like to make European Commission services aware of?**

**Question 9: Do you have any comments on the conditions set up in the adequacy**

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<b>Question 10: Which circumstances could, in your view, be considered as exceptional?</b>
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As stated earlier, the Japanese government is currently contemplating further improvements to its auditor oversight regime. A bill amending the CPA law is to be submitted to the Diet shortly, which aims at enhancing the governance and transparency of audit firms; solidifying auditor independence; and reinforcing disciplinary measures (including financial penalties). The bill will also propose introducing a notification requirement for foreign auditors and audit firms that produce audit attestation for foreign issuers whose securities are publicly traded in Japanese markets. Such foreign auditors and audit firms would be required to notify the Japanese authorities of their identities and be subject to Japanese oversight, unless they are already subject to foreign auditor oversight systems which are considered appropriate by Japanese authorities. In the case where foreign auditors and audit firms become subject to such Japanese oversight, they would be required to produce all relevant information as requested by Japanese authorities and to accept inspections by Japanese authorities, to the extent necessary for achieving the public interest and investor protection.