

Guidance on Equivalency Assessment on Audit and Public Oversight Systems of Foreign Jurisdictions

I. Introduction

With respect to information requirements and inspections regarding foreign audit firms, etc. (hereafter referred to as “audit firms”¹), the Financial Services Agency (FSA) and the Certified Public Accountants and Auditing Oversight Board (CPAFOB) will, in principle, rely on such actions by the competent authorities of the firms’ home jurisdictions, 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, (b) necessary information can be provided from the foreign competent authorities through appropriate arrangements of information exchange, and (c) reciprocity is ensured.

The FSA and CPAFOB published the policy above in “A Framework for Inspection / Supervision of Foreign Audit Firms, etc.”² on September 14, 2009, after public consultation. In the course of publication of the Framework, the FSA stated that it will disclose criteria for equivalency assessment and examine the equivalency of audit and public oversight system of foreign jurisdictions in a holistic manner. In this respect, the FSA publishes herewith principles and criteria to assess the equivalency of audit and public oversight systems to that of Japan.

II. Principles for equivalency assessment

The FSA will decide the equivalency of audit and public oversight systems of foreign jurisdictions based on the following five principles to ensure effectiveness of oversight cooperation. The FSA will assess equivalency of each jurisdiction with due consideration of the effectiveness of the system as a whole and will not decide it based on appearance.

- There should be a public oversight system on auditors that is independent from the audit profession.
- The oversight body should have an effective inspection and/or review system to ensure audit quality.

¹ A person who has notified the authority according to Article 34-35 (1) of the Certified Public Accountants Act

² <http://www.fsa.go.jp/en/news/2009/20090914-2.html>

- The audit oversight body should have the authority to stipulate remedial actions and/or to take disciplinary actions when problems are detected.
- There should be an appropriate qualification system of auditors and audit standards.
- The audit oversight body should have the competence and willingness to mutually rely on audit activities in its home jurisdiction.

Principles will be examined from the respect of whether the FSA is able to seek a cooperative arrangement toward mutual reliance with the oversight body of a foreign jurisdiction instead of seeking information and inspections. Therefore, the assessment will not be intended to give any assurance to the audit quality of jurisdictions.

III. Criteria for Equivalency

The FSA also prepared criteria clarify which points will be referred to when it examines conformity to the principles.

1. Oversight Structure

Principle: There should be a public oversight system on auditors that is independent from the audit profession.

This principle will be assessed based on the following criteria:

- Are there mechanisms for oversight on auditors in the jurisdiction? The mechanism may include for example, (i) registration, (ii) setting of standards, (iii) inspection or review of audit quality and (iv) investigation and remedial/disciplinary action.
- Is there an oversight body that operates in the public interest?
- Does the oversight body have an appropriate membership and an adequate charter of responsibilities and powers?
- Is the audit oversight body operationally independent of the audit profession? The majority of the relevant governing body should be non-practitioners (with an appropriate cooling off period).
- Does the audit oversight body have adequate funding? Funding should be free of undue influence by the audit profession.

- Does the oversight body adequately recognize who or which entity provides audit services in its jurisdiction through a registration requirement or other measures?
- Does the oversight body cover audit firms in its jurisdiction that audit financial statements of a company with securities issued or traded on markets in Japan?
- Does the oversight body have in place appropriate arrangements to protect confidential information?
- Does the oversight body secure transparency and accountability through measures such as adequate publications about programs and outputs of their activities?

2. Inspection

Principle: The oversight body should have an effective inspection and/or review system to ensure audit quality.

This principle will be assessed based on the following criteria:

- Does the auditor oversight body have an inspection process to review quality control policies, audit procedures to assess compliance with applicable professional standards, independence requirements, and other laws, rules and regulations of audit firms?
- If the inspection process is performed in coordination with a quality control review by professional bodies, does the oversight body maintain control over key issues such as the scope of reviews, access to audit work papers and other information needed in reviews, and follow-up the outcome of reviews to ensure the integrity of oversight?
- Does the oversight body conduct inspections on a recurring basis?
- Inspections will be ensured to include effective procedures for both firm-wide and file reviews.
- Does the oversight body have sufficient inspectors who are independent from the audit profession and with appropriate competence?
- Is there any mechanism for reporting inspection findings to the audit firm and ensuring remediation of findings by the audit firm?

3. Investigation and Remedial/Disciplinary Action

Principle: The audit oversight body should have the authority to stipulate remedial

actions and/or to take disciplinary actions when problems are detected.

This principle will be assessed based on the following criteria:

- Does the oversight body have the authority to initiate the investigation process to take disciplinary actions on auditors and/or audit firms when non-compliance or significant deficiency in their operation or audit process is considered?
- Is the oversight body able to order remedial actions on audit firms?
- Does the authority have the ability to impose a range of sanctions including, for example, suspension for an audit service and the removal of an audit license and/or registration?

4. Qualification of Auditors and Audit Standards

Principle: There should be an appropriate qualification system of auditors and audit standards.

This principle will be assessed based on the following criteria:

- Are auditors required to have proper qualifications and professional competency before being licensed?
- Are there appropriate audit standards, quality control standards, an ethics code, and independence requirements?

5. International Audit Oversight

Principle: The audit oversight body should have the competence and willingness to mutually rely on audit oversight activities in its home jurisdiction.

This principle will be assessed based on the following criteria:

- With regard to oversight on audit firms in foreign jurisdiction, is the oversight body allowed to rely on oversight activities by the competent authorities of the firms' home jurisdictions instead of seeking to obtain information from or conducting inspections on foreign audit firms itself?
- Is the oversight body capable of providing assistance to and sharing information with Japanese audit oversight authorities with regard to audit firms of both jurisdictions?

IV. Assessment Process and Announcement

To start the process of equivalency assessment, the FSA is sending questionnaires related to the above criteria to the audit oversight bodies of foreign audit firms' home jurisdictions. The FSA will also utilize existing information available from such sources as websites of foreign authorities and the IFIAR³ Members' Profile. Assessment will be conducted on an on-going basis. Foreign jurisdictions which are recognized as equivalent will be publicly announced on the FSA website.

³ International Forum of Independent Audit Regulators