



FINANCIAL SERVICES AGENCY  
GOVERNMENT OF JAPAN  
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March 28, 2003

Office of the Secretary  
Public Company Accounting Oversight Board  
1666 K Street, N.W.  
Washington, D.C. 20006-2803

Re: Proposal of Registration System for Public Accounting Firms  
(PCAOB Rulemaking Docket Matter No.001)

Dear Sir:

As the Director for International Financial Markets of the Financial Services Agency of Japan (" FSA" ), I am pleased to submit this letter on behalf of the FSA in response to the request of the Public Company Accounting Oversight Board ("Board") for comments on its Proposal of Registration System for Public Accounting Firms (" Proposal" ) under the Sarbanes-Oxley Act of 2002 as contained in PCAOB Release No. 2003-1 (March 7, 2003).

We appreciate that the Board recognizes that the registration of foreign public accounting firms may raise special issues that are not present in the case of U.S. firms, and that it will convene a public roundtable on March 31, 2003 concerning the registration of foreign public accounting firms and seek the views of interested persons on whether its registration requirements should be modified.

While the Proposal seems to seek views of interested persons on the issues including the appropriate scope of the Board's oversight of non-U.S. public accounting firms, we would like to point out, first and foremost, our position that it is not appropriate for the Proposal to include non-U.S. public accounting firms in its scope and require them registered with the Board. ***As we have been respectfully requesting the Securities and Exchange Commission ("SEC") to provide an appropriate exemption from the registration requirement to Japanese audit firms, we reiterate our request for the appropriate exemption in this comment letter.*** Based on this premise, we set forth below additional

comments on the Proposed Registration System.

? . Request for an appropriate exemption from the registration requirement

*We respectfully request the Board to provide an appropriate exemption from the registration requirement to Japanese audit firms, utilizing the exemption authority provided by Section 106(c) of the Sarbanes-Oxley Act. Needless to say, the Japanese audit firms should not be subject to such oversight powers as inspections, investigations, and disciplinary proceedings by the Board.*

**1. Principle of registration with and oversight by the authority of a home jurisdiction**

**(1) IOSCO Principles**

The establishment of the Board and registration of U.S. public accounting firms with the Board and oversight by the Board are important aspects of the Sarbanes-Oxley Act that are designed to restore investors' confidence in the United States securities markets. The issues addressed by the Sarbanes-Oxley Act are global, and we share the same objective.

From this global viewpoint, the Technical Committee of the International Organization of Securities Commissions ("IOSCO") issued last October the Statement titled "Principles for Auditor Oversight" ("IOSCO Principles"). The IOSCO Principles state that "In relation to companies operating or listing on a cross-border basis, IOSCO members are encouraged to provide each other, whether directly or through coordinating with the auditor oversight body in their jurisdiction, with the fullest assistance permissible in efforts to examine or investigate matters in which improper auditing may have occurred and on any other matters relating to auditor oversight."

We understand that registration requirement is in general considered to constitute authority of oversight. Thus, we believe that *it is an essential aspect of the IOSCO Principles that registration and oversight of auditors (CPAs and audit firms) are within the responsibility of the authorities of the home jurisdiction of auditors* unless such auditors have substantial physical presence such as the establishment of a branch office within another jurisdiction. Even if

such auditors have substantial physical presence in another jurisdiction, the authority of an auditor oversight body of such other jurisdiction should be limited to such substantial physical presence. ***This principle is critically important from the viewpoint of mutual respect and international comity over each jurisdiction's sovereignty and auditor oversight system. Moreover, this principle is also important to avoid regulatory duplications or contradictions among auditor oversight bodies in different jurisdictions, and unnecessary regulatory burden or costs to foreign public accounting firms.***

## **(2) Japanese auditor oversight system**

In Japan, under the current Certified Public Accountants Law ("CPA Law"), certified public accountants ("CPAs") are required to be registered with the Japan Institute of Certified Public Accountants ("JICPAs"), and the establishment of audit firms is subject to approval by the FSA. Both CPAs and audit firms are required to be members of the JICPA which is a self-regulatory organization established as required by the CPA Law. CPAs and audit firms are subject to oversight by the FSA and the JICPA. The JICPA is subject to oversight by the FSA. Thus, the CPA Law provides the legal structure in which registration and oversight of CPAs and audit firms are the responsibilities of the Japanese authorities (the FSA and the JICPA).

***The FSA has the same mission as the Board to protect investors in securities markets and to further the public interest by ensuring that public company financial statements are audited according to the highest standards of quality, independence, and ethics.***

If a Japanese audit firm improperly prepares or furnishes an audit report with respect to an issuer or improperly plays a substantial role in the preparation and furnishing of an audit report for an issuer within the jurisdiction of Japan, such a problem should be dealt with by the responsible Japanese auditor oversight bodies. In such cases the FSA will exercise its auditor oversight powers including investigations and disciplinary actions as necessary. If the Board intends to collect information concerning the Japanese audit firms, the FSA is prepared to cooperate with the Board appropriately in line with the above-mentioned IOSCO Principles. Therefore, ***we believe it is not only inappropriate but also unnecessary for the Board to subject Japanese audit firms to registration with and oversight by the Board. We respectfully request the Board to respect and not infringe on the auditor oversight system by the***

*Japanese authorities.*

## 2. Enhancing the Japanese auditor oversight system

### (1) IOSCO Principles

The IOSCO Principles state that "within a jurisdiction, auditors should be subject to oversight by a body that acts and is seen to act in the public interest." They also state that "effective oversight structure generally includes that a mechanism should exist to require auditors to be subject to the disciplines of an auditor oversight body that is independent of the audit profession, or, if a professional body acts as the oversight body, is overseen by an independent body. Such an auditor oversight body must operate in the public interest, and have an appropriate membership, an adequate charter of responsibilities and powers, and adequate funding that is not under the control of the auditing profession, to carry out those responsibilities."

### (2) Enhancement of the Japanese auditor oversight system

Since the FSA is an auditor oversight body under the CPA Law as mentioned above, the current Japanese auditor oversight system is consistent with the IOSCO Principles. Considering the international developments including the enactment of the Sarbanes-Oxley Act, ***the Japanese government submitted a bill ("Bill") to the current regular session of the Diet (the Japanese legislature) on March 14 to comprehensively revise the CPA Law.*** The Bill is pursuant to the report issued last December by the Subcommittee on Regulations of Certified Public Accountants of the Financial System Council, an important advisory council established within the FSA. The revised CPA Law will be in principle effective in April 2004 if the Bill is passed by the Diet.

The major points in the Bill are further enhancing auditor oversight, further strengthening auditor independence, and reviewing CPA examinations to increase the number and enhance the quality of CPAs. ***Through this revision, the Japanese auditor oversight system will further provide an auditor oversight system substantially equivalent to that provided under the Sarbanes-Oxley Act*** Major concrete measures included in the Bill are as follows:

#### ( Enhancement of the system of quality control review)

- Quality control review by the JICPA will be monitored and reviewed by the CPA and Auditing Oversight Board ("CPA AOB"), an independent third-party

board established within the FSA. (The current CPA Examination and Investigation Board will be reorganized and its functions will be expanded and strengthened.)

- Members of the CPAAOB will be appointed by the Prime Minister with the consents of both Houses of the Diet. The term of office of the members will be three years. The members will exercise their authorities independently. The CPAAOB will have its Executive Bureau including the Secretary-General.
- The JICPA will be required to make reports on the quality control review of its members' auditing to the CPAAOB.
- The CPAAOB will have the authority to inspect CPAs and audit firms in this respect.
- The CPAAOB will be authorized to issue recommendations of administrative actions or directions against CPAs, audit firms or the JICPA to the FSA.

**(Enhancement of the government oversight function)**

- Introducing the general authority of on-site inspections of audit firms (currently, on-site inspections of audit firms are conducted for the purpose of taking disciplinary actions.)
- Introducing the authority of administrative direction against audit firms (in addition to the current authority of the FSA to take such disciplinary actions as issuing business suspension orders against audit firms.)
- Introducing the authority to issue business improvement orders against the JICPA (in addition to the current authority of the FSA to take such disciplinary actions as issuing an order for revocation of the resolution of the JICPA's general meeting)

**(Enhancement of the JICPA's oversight function)**

- Introducing the legal authority for the JICPA to conduct quality control review (currently, the JICPA's quality control review is pursuant to the Constitution of the JICPA, and there is no explicit provision in the CPA Law.)

Therefore, *we respectfully request the Board to respect the further enhanced and more substantially equivalent auditor oversight system in Japan.*

**3. Conflicts with the duty of keeping confidentiality of information**

It is indispensable for auditors to have sufficient information on corporate and financial affairs of an audited corporation. From this viewpoint, the Japanese Law for Special Exceptions to the Commercial Code concerning

Audits, etc. of Corporation gives external accounting auditors of large corporations such powers as perusing account books and documents of audited corporations, requesting directors and employees to make reports on accounting, and investigating conditions of businesses and finances of audited corporations. In order for auditors to collect sufficient information, it is also critical for auditors to keep confidentiality of information. For this purpose, CPAs in Japan are required not to leak or misuse confidential information obtained through their services without justifiable reasons. The duty of keeping information confidential is one of the main pillars of auditing and is clearly stipulated in Article 27 of the CPA Law. Violation of this legal duty by a CPA is a criminal offense under the CPA Law.

Section 105(b)(2) of the Sarbanes-Oxley empowers the Board to impose on registered public accounting firms, including foreign public accounting firms, the duty to testify and to require production of audit work papers and any other document or information. Thus, if the Japanese audit firms were registered with the Board, they could be forced to testify to the Board or produce confidential information. This would raise ***a clear conflict between the Japanese CPAs' duty to keep confidentiality of information imposed under the CPA Law and the duty to provide information to the Board if such duty were imposed on the Japanese audit firms under the Sarbanes-Oxley Act***

The Japanese audit firms are established and conduct their auditing services under the CPA Law. If they intend to comply with the duty of keeping confidentiality of information under the CPA Law, they could not help but avoid registration with the Board and thus give up auditing of SEC-registered Japanese issuers. Such serious outcome should be avoided.

Therefore, ***we respectfully request the Board to respect the Japanese CPA Law in this respect.***

#### **4. Other issues**

##### **(1) Contradiction with the promotion of competition in the auditing industry**

Auditing of listed corporations in Japan is concentrated among large audit firms. The four largest audit firms in Japan audit more than 80 percent of listed and other corporations pursuant to the Securities and Exchange Law in Japan. We recognize that concentration of auditing on the largest accounting firms is a

global issue.

The Bill includes an amendment of the current CPA Act provision that makes the establishment of audit firms subject to approval by the FSA so that notification to the FSA would be necessary requirement. While the fit and proper test will be continuously imposed on partners of audit firms, this proposed change in the requirement will contribute to the promotion of more flexibility and competition including new entry into the auditing industry through the establishment of audit firms. At the same time, the Bill is designed to strengthen the Japanese auditor oversight system over both approved audit firms and newly established audit firms.

If a newly established audit firm has an SEC-registered issuer as its audited corporation, the Proposal should also subject such new audit firm to registration with the Board. If registered with the Board, such new audit firm could be subject to oversight powers of the Board. Such prospect should be enough of a reason for making such new audit firm hesitant in concluding an audit engagement with an SEC-registered issuer, and would be enough of a reason for not establishing a new audit firm at all.

Therefore, the Proposal would rather encourage concentration of the audit of SEC-registered issuers among the largest Japanese audit firms and would be contradictory to the promotion of competition in the Japanese auditing industry through the establishment of new audit firms. ***Such a problem should be resolved by providing an appropriate exemption from the registration requirement to Japanese audit firms.***

## **(2) Unfounded justification for registration of foreign public accounting firms**

The Proposal indicates that "foreign accountants that participate in the audit of U.S. public companies have long been subject to various U.S. requirements." However, ***we believe this justification for requiring registration of foreign public accounting firms is unfounded.*** The followings are examples :  
**(Auditing in accordance with U.S. generally accepted auditing standards ("GAAS"))**

We recognize that financial statements filed with the SEC are audited in accordance with U.S. GAAS. This is just because the SEC does not accept issuers' financial statements audited in accordance with non-U.S. GAAS standards. Thus, this does not justify registration of foreign public accounting

firms. We would like to note that the FSA can accept financial statements not audited in accordance with Japanese GAAS if consistent with the Cabinet Ordinance of the Securities and Exchange Law.

**(Auditing by an auditor satisfying U.S. independence requirements)**

The FSA requested the SEC to provide an appropriate exemption from the U.S. auditor independence requirements to Japanese audit firms, as shown in our comment letter dated January 10, 2003. The final SEC rule does not reflect this comment. Thus, this does not justify registration of foreign accounting firms.

**(Enforcement action by the SEC)**

As mentioned above, it is the responsibility of the FSA to exercise oversight powers including disciplinary actions against the Japanese audit firms. We do not recognize that the SEC is authorized to take enforcement actions against the Japanese audit firms.

**(SEC Practice Section of the AICPA)**

We recognize that this is just the requirement for the U.S. member firms of the AICPA. Since the Japanese audit firms are not members of the AICPA, this does not justify registration of the Japanese audit firms. The same is true for inspections procedures and file review procedures.

**(Inquiry from the SEC staff)**

There is no legal requirement for the Japanese audit firms that are not associated with U.S. accounting firms to provide information to the SEC staff. If there were cases that the Japanese audit firms positively responded to information requests from the staff, they should be deemed to be on a voluntary basis.

**? . Comments on Proposed Registration System**

The oversight body of the Japanese audit firms is the FSA, not the Board nor the SEC. If the Board needs information on the Japanese audit firms, the FSA is prepared to cooperate in line with the IOSCO Principles as mentioned above. Based on this premise, we would like to make the following comments on the Proposed Registration System.

**(1) Excessive requirements for information**

The mission of the Board is to protect investors in the U.S. securities markets. Thus, *the Board's need for information should be focused on*



***SEC-registered issuers in the U.S. securities markets.***

From this viewpoint, the Proposal includes excessive requirements for information. The following are such excessive requirements, which should not be required.

**(Part III- Applicant's Financial Information)**

The Board should not require information on the firm-wide source of revenue.

**(Part V-Listing of Certain Proceedings Involving the Applicant's Audit Practice)**

The Board should not require information in connection with "a comparable report prepared for a client that is not an issuer." Information should be at least confined to one "in connection with any audit report" as stipulated in Section 102(b)(2)(F) of the Sarbanes-Oxley Act.

In addition, ***the Board should not be an oversight body of the Japanese audit firms.*** From this viewpoint, "Part VIII-Consents of Applicants" is inappropriate. Under Part VIII, the Board requires "consents to cooperate in and comply with any request for testimony or the production of documents made by the Public Company Accounting Oversight Board in furtherance of its authority and responsibilities under the Sarbanes-Oxley Act of 2002." Such a broad power corresponds to the FSA's power for requesting reporting and submission of materials from the Japanese audit firms, and is not acceptable to the FSA.

**(2) Others**

With regard to the issue of the definition of "substantial role", it should be noted that only the issuer (the parent corporation) and its audit firm have information on the amount of "assets or revenues" of the issuer and its "subsidiary or component" and "total engagement hours or fees." It is not feasible for the Japanese audit firms that audit Japanese subsidiaries of an issuer to make calculations as proposed.

**? . Conclusion**

The Japanese auditor oversight system, which has been well established and will be further enhanced as prescribed in the Bill, is designed to achieve the

same goal as the related provisions of the Sarbanes-Oxley Act and the Proposal. ***We respectfully request that the Board will take full accounts of our comments in promulgating the final rules.***

Yours Sincerely,

Naohiko MATSUO  
Director for International Financial Markets  
Financial Services Agency  
Government of Japan