

Opening Remarks for PCAOB Public Meeting,

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Koichiro Kuramochi
Financial Services Agency, Japan

Introduction

Chairman Doty, members and staff of PCAOB, thank you very much for this opportunity to participate in the discussion of auditor independence, objectivity, and professional skepticism. Please be reminded at the outset that the views I express this afternoon are my own remarks and are not necessarily representing those of Japan or the Financial Services Agency (FSA).

With respect to the enhancement of audit quality, we have also had many discussions in Japan for decades and have made a series of reforms to our systems and auditing standards. The steps we have taken on auditor independence, objectivity and professional skepticism include the following:

The Certified Public Accountants Act, our legislation governing CPAs and auditor activities, stipulates principles such as independence, and further prescribes specific requirements for independence. For example, lead audit engagement partners and audit reviewing partners are subject to a five-year rotation requirement with a five-year cooling-off period. All the other audit partners are subject to a seven-year rotation requirement with a two-year cooling-off period. Other examples include stringent restrictions on non-audit services (e.g., consulting work). In addition, the Certified Public Accountants and Auditing Oversight Board (CPAAOB) was established as an independent body in the ambit of the FSA in 2004 and it has been conducting CPA examinations as well as inspections of audit firms. The Japanese auditing standards are set by the Business Accounting Council, which is established under the FSA.

Current Initiative in Japan: Enhancing Auditors' Professional Skepticism and Auditors' Response to Accounting Frauds

Furthermore, we are currently engaged in revising the Japanese auditing standards to enhance auditors' professional skepticism as well as auditors' response to accounting frauds.

Audit Committee of the Business Accounting Council started deliberation on this topic in May 2012, aiming at concluding the discussion in about one year.

I personally expect following matters would be covered in the deliberation:

- Reaffirming the importance of professional skepticism
- Clarifying auditors' responses to accounting frauds
- How the firm-level involvement should be articulated
- Enhancing auditor's report by including additional information (e.g., on audit risks)
- Improving education and training to deal with accounting frauds
- How audit evidence should be evaluated
- How auditor should modify audit planning to address a revised assessment of risk of material misstatement or an identification of fraud risk factor

Japan's Past Initiatives to Enhance Auditor Independence

The PCAOB's concept release discusses audit firm rotation from various aspects. We also debated over potential audit firm rotation six years ago. At that time, there was an accounting fraud incident committed by a large listed company, and the company's auditor issued a clean opinion, although the audit partners had knowledge of the fraud. In response to the incident, we deliberated on how auditor independence should be enhanced. After a thorough deliberation, the stringent partner rotation I mentioned earlier (five-year rotation and five-year cooling-off period), rather than audit firm rotation was introduced, because of the following reasons:

- (i) Disruption of auditors' accumulation of knowledge and experiences
- (ii) Costs associated with the change in auditors, on the auditors' as well as issuers' sides
- (iii) The fact that mandatory audit firm rotation has not been put in place in major developed countries
- (iv) Practical difficulties in audit firm rotation due to limited number of large audit firms

Concluding Remarks

As a result of the financial crisis, we understand that various debates are in progress with regards to audits in the U.S. and Europe. Although direct effects of the financial crisis were relatively limited in our country compared with the situations in the U.S. and Europe, Japan also experienced the burst of the bubble economy in 1990s and subsequent collapses of large companies. Prompted by such incidents, we have debated over the role of audits for decades and implemented various changes in our systems. We consider that the measures responding to accounting frauds should evolve as accounting frauds become increasingly scheming and complicated. At the same time, however, we believe that exercising professional skepticism should be the foundation for the financial statement audit.

We understand that institutional measures such as audit firm rotation are debated when audit failure occurs, as we also have similar experiences. However, when reviewing the established system, we believe that it is important to have cool-headed discussion, carefully exploring whether or not the possible change would truly have positive effects on professional skepticism or accumulation of knowledge / experiences of auditors.

Given the globalization of corporate activities, audit systems are getting increasingly prone to global influence, and PCAOB's decision could have certain effects on Japanese companies and Japanese audit firms. I appreciate this opportunity to express my views today and I hope that PCAOB gives due consideration to various views and reaches an appropriate decision at the end.

Thank you very much.