Japanese accounting profession in transition

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Abstract *This study describes the history and present conditions of the accounting profession in Japan. In particular, the crises of the 1990s have highlighted the fact that Japanese CPAs operate under quite different institutional arrangements from their Anglo-American counterparts. In addition, there are no equivalent Japanese bodies to the British Chartered Public Finance Accountants and Chartered Management Accountants for public sector or management accountants. This paper identifies factors behind such differences. We discuss three points at issue: currently existing problems with auditing in the private sector, the long absence of external auditors in the public sector and the reason why the accounting profession has not been formed in a management accounting field. Finally, we point out issues involving the Japanese accounting profession that might be tackled in the future.*

Introduction

In Japan, certified public accountants (CPAs) and certified public tax accountants are recognised as part of the accounting profession. In addition, one may pursue certain specialist qualifications, namely, systems auditor (auditor of information systems) and construction industry accounting controller (processor of accounts unique to that industry). However, such controllers and systems auditors lack several of the essential characteristics of a profession, such as skill based on theoretical knowledge, professional association, institutionalised training, testing of competence, licensing, work autonomy, a code of ethics, and self-regulation (Perks, 1993, p. 2). As such, there is little social awareness of systems auditors and construction industry controllers and it cannot be said that they have established their status as professionals.

In the UK, major accounting profession divisions include not only chartered accountants and chartered certified accountants, but also chartered public finance accountants and chartered management accountants. Chartered public finance accountants conduct accounting operations and auditing of corporations in the public sector. In Japan no equivalent professional accounting position exists. British chartered management accountants offer management accounting services within corporations; again, there is no

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equivalent in Japan. Moreover, it cannot be said that Japanese CPAs or certified public tax accountants carry out auditing for corporations in the public sector or provide a management accounting service.

CPAs and certified public tax accountants both came into being in Japan as part of the reforms carried out by the Allied Occupying Forces in the post-World War II era. The process of their formation is completely different from that in other countries. Furthermore, when thinking about the problems of the accounting profession in Japan, one should also take into consideration the conditions that were very different from those in Western countries. For example, external auditors for corporations in the public sector did not exist in Japan for a long time. Within Japanese manufacturing, on the other hand, accounting functions became dispersed, being delegated to employees who were not in charge of accounting, as seen for example in target costing activities. These themes will be pursued below.

Until recently, a variety of organisations in Japan have carried on their business under the protection of the so-called convoy-group method[1]. Japan's long-running and deep-seated economic recession, extending from the early 1990s to the present, has affected its economic and social system. The convoy-group method has been one of the casualties, having lapsed into dysfunction in many different fields. Many banks went bankrupt and the myth of the immortality of banks has also collapsed. Fraud and abuse came to light not only in financial circles but also in government organisations. McKinnon (1984a) notes that Japanese social relationships, which are based on interdependence rather than on independent, arms-length relationships, led to *amae* (psychological dependence). This cultural determinant sometimes brought about corner-cutting in audit work. The resulting scandals revealed the poor state of actual audit practice. Public criticism exploded, leading to a demand for a new national system.

The Japanese government's economic reforms have been labelled financial big bang[2]. The intention of this reform is to part with the convoy-group method and to establish a new social system based on self-responsibility principles. No psychological dependence will be accepted under the new system. So far there has been little censure against auditors for the fraud and abuse by management, but recently, some auditors have been sued by the shareholders of a bankrupt corporation for overlooking management's fraud. Not only a reconsideration of accounting practice itself but also the ethics of those people involved in accounting have become important issues. The environment and status of professional accountants is surely changing.

To date, the Japanese profession has received relatively little attention from scholars, Japanese or otherwise (as noted in the next section). The purpose of this paper is to arouse scholarly interest in the Japanese profession by describing its history and the present conditions faced by it. In particular, the paper highlights features of the Japanese institutional framework that differentiate the Japanese from the Anglo-American accountant. A number of these features have been thrown into the spotlight by the present crisis in

Japan. To achieve its purposes, the paper will deal with the following matters. First, it will elucidate the stages in the formation of the accounting profession in Japan. Then it will discuss auditing in the private sector, and consider the problems involved in auditing by CPAs. It will then point out the lack of accounting professionals in the public sector and consider why external auditors have not permeated the system. Finally, the paper investigates why the accounting profession has not built up a management accounting field, highlighting the dispersal of accounting functions as an explanatory factor. During the course of the discussion currently existing problems will be clarified. The conclusion will pinpoint some issues that should be tackled in the future.

Prior research

There is relatively little Japanese-language research concerning the accounting profession in Japan. We can give Miyagami (1980) and Chiyoda (1987) as examples of reasonably extensive work, but since the Japanese CPA system was introduced using the American CPA system as a model, the contents of both works focus on the accounting profession in the US. We can really say that the work by Hara (1989) is the only comprehensive research concerning the formation of the accounting profession in Japan. There is also the work by JICPA Keijikai (1997) written about current conditions and important issues in the CPA system.

On the contrary, we can find many English-language examples in the literature concerning the accounting profession and its practice in Japan. Watanabe (1939) introduces the status of the Japanese accountancy profession in prewar times and is probably the first to introduce the status of professional accountants in Japan. Murase (1950) introduces the newly established Certified Public Accountant Law of 1948 as part of the economic reform by the Allied Occupying Forces after World War II. Essene (1953) also illustrates the reform, focusing on the cooperatives' accounting system in postwar Japan. Murase (1962) provides a brief history and the then status of the accounting profession in Japan. Cooke and Kikuya (1992, ch. 7) and Ballon and Tomita (1988, ch. 12) devote a whole chapter to the Japanese accounting profession. Both mainly deal with the history and state of the Japanese Institute of Certified Public Accountants.

McKinnon (1984a) focuses on the cultural aspect of Japanese social relationships that has had a serious impact on auditors' independence. Harrison and McKinnon (1986) describe accounting change in Japan using a framework based on the theory of social systems change. In their work, the mechanism of audit change, influenced by cultural determinants peculiar to Japan, is clarified. McKinnon (1986) gives a more comprehensive study of accounting change in Japan and devotes many pages to the Japanese accounting profession.

Jinnai (1990) points out that the influence of the Japanese accounting profession on the economy as a whole is relatively weak in comparison with the Western accounting profession. He explains that a considerable percentage of the shares of listed companies are typically owned by institutional investors and that this relation of capital ownership has affected accounting practice. Consequently, this has been a major reason for the slow development of accounting professional bodies in Japan (pp. 14-5).

Though not directly dealing with the Japanese accounting profession, Ballon and Tomita (1988), Oguri and Hara (1990), Nobes (1991), Fujita (1991) and Someya (1996) give a detailed explanation of Japanese accounting regulation and practice.

The formation of the accounting profession in Japan

It is said that Western-style double-entry bookkeeping was first introduced into Japan in 1865 during the Edo Period (Shimme, 1937, p. 291). It was properly adopted after the carrying out of the National Bank Regulations in 1872 and the publication of *Ginko Boki Seiko* (Bank Bookkeeping Method) by the Ministry of Finance (Someya, 1996, pp. 12-4). In 1878 stock exchanges were opened in Tokyo and Osaka, and then many joint stock companies were established in rapid succession. In 1890 the old Commercial Code was promulgated, making it an obligation to produce and show to the public an inventory of assets and a balance sheet. The establishment of this Commercial Code was the factor that created professional accountants in Japan.

The Tax Law also played a major role in the birth of professional accountancy in Japan. Income tax was inaugurated in 1896, leading to the appearance, particularly in Osaka, of tax agents who made their living giving advice related to taxes[3]. In this way, two types of accountant – one who undertook corporate bookkeeping and account closing on behalf of companies, and one who acted as a tax agent – appeared in Japan, almost at the same time, as a natural phenomenon.

For corporate accounting, the Commercial Code made auditing by a statutory auditor obligatory. A statutory auditor's role was similar to that of an internal auditor in companies in many Western countries and she/he was not required to be a professional accountant (Cooke and Kikuya, 1992, p. 17). In practice they were auditors in name only, and did not carry out an auditor's actual functions. In 1909 dishonest accounting practices by Dai Nihon Seito Co. Ltd were detected. This was known as the Nitto Inc. case. It involved the coming to light of window-dressing accounting and bogus dividends that were effectively bribes to members of the Diet. The result was a sudden fall in the price of shares, resulting in the company's bankruptcy. Sir Claude Maxwell MacDonald, the British Ambassador to Japan at the time, pointed out the need for public accountants in Japan (Murase, 1962, p. 88). This incident prompted a reaching out to introduce the same kind of auditing by accountants as existed in British corporate law.

The Ministry of Agriculture and Commerce, which was the competent authority at the time, immediately carried out surveys on the accounting systems in the UK, the US and Europe. A summary of this research was published in 1909 as '*A Report on the Survey of Certified Public Accountant*

Systems. At the same time, the movement within the accountancy world for the establishment of a Registered Accountant Law was swelling. A first draft was prepared in 1914, but it was abandoned before discussions could be completed. Subsequently, drafts were proposed and abolished no less than eight times. It took a full 13 years before the Registered Accountants Law was finally established in 1927 (Hara, 1989, pp. 51-101).

The reason that the early drafts were abolished was that in Japan at that time, there was not yet an atmosphere in which auditors would be accepted. Hardly any accountants who had the temperament to serve as external auditors existed. Therefore, there were doubts about the actual effectiveness of the proposed law. The Registered Accountants Law eventually produced, after many drafts and revisions, emerged as something very different from the British accounting system which had been the original aim. It was quite slipshod. There were no regulations to protect professional accountants, nor regulations about monopoly. Anyone who had studied accountancy at university or college, or who had at least one year of practical accounting experience, could register as an accountant.

Ignited by the passing of the Registered Accountants Law in 1927, the desire to legislate the tax agent industry in the same way grew. World War II provided the opportunity for this legislation to be passed. Japan entered the war in 1941 and conducted wartime tax raising. In order to respond to the requirement of the national government policy to proceed with smooth tax reforms, the Tax Agents Law was passed in 1942.

Following the defeat of Japan in World War II in 1945, all kinds of reforms were undertaken as part of occupation policy of the General Headquarters of Allied Occupying Forces (GHQ). One of the policy's main pillars was economic reform, centring on the dissolution of the *Zaibatsu* (financial combines). This meant promoting the democratisation of securities and the introduction of foreign capital, and putting in place the legal arrangements needed to accomplish this. The Securities and Exchange Law was passed in 1948, and disclosure of financial statements and an auditing system were introduced to protect investors[4]. Problems arose in the introduction of the auditing system, because professional auditors did not exist. The occupation forces considered registered accountants to be inadequate for the new regulatory environment (Fujita, 1966, p. 67), and so a new Certified Public Accountants Law came into force in 1948. A special examination was introduced for registered accountants who had a minimum of three years of practical experience. Japanase CPAs came into being in this way. Accordingly, the existing accounting system was abolished. Until then, many accountants had not even done auditing procedures. In short, during the post-war period of confusion, a Western-style auditing system based on CPAs was suddenly established by an occupying force.

The GHQ economic reforms included the tax system. In 1949 a group of envoys, headed by Carl S. Shoup, who at the time was a professor at Columbia University, came to Japan to give advice concerning the tax system. Based on this advice, the tax system currently in force, which features progressive taxation centred on direct taxes, was established. Moreover, this advice pointed to the existence of low-standard tax agents as one cause of the confusion that arose in the postwar tax administration. As a result of this counsel, the tax agent system was abolished and the Certified Public Tax Accountant Law was established in 1951, bringing us to the present day.

In this complicated, convoluted way, CPAs and certified public tax accountants came into existence. Both groups installed a relatively difficult national examination, gained regulations to protect those professional accountants who were engaged in monopolised businesses like auditing and taxation, and established their own specialised organisations. Thus CPAs and certified public tax accountants were able to establish their status in Japan as an accounting profession.

Auditing in the private sector and CPAs

As mentioned in the previous section, the corporate financial disclosure system and the auditing system in the private sector were not organised along Western lines in Japan until after World War II, so they have a history of about 50 years only. These systems were set up as part of the economic policies that concentrated on dissolving the *Zaibatsu*, which had single-handedly controlled Japan's financial and industrial worlds. Thus the Japanese accounting system was organised under rather different conditions from those in other countries.

The main reason was that a consolidated accounting system – which takes as its premise the existence of corporate groups – was not introduced. The reason for this was that because of the dissolution of the *Zaibatsu*, corporate groups ostensibly no longer existed. However, there was more emphasis on indirect financing from banks than on direct financing from the securities market, so in actual fact, corporate groups centred around banks, in the old *Zaibatsu*-style, continued to exist. Since a consolidated accounting system was not introduced, many corporations kept repeating incomprehensible dealings with their subsidiaries when it came to account-closing time. Actions very close to, though not exactly the same as, profit manipulation came to be standard practice. Later, this became fertile ground for creating window-dressing accounting using subsidiaries.

In addition, few CPAs had any experience of auditing operations. The reason for this has already been explained in the previous section. Since there were not enough auditors, the enforcement of auditing by CPAs was limited to those few corporations that were listed on the stock exchange and therefore required to do so by the Securities Exchange Law 1948. Relatively large-scale corporations were included among those corporations that did not undergo auditing by CPAs. Also, for small and medium-sized corporations, only auditing by internal auditors was required under the Commercial Code. Many internal auditors were people who had once worked for the corporations in question and lacked independence, had limited knowledge of accounting, and were auditors in name but not in substance. By leaving the low-standard internal auditing system in place, the system of corporate checking was loosened, and it became a hotbed of questionable accounting practices.

Finally, at the time, audit firms did not yet exist, so auditing activities were conducted by individual CPAs. There were cases where several CPAs audited a corporation in co-operation with each other, but there were also many corporations that drew up auditing agreements with individuals. Realistically, the reason that these kinds of auditing agreements were drawn up, in spite of the fact that it is impossible for an individual CPA to do all of the auditing for a major corporation, was the deficiency in the prevailing system, whereby the establishment of audit firms was not yet permitted. For an individual CPA, the substantial auditing fee from a large corporation would be very attractive. This was undeniably a major cause of the threat to CPA independence, which arose from the desire not to lose clients[5].

There were other problems as well. Firstly, as a preliminary stage, experimental auditing was carried out from 1951 to 1957. The accountants built up their practical experience through repeated trial and error. After a trial period of about six years, full-scale auditing operations began in 1957. The transition was made without any major trouble for some time, and it seemed as if the auditing system was taking root firmly. In fact, window-dressing accounting, for the purpose of obtaining secure dividends, was rampant. Window-dressing accounting did not appear on the surface because Japan was then in a period of rapid economic growth and corporate expansion was proceeding smoothly (JICPA Keijikai, 1997, p. 11).

From about 1963, the Japanese economy suffered a recession, and in 1964 and 1965 many corporations went bankrupt, thus exposing the details of the window-dressing accounting that until then had been largely unknown. One example was the Sanyo Special Steel Co. case, in which large-scale window-dressing accounting using subsidiary companies had occurred. Moreover, it became obvious that the CPA responsible for auditing the company, although aware of the truth, had proffered a clean opinion. This case became a major social issue.

With this case as a starting point, the consolidated accounting system was introduced and auditing by individuals was banned. Audit firms were established and a complete transfer from individual auditing to collective auditing took place. The Japanese Institute of Certified Public Accountants, with which the great majority of CPAs were affiliated, became a special corporation, and it became obligatory for all CPAs to belong to the Institute. Also, since the incompetence of internal auditors had been exposed once again, there was a strengthening of the internal auditing system[6]. Looking at all these related reforms and the course of events afterwards, it is starkly obvious that Japan's professional auditors encountered new problems.

Firstly, the Japanese Institute of Certified Public Accountants became a special corporation. This occurred as part of the government's response to the Sanyo Special Steel Co. case. The CPAs responsible for auditing in that received the most serious administrative punishment possible – the cancellation of their registration. The government, however, did not stop there. The Ministry of Finance, which had abandoned its belief in the power of the Japanese Institute of Certified Public Accountants to purge itself, reorganised the Institute as a special corporation. A special corporation is one that has been deliberately established by the government with a specific strategy in mind, and is extremely closely controlled by the government. By this means, the Japanese Institute of Certified Public Accountants lost the means to reform and improve itself. The effectiveness of reform would depend on governmental officials rather than the professional accountancy community.

Secondly, the reforms of the accounting system were very slow in producing any progress. It was not until 1974, ten years after the chain of window-dressing accounting cases occurred, that auditing by CPAs was enforced by commercial law in order to strengthen the internal auditing of major corporations. These reforms of the accounting system were all determined by government deliberations, but all of these meetings were secret conferences in which all proceedings were closed. CPAs participated hardly at all in these reforms.

Thirdly, in spite of the strengthening of auditing by CPAs and the reforms of the accounting system, every few years, more window-dressing accounting cases related to corporate insolvencies came to light. Included among these were cases where there were even false documents that had been made by people fully aware that they were based on the addition of imaginary profits, using related companies. Nevertheless, the accountants responsible got off with relatively light punishments, such as having their business operations stopped. Furthermore, in cases of dishonest accounting by business managers, there was basically no attempt made to track the responsibility of those who had been unable to detect the dishonest practices, and government authorities, which were supposed to strengthen auditing practices, gave their tacit approval.

In the midst of these conditions, after the bursting of the bubble economy in the early 1990s, Japan sank into an unprecedented depression. In 1996 many housing loan companies (*Jusen*) broke down (Hall, 1998, pp. 167-71), while in 1997 numerous construction companies collapsed. Eventually, this inflamed the collapse of the Hanwa Bank and the independent closing of business by Yamaichi Securities Co., and led to the bankruptcy of the Long-Term Credit Bank of Japan in 1998. Amazingly, in all these cases, all the different kinds of financial records had been kept by CPA audits, and in all cases there had been clean opinions. As "clean" corporations collapsed one after another, criticism of auditing exploded dramatically.

In an article in the 13 October 1997 issue of *Nikkei Business* magazine, the following three factors were cited as being the underlying causes of these conditions:

(1) the lack of any competition in the accountancy field;

(2) the strong protection received from the Ministry of Finance, the competent authority in charge of auditing; and
(3) the lack of any arrangements to pursue the responsibility of auditing corporations and accountants.

The relationship with the Ministry of Finance, the competent authority, was considered particularly problematic. Among the Japanese Institute of Certified Public Accountants and auditing corporations are many former members of the Ministry of Finance, who tend to occupy the positions of president or chairman and exert a strong influence. As one CPA testified, "if we go against the Ministry of Finance, who knows what kind of harassment we'll suffer?" (*Asahi Shimbun,* 19 February 1997). Therefore, they had no choice but to give a clean opinion for those financial institutions that ended up collapsing, in accordance with the wishes of the Ministry of Finance.

No punishment was meted out to CPAs when corporations that had been given a clean opinion failed because it was the Ministry of Finance itself that had instructed that a clean opinion be given in the first place. If, for example, the Ministry of Finance said that something was red, even if it was really white, the CPAs would declare that it was indeed dyed red. In the 26 November 1997 issue of the *Financial Times* newspaper, an article made fun of this state of affairs, dubbing it "Wonderland accounting".

Strangely enough, 1998 was the 50th anniversary of the CPAs system in Japan. In connection with the celebration of this special event, the Japanese Institute of Certified Public Accountants made the following declaration of resolution: "We Certified Public Accountants, believing in the absolute necessity for trustworthiness and the open disclosure of information, will strictly protect our independence, being unmoved by any kind of pressure, and will make ceaseless efforts to improve ourselves, maintain absolute social trust, and contribute to creating a freer, more just society." In order to make the contents of this declaration of resolution a reality, CPAs must be strictly responsible for their actions and practices and resolutely enforce reforms, as well as redeem the negative assets they have accumulated up until now. Whether or not society gives them a clean opinion will depend on the future actions of the accountants themselves.

The accounting profession in the public sector

There have been relatively few opportunities to explain the role of the accounting profession in Japan's public sector. We can give Yoshida (1980) or Kokubu *et al.* (1998) as examples of work. Yoshida (1980) introduces the development of public sector accounting in Japan. Kokubu *et al.* (1998) deal with recent reform of public sector financial management in Japan. Both, however, give little detail regarding the accounting profession in the public sector. The reason for this is that in Japan, the accounting profession has played hardly any role at all in the public sector. Of course, accountancy is needed in the Japanese public sector, which, in turn, holds an extremely important position in the country's economy.

Japan has a very large economy and its budget is enormous. Moreover, Japan's local government bodies are larger in scale than those of many Western countries, and also more numerous. There are a total of 47 prefectures, Japan's equivalent to the states of America. Moreover, Hokkaido, for example, the prefecture with the greatest land area, includes 212 cities, towns and villages. Naturally, all local government bodies have many employees and hold assemblies. And since almost all of Japan's major corporations have their head offices located in either Tokyo or Osaka, the local government bodies in areas other than these two cities are both the largest employers and the organisations with the biggest budgets. Furthermore, these local government bodies have many public corporations. Almost all of Japan's waterworks are operated by each city, town or village, and many cities, towns and villages manage public transportation, while some operate gas systems. Two prefectures run public transportation systems themselves, and several prefectures operate horse racing (see Kokubu *et al.,* 1998, for detailed analysis).

However, in the same way as Japanese private corporations, it is rare for these local government bodies to employ accountants to be responsible for accounting. In principle, all employees in local governments are selected by means of examinations, but these examinations do not touch on knowledge of accountancy. Accordingly, whether for good or for bad, employees assigned to the accounting section of local governments learn their work from their predecessors and, in some cases, have to suddenly start studying accountancy. And frequently, several years later, just when they have gained a thorough understanding of their work, they are transferred to another section.

The closing of accounts in the public sector is reported to the assemblies and checked. This is the same in most countries and is not unique to Japan. What is different is that in Japan, an audit report by an independent auditor such as a CPA is not attached to the account closing report. However, this does not mean that in Japan there is no auditing of accounts in the public sector. For national accounts, the Board of Audit of Japan (BAJ) conducts auditing[7]. Auditing by the BAJ covers all the organs included in the national budget. Accordingly, local government bodies, which are included in the national budget, undergo auditing by the BAJ. In fact, auditing by the BAJ is carried out in the same way as the 3E auditing in the US and the Value-for-Money (VFM) auditing in the UK. However, in Japan it is not specially named in that way. As a general rule this auditing is conducted appropriately. The problem is that the number of people involved is so strikingly few, considering the number of things to be audited.

The BAJ is an organ that is separate from other national organs. However, the BAJ is of course itself a national administrative organ. For this reason, there is disagreement as to whether or not it is an independent auditing organ. BAJ staff are employed to do auditing, but recruiting is done in the same way as for general public officials. Accordingly, it is not a requirement that staff at the BAJ be CPAs.

Local governments also have their own auditing organ, called an audit commissioner. In the case of prefectures, four audit commissioners are usually engaged[8]. In many cases, two of these are chosen from among the members of the assembly, and the other two are chosen from among qualified candidates. However, in reality these latter two people are almost always selected from the ranks of former staff of administrative divisions.

The audit commissioners have an office and their own staff, but the number of such staff is insufficient. Moreover, the staff members are frequently transferred from other administrative divisions. So both the audit commissioners themselves and their office staff are not required to be experts in accounting.

Doubts arose in Japan regarding auditing by local government bodies, and hit their peak in 1996. Starting with Hokkaido, dishonest accounting practices were discovered in a number of prefectures. Moreover, in several such cases, the audit commissioners and their offices had themselves been involved in the illegal activities. As a countermeasure against this problem, the external auditing system was reintroduced. This involved adding an external expert to the existing audit commissioners, a person who was not an employee of the self-governing bodies and who had to do the auditing.

An external auditor is by definition independent; that is the reason why someone who is an accountant by profession is required to be the auditor (Jones and Pendlebury, 1996, p. 218). This external auditor must be a CPA, a certified public tax accountant or a lawyer. The fact that it has become acceptable for a certified public tax accountant or a lawyer, as well as a CPA, to be chosen for this external auditor position reflects the present reality in Japan of the trend to place less importance on expertise than on disposition and independence. Also, the fact that certified public tax accountants, who have no special knowledge apart from taxation, have come to be selected is a result of the political power of the certified public tax accountants, who are far greater in number than CPAs or lawyers.

However, only one external auditor is selected per prefecture. Furthermore, it is not permissible to employ an audit firm. As a result, there are doubts as to how effective this new system will actually be.

Several reasons why attention was not paid in Japan to professional accountants in the fields of public accounting and auditing can be suggested. Firstly, there is the small number of CPAs. The Japanese CPA system has a history of 50 years. Apart from certified public tax accountants, who are experts on taxation, the only accountants in Japan with professional expertise are CPAs. Compared to the equivalent US examination, the Japanese CPA examination is difficult, and there is a dramatically smaller number of successful candidates. Given this situation, CPAs had no choice but to focus their attention on auditing for listed companies first of all.

Secondly, Japan's public sector is extremely large – not only the central government, but Japan's local government organisation also. With their limited numbers, and working in a limited amount of time, it was extremely difficult for CPAs to audit the whole system.

Thirdly, the trust of the people in the public sector is an issue in itself. Japanese people often severely criticise the public sector, which has such powerful authority. Despite this, they basically trust people in the public sector, and those engaged in the public sector try to respond to that trust. The people do not demand accountability of the public sector, but rather, in return for giving what could be called their absolute trust, they want responsibility. In other words, just as parents blindly protect their children, the public sector tries to protect the people, with limitless responsibility. In these conditions, there is little possibility that auditing using verification of the execution of accountability as a tool would be considered necessary. This understanding tallies with Cooke (1994, pp. 46-7), who proposed the opposing concepts of expertise and legal regulations.

These conditions are changing. As already mentioned, the detection of dishonest dealings in local self-governing bodies revealed that local governments had betrayed the trust of the people and were not fulfilling their responsibilities. As a result, there were discussions about the importance of disclosure and accountability, and the external auditing system was introduced. However, in order for professional accountants to play a central role in this external auditing system, it is essential both for their numbers to increase and for them to gain socially recognised independence.

The dispersion of management accounting functions

The 1990s economic crisis has not resulted in credibility problems for Japanese management accountants of the kind faced by CPAs. Partly, this is because management accountancy in Japan is organised on a completely different basis from both private sector auditing in Japan and management accountancy in the West. In the West, professional bodies such as the Institute of Management Accountants (IMA) in the USA, the Chartered Institute of Management Accountants (CIMA) in the UK, and the Society of Management Accountants in Canada (SMAC) provide training and credentials for management accountants. In Japan, however, equivalent groups do not exist. Or rather, to be more accurate, we should say that there are no associations or groups that can be joined only by those who have become eligible by passing a qualifying examination of the same level as the CPA examination. However, to come to our conclusion in advance, we cannot simply compare Western corporations, in which the function of management accounting is concentrated in specified individuals such as controllers or chief financial officers, with Japanese corporations, where this function is dispersed among related organisations.

Although in Japan the management accounting profession does not exist as a body with qualifications, it is too simple to reach the conclusion that there is no management accounting function in Japanese corporations, or that it is not considered important. Concerning this debate, if we look at the fact that advanced systems such as target costing and *kaizen* costing emerged from the business practices of Japanese corporations, that mistake becomes obvious. In order to study the special characteristics of management accountancy in Japan, it is necessary to analyse not only systems of calculation but also management systems in the context of organisational forms, including responsibilities and relationships of authority, as well as the social systems set up to operate these things smoothly (Okano, 1995). Below, we will investigate the background that produced the management accounting practices of Japanese corporations after World War II and consider the dispersion and integration of accounting functions, centered on target costing.

The following are the special features of management accounting practices in postwar Japanese corporations[9]. With the background of lifelong employment and pay based on ranking according to length of service, it was usual to have in-company training focus on on-the-job training (OJT) and manager education (Odaka, 1993). In the same way that Japanese-style production systems, beginning with quality control, came into being, systems unique to particular corporations also emerged in management accounting practices.

As a way of supplementing these, various groups and organisations, such as the Japan Productivity Centre (the current Japan Productivity Centre for Socio-Economic Development), the Kansai Productivity Centre, the Japan Chamber of Commerce and Industry and the Industrial Accounting Association, were established by industry and the Ministry of International Trade and Industry, as well as by national and local public bodies. Educational organs such as universities and advanced technical schools participated directly, while members of the groups already mentioned participated indirectly. In this context, voluntary bodies of practitioners did not emerge to take a leading role in fostering management accountancy, as had occurred in Britain with the Institute of Cost and Works Accountants and in the USA with the National Assocation of Cost Accountants.

At the organisational level, the controller system was introduced into Japan before the war. But it was the Industrial Rationalisation Discussion Council's "Concerning Internal Control for Corporations" (July, 1951) which provided the opportunity for the main body of Japanese corporations to actually introduce the system (Kato, 1991). NEC, which had a joint venture with Western Electric Co., had the position of controller as part of its accounting staff from the time of its establishment, as did the Matsushita Electric Industrial Co, Ltd, which was the first Japanese corporation to set up divisional organisations. Accounting staff were positioned as staff in charge of management accounting (controllers) and were under the supervision of the head office. Matsushita's accounting staff system, which is kept outside the control of each enterprise division head, is still in operation today (Sakurai, 1997). However, the functions and responsibilities of controllers or management accountants have been dispersed amongst persons-in-charge at each division[10].

At the very root of this lies cross-functional management, one of the fundamental concepts of Japanese-style total quality control (TQC). By defining quality, cost, reliability, delivery time, etc. as *kinou* (function) and having each organisation's duties overlap, cross-functional activities are created. In other words, it is an arrangement that sees the relationship between responsibility and person-in-charge as being a loose one. By making all the employees committed while their work itself overlaps, it develops group responsibility[11]. This special character appears straightforwardly in the unique systems that have been developed to manage the tense relationship between the product manager and the function manager. We can call this system *Shusa-Seido* (chief engineer system), which seems similar to, but is actually quite different from, the Western-style product manager system or the brand manager system. In the product development process, the chief engineer performs some of the functions not only of the design and process engineer, but also of the product manager, sales manager, and controller (or management accountant). Where functions and responsibilities are divided up in this way, there is little scope for the emergence of a singular "management accountant" who can be organised into a coherent, specialised, professional grouping of management accountants.

Concluding remarks

We have described the history and state of the art of the accounting profession in Japan. As the above discussion shows, the development of the accounting profession in Japan is still slow and lags far behind the profession in the West. Only two major groupings of professional accountants (CPAs and certified public tax accountants) are socially recognised. Their emergence is hardly the natural product of Japanese history. Rather, they arose as a component of the economic reforms of the Allied Occupation Forces. They have been protected in their work and fees by the social and economic system and have been content with the status quo. It seems that they chose active obedience to government authorities rather than struggle to obtain effective power or control over their work. Consequently, they have not had the authority to issue accounting standards, and even the reform of the body itself has been carried out under the leadership of the government. The Japanese accounting profession, especially the CPAs, have failed to win their independence from government authorities.

As McKinnon (1984a) shows, there are also some difficulties with accountants being independent from client companies, which are attributed to cultural factors. Japanese social relationships are based on group consciousness and interdependence. In this situation, auditors have a tendency to overlook fraud and abuse. This tendency has sometimes given rise to economic scandals such as the Sanyo Special Steel Co. case. It is certain that individual auditors must change their consciousness about independence. But it might also be true that we really need the reform of social relationships based on interdependence.

In the public sector, an accounting profession has not been formed. Rather, the governmental institution, the BAJ, conducts auditing of national accounts. Local government bodies are included in the national budget and therefore undergo auditing by the BAJ. The existence of the BAJ prevents the accounting profession forming in the public sector. Recent scandals involving local government bodies such as Hokkaido prefecture raised serious doubts regarding the auditing of one governmental institution by another, and highlighted the need for auditing by external auditors. However, there are not sufficient numbers of auditors and CPAs have lost confidence. In order for professional accountants to play a central role in the external auditing system, it is essential both for their numbers to increase and for them to gain socially recognised independence.

In the management accounting field there is no accounting profession like those in the West. Generally, in corporations in the US and Europe the function of management accounting is concentrated in specified individuals, for example controllers. Moreover, since job-hopping occurs frequently, management accountants as a profession are demanded by society. In contrast to this, for Japanese corporations, where the functions of management accounting are dispersed among various related organisations and promotion within the company or *Keiretsu* companies is usual, there has been no particular necessity for professional management accounting to attain independence.

So far, there has been relatively little awareness of the role of the accounting profession amongst the Japanese people; meanwhile, the Japanese economy has been growing continuously. But Japan's deep and long-term recession in the 1990s reveals various problems in accounting and auditing practice. In order to restore confidence, the accounting profession must understand the real meaning of independence and public practice and grapple to obtain autonomy.

Changes in accounting and auditing practice are now underway and it is therefore still uncertain what these changes will bring about. Further analysis of this reform might be entrusted to future researchers. For example, it would be useful for the current reforms to be analysed using the framework of social change applied in Harrison and McKinnon (1986). It would also enable us to properly evaluate these reforms in relation to the transition of the accounting profession in Japan.

Notes

1. The convoy-group method is a governmental policy mainly applied to regulate and protect finance businesses. For example, an interest rate for deposits might be fixed at a low level by a governmental authority so that weak banks can survive. Strong banks must follow the line and as a result all banks can be profitable. Weak banks are protected as if the main ship had an escort of destroyers.
2. The reforms are divided into the following groupings: (1) those designed to expand user choice; (2) those designed to improve the quality of service provision and to promote competition amongst intermediaries; (3) those designed to ensure the development of an "easy-to-use" market; (4) those designed to ensure the establishment of a "fair" market: and (5) those designed to help preserve financial stability in the face of financial reform and structural upheaval (Hall, 1998, p. 139).

3. It is said that the first accountant's office in Japan was opened in the city of Osaka in 1907 (Murase, 1962, p. 88). At the time there was nothing like an examination system, and there were many people who were not properly qualified. Therefore, in 1912 Osaka Prefecture enacted the Taxation Spokesman Supervising Regulation. This was Japan's first ever regulation concerning professional accountants.
4. The Japanese Securities Exchange Act was introduced almost entirely as a translation of the existing American laws, the Securities Act of 1933 and the Securities Exchange Act of 1934.
5. McKinnon (1984a) also points out that cultural determinants in Japan also cause a threat to the independence of an auditor.
6. On the application of consolidated accounting in Japan please see MnKinnon (1984b) and Lowe (1990).
7. In Japanese, this is not called *kansa* (audit) but *kensa* (inspection). In Japanese, the word audit or auditing is usually translated as *kansa*. However, the formal Japanese name of the Board of Audit of Japan is *Kaikei Kensa-in*. This means that the word audit is not contained in the BAJ's formal Japanese name. The BAJ itself translates the word *kensa* into audit in English, but usually *kensa* is understood as the same word as check or inspection in English.
8. They call themselves simply auditors.
9. We can see the influence of the West in the principles of cost accounting for the army (1939), navy (1940) and manufacturers (1942) made by *Kikakuin* (the Planning Institute), and in the postwar cost accounting standards of 1962. These contributed to the establishment of high-quality cost calculation standards. The cost accounting standards of 1962 were unofficially circulated to interested groups as a Temporary Draft in 1957, having previously taken the form of an unpublished First Temporary Draft in 1955. The 1957 draft had a strong flavor of managerial accounting standards about it, but instead it ended up as a financial accounting standard dealing with long-term profit and loss calculation (Tsuji, 1977). However, we should bear in mind that it was not that the usefulness of managerial accounting standards themselves was denied.
10. Toyota is another suitable case in point. Okano (1995) traces the historical development of cost management at Toyota Motor Coproration. By providing a detailed analysis of cost maintaining, *kaizen* costing, and target costing at Toyota, Okano examines the relationship between organisational reforms and management accounting practices.
11. Formally, responsibility and authority are allocated to the person in charge of each division or section. However, in most Japanese companies responsibility is co-operative and shared. For example, every manager of product development is made liable for some amount of responsibilty.

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