
A Critical Examination of Accounting Regulation in Japan

Accounting
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Takashi Oguri
Kagoshima Keizai University, Japan, and
Yoichi Hara
Ritsumeikan University, Japan

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Objective of the Study

The principal objective of this article is to present a critical overview of accounting regulation in Japan. The authors believe that an analysis of the structure and functions of Japanese accounting regulation will provide a key to understanding the characteristics of Japanese economic development and business growth, since accounting practice and the underlying accounting regulation have played an important part in enabling Japanese business to accumulate capital at breakneck speed and in allowing the economy to grow at phenomenal rates. The authors also hold that such an analysis will be instrumental in discerning the role of accounting regulation in a broader arena involving the state, the economy and the society at large. The growing body of English-language literature dealing with Japanese accounting regulation appears largely confined to an exposition of Japanese statutory requirements and accounting standards, underscoring the need for examining accounting regulation in a broader social perspective. The present article is intended to advance this aim, drawing on the work of academic accountants identifying with a broadly defined critical school of accounting in Japan.

The article is organised as follows. The first section outlines and contrasts the concepts of accounting regulation typically employed in Western and Japanese research studies. The second section explains the structure of Japanese accounting regulation focusing on the legal framework underpinning that structure and the dual regulatory framework that developed in post-war Japan. Attention is directed towards the organisational structure of the regulatory machinery in Japan and to the impact of this on accounting regulation in practice. The third discusses the principal factors leading to the current primacy of public regulation in Japan, and the final section, entitled 'Prospects', presents the authors' views on the future direction of regulation in Japan.

From Accounting Institution to Accounting Regulation: Towards a Broader Scope of Research

Before discussing the nature of accounting regulation in Japan, the concept of regulation adopted in research studies conducted in Western nations is contrasted with the concept adopted in Japanese studies. Termed in this article an accounting regulation concept[1], the concept adopted in the West embraces such issues as the relationship among the political, economic, social and environmental factors

bearing on accounting and the interplay of regulation and regulation avoidance that unfolds among organisations and groups with conflicting interests.

The approach covers a whole spectrum of issues related to the regulatory process. These issues range from the setting of accounting standards and their enforcement to the assessment of their economic consequences. Other concrete issues falling within the scope of this concept include the identity and nature of the regulatory body (private or public sector); the regulatory objectives to be advanced (such as the choice of economic and social interests to be served or the trade-off between private and public interest); the method or means of regulation (whether to regulate, for example, through mandatory legal requirements or through voluntary codes); and the organisational structure of the regulatory machinery and whether it ultimately promotes regulation or otherwise facilitates avoidance. It is through the analysis of these issues that the accounting regulation concept seeks to reveal the complex relationship which accounting has with society as a whole.

The concept of accounting regulation, as it is used today in the West, has not enjoyed a comparable measure of attention in Japanese accounting literature. What has been employed instead is the concept of *kaikei seido*, literally meaning "accounting institution". This is a key term in developing an appreciation of Japanese research and practice. It implies a view of accounting as a form of social institution. From this perspective, the main thrust of enquiry is focused on the legal framework of accounting regulation, with the primary objective of identifying the economic and ideological functions of that framework[2].

The accounting institution concept has been subject to a range of interpretations. On the one hand, the concept has been identified with the existing system of laws and other norms. On the other, it has been perceived, on a more abstract, theoretical plane, as an apparatus for promoting exploitation and accumulation of capital in a capitalist economy and also as an ideological apparatus for vindicating and legitimising such a process. Some advocates of the concept, out of their zeal to underscore the ideological nature of what they called accounting institution, extended its scope to include both accounting theory and accounting practice, contending that accounting under capitalism would necessarily become an element of the legal, political and ideological superstructure which at once is defined by and in turn underpins the capitalist economy (Miyagami, 1959, 1965, 1969, 1979; Kanda, 1971). From this perspective, accounting in its entirety is conceived as an institution, with the relevant laws and other norms at its core. Accounting practice, as defined by the laws and other norms, is also regarded as part of this institution, along with accounting theory which is perceived as having a legitimising function (Jinnai, 1988).

The accounting institution concept has been instrumental in critically examining the role of accounting in Japanese society. It has made a number of contributions to accounting research. First, it has established the study of accounting as a social science in Japan by viewing accounting as a social phenomenon occurring in a given social formation. This marks a departure from the conventional focus on interpreting accounting technicalities. Second, it has highlighted the arbitrary and fictitious aspects of accounting as it exists today, revealing its functions

of promoting capital accumulation and of conferring ideological legitimisation.

Finally, it has facilitated analysis of the accounting institution and accounting policies that underpinned Japan's rapid economic growth (Kakurai, 1986; Endo, 1986; Oguri, 1987). Many of these analyses have focused on the role played by individual financial statement items. For example, studies have examined how accelerated depreciation expedites the expensing of the cost of assets and thus facilitates capital accumulation; how allowances and reserves serve the cause of capital accumulation by retaining profits within the firm and how profits have been transformed into expense items through changes in financial statement display in order to understate reported earnings (Kakurai, 1973; Endo, 1980; Ohashi, 1985; Study Group for Critical Financial Analysis, 1971, 1972, 1973; Yamaguchi, 1977; Nomura, 1977).

The recourse to the accounting institution concept in Japanese accounting analyses is attributable, in part, to the fact that Japanese accounting today is governed primarily by the Commercial Code and related statutory rules while private sector regulation of accounting through the accounting profession remains relatively underdeveloped. Thus, in the face of the powerful influence of the state exercised through the force of law, the complex, interactive relationships that surround the capitalist firm tend to be obscured, allowing static concepts such as the one of accounting institution to suffice as the principal frame of reference.

Despite a certain degree of demonstrated validity in analysing the state of Japanese accounting, the accounting institution concept has a number of weaknesses (Baba, 1975; Okabe, 1969, 1973). First, some advocates of the concept have inadvertently created self-imposed impediments to substantive analysis of the complexities of accounting by concluding that the essential role of the accounting institution was to serve the capitalist economy through capital accumulation and its legitimisation.

Second, the impact brought to bear on accounting practice by the state and economic and social structures has been given scant attention because the focus remains primarily on analysing and interpreting legal codes. The accounting institution concept has not adequately dealt with the inter-relationships between various organisations and groups involved in accounting matters. Third, the analysis has fallen short of a more functional and dynamic probe of the complex web of relationships in corporate accounting. All told, the accounting institution concept is hardly a panacea for analysing accounting in the real world (Tanaka, 1976).

In comparison, the concept of accounting regulation outlined earlier is more functional, more dynamic and more comprehensive. While the accounting institution concept tends to regard the accounting institution as an element of the social superstructure exercising unitary control over accounting matters, the accounting regulation concept facilitates analysis of the inter-relationships among the political, economic, social and environmental factors inherent in a social structure and the interplay of regulation and avoidance that develops among organisations or groups with conflicting interests (Taylor and Turley, 1986).

The analysis of Japanese regulation presented in this article draws on both

the accounting institution concept and the accounting regulation concept. In the next section, the structure of Japanese accounting regulation is outlined and key characteristics are explained.

Structure of Japanese Accounting Regulation

An examination of the structure of accounting regulation in Japan reveals several important characteristics. One is the primacy of public regulation, or regulation by the state, coupled with the relative underdevelopment of private regulation. Statutory codes combine to form a powerful legal framework and thus the backbone of public regulation of accounting. Although accounting standards in the Anglo-American tradition do play a certain role, they are issued by bodies set up inside the central government bureaucracy and are effectively incorporated into the legal framework.

A second characteristic, pertaining to the geography of organisations involved in accounting regulation, is that a legal framework comprising heterogeneous bodies of law is translated into an array of bureaucratic structures with often conflicting agendas. In addition, those structures provide a mechanism for advancing certain private interests and bringing them to bear upon accounting regulation. In this connection, a third characteristic is that despite the *pro forma* existence of mandatory public regulation, the actual requirements imposed on accounting practice remain less stringent in substance and allow room for various forms of avoidance. These characteristics are elaborated below.

The Legal Framework and the Primacy of Public Regulation

In the Japanese context, the pre-eminence of public or state regulation is not unique to accounting but rather a pervasive feature of the social fabric of the nation. It is ascribable primarily to the nation's late entry into the global race for capitalist modernisation in the nineteenth century and to the leading role played by the state bureaucracy in that drive for modernisation. The choice of Bismarckian Germany as the nation's role model prompted the introduction of a German-inspired system of statute law as a mainstay of public regulation. In contrast to the development of the state bureaucracy, regulation by the private sector remained underdeveloped. Private regulation was expected to flourish as a consequence of post-Second World War reforms but, as will be seen in the following discussion, the results fell substantially short of expectations.

A peculiar trait is readily observable in the legal framework governing Japanese accounting, namely the concomitant existence of the Securities and Exchange Law and the Commercial Code, two bodies of law with different characteristics and purposes. One might count tax laws as a third component of this multiple legal structure, since they indeed play a special part in Japanese accounting regulation (Choi and Hiramatsu, 1987). In this article, however, the Commercial Code and the tax laws are functionally grouped together and viewed as operating in tandem (see related discussion in the next section). Hence, the legal framework is defined as a dual structure comprising the Securities and Exchange Law and the Commercial Code (plus the tax laws).

The duality of the structure takes on an added significance when we consider

the fact that the combination represents a marriage of two heterogeneous legal systems, with the Securities and Exchange Law having its origins in United States legislation, while the Commercial Code is of continental European extraction (Morikawa, 1986). The two laws each have accounting provisions designed to serve different purposes, and in effect impose a dual form of regulation on the accounting practice of major corporations. The particular form of dual regulation that operates in Japan is quite unique.

The duality in the legal framework evolved after the Second World War, as the US occupation rule (1945-1952) helped implant an American-inspired Securities and Exchange Law and related system of accounting regulation into a regulatory environment previously governed solely by the German-influenced Commercial Code (Kawai and Terashima, 1983). The introduction of the securities legislation had a clear objective. That objective was to democratise the Japanese economy by dismantling the *zaibatsu*: closely-held groups of companies bound together and dominated by holding companies and affiliated banks. The *zaibatsu* were widely regarded as a major driving force behind Japanese militarism. Their dismantling called for the introduction of anti-trust legislation to ban holding companies and for a radical shift in corporate finance away from dependence on bank lending towards direct financing through the securities market. "Democratising" the corporate structure by dispersing stockholdings and drawing on a vast potential pool of individual investors was considered an effective and essential means of precluding a resurgence of *zaibatsu* control. The Securities and Exchange Law was intended to create such a securities market.

The Securities and Exchange Law of Japan enacted in 1947 (amended in 1948) was modelled on the US securities legislation of 1933 and 1934. It was further augmented by the establishment of a Securities and Exchange Commission, an independent regulatory body also fashioned after the US precedent. The Commission's role was to regulate both the activities of the newly established stock exchanges, and public financial disclosure by corporations trading on the exchanges.

In 1949, the Japanese Institute of Certified Public Accountants was established. Shortly thereafter, the Financial Accounting Standards for Business Enterprises were issued[3]. The stage was thus set for accounting regulation under the US-influenced Securities and Exchange Law, featuring emphasis on private regulation, generally accepted accounting principles and disclosure of accounting information (Tsumori, 1988). The subsequent history of Japanese accounting regulation, however, was to be characterised by both conflict and compromise between the two disparate legal systems of the Commercial Code and the Securities and Exchange Law.

A primary difference between the Securities and Exchange Law and the Commercial Code lies in their scope of application. The Securities and Exchange Law applies only to some 3,000 joint stock companies whose shares are listed on the nation's stock exchanges or traded over the counter. The Commercial Code applies to all forms of business organisation and features accounting

provisions that apply to all joint stock companies. This is the most popular form of business organisation in Japan numbering upwards of one million.

A second difference lies in the intended aims of the two laws. The Securities and Exchange Law is designed primarily to protect present and future investors in the securities market, while the Commercial Code is intended mainly to protect creditors and present shareholders in the process of sorting out conflicting claims on joint stock companies (Morikawa, 1986).

The different aims of the two laws give rise to a difference in the type of information that accounting is expected to measure and disclose. The Securities and Exchange Law emphasises disclosure of accounting information needed for equity transactions, notably earnings information as indicators of corporate performance, while the Commercial Code calls for accounting measurement to be geared to capital maintenance and the determination of distributable income.

A fourth difference is that while the Commercial Code relies primarily on its own mandatory provisions for enforcement, the Securities and Exchange Law is predicated on the performance of external audit by independent CPAs. CPA audit was the primary vehicle for the private regulation of accounting embedded in the Securities and Exchange Law under the influence of the occupation rule. In summary, the difference between the two legal systems involved, to a certain extent, the choice of public versus private regulation.

In the conflict between the two legal systems since the early post-war years, the initial primacy of accounting regulation based on the Securities and Exchange Law has given way to the regime based on the Commercial Code. The Securities and Exchange Commission, the independent body established to administer the Securities and Exchange Law, was abolished in 1952, shortly after the end of the occupation. The functions of the Commission were transferred to the Securities Bureau of the Ministry of Finance. However, only a fraction of the initial mandate of the original Commission survived. This change represented a retreat, of sorts, of a foreign or extraneous system (i.e. the US-inspired Securities and Exchange Law regime) in the face of a more entrenched or indigenous form of public regulation administered by a government bureaucracy intimately linked with the business community.

A second element of private regulation embedded in the Securities and Exchange Law was the *Financial Accounting Standards for Business Enterprises* issued in 1949 by the Investigation Committee on Business Accounting Systems. The Investigation Committee was the predecessor of the present-day Business Accounting Deliberation Council (BADC)[4]. The publication of the standards came in response to *Instructions on the Preparation of Financial Statements by Industrial and Commercial Concerns*, issued by the US occupation authorities for dissolving the *zaibatsu* and democratising the economy (Kawai and Terashima, 1983). Drawing on and characterised as resembling the generally accepted accounting principles in the US, the standards were designed to modernise Japanese corporate accounting. The preamble to the standards defined their nature and role as: (a) a summary of accounting conventions which have been generally accepted as fair and proper (and which) should be followed by all business enterprises even if it has no statutory binding force; (b) the standards

that Certified Public Accountants should follow when they audit financial statements under the requirements of the Certified Public Accountants Law and Securities and Exchange Law in Japan; (c) the standards that should be highly regarded when the laws and ordinances affecting business accounting, such as the Commercial Code or the tax law, are enacted, amended, or abolished in the future.

The initial post-war design, then, was to create a system of accounting regulation around the standards, with accounting practice on individual issues to be regulated not by law but by accounting standards issued by a standard-setting body favouring a private regulation approach. In fact, however, conditions were less than favourable for such accounting principles or standards to evolve from accounting practice in a country with scant tradition of private autonomy. Whereas the generally accepted accounting principles in the American tradition were envisaged to result from broad recognition of accounting conventions and the distillation of accepted practices, the Japanese experience saw the imposition of what was apparently a seminal core of generally accepted accounting principles. This process was carried out through a governmental body under US occupation.

Within the Securities and Exchange Law regime, the standards fulfilled a special role. When the law was revised in 1950, the accounting standards were fleshed out and issued as a Ministry of Finance Ordinance, entitled *Regulations Concerning the Terminology, Form and Preparation Methods of Financial Statements*. Contrary to the private sector standard-setting approach taken in the United States, the standard-setting body in Japan, the BADC, has remained in the public sector as part of the Finance Ministry.

After being embodied in the legal framework as principles for the modernisation of accounting in Japan, the accounting standards, as originally conceived, have progressively lost influence. Certain parts of their contents have been introduced into the Commercial Code with the original standards being subject to successive amendments in a compromise with the Commercial Code. The declining influence of the standards has paralleled the shift in primacy from the Securities and Exchange Law-oriented regime of accounting regulation to one based on the Commercial Code. In 1962, the Commercial Code was revised to incorporate elements of accounting regulation originally contained in the Securities and Exchange Law-based regime, inaugurating a fully fledged system of accounting regulation based on the Commercial Code. The contradictions between the two legal systems were thus tentatively put to rest in favour of a Commercial Code-based system.

Geography of Accounting Regulation and Regulation in Practice

The geography of organisations involved in Japanese accounting regulation also reveals characteristic features of the Japanese scene. Figure 1 depicts the structure of accounting regulation in Japan.

The organisational machinery for accounting regulation remains unintegrated, with related functions scattered across a number of governmental bodies, resulting at times in a confusing state of affairs. Regulatory authority over the securities market on the basis of the Securities and Exchange Law is vested

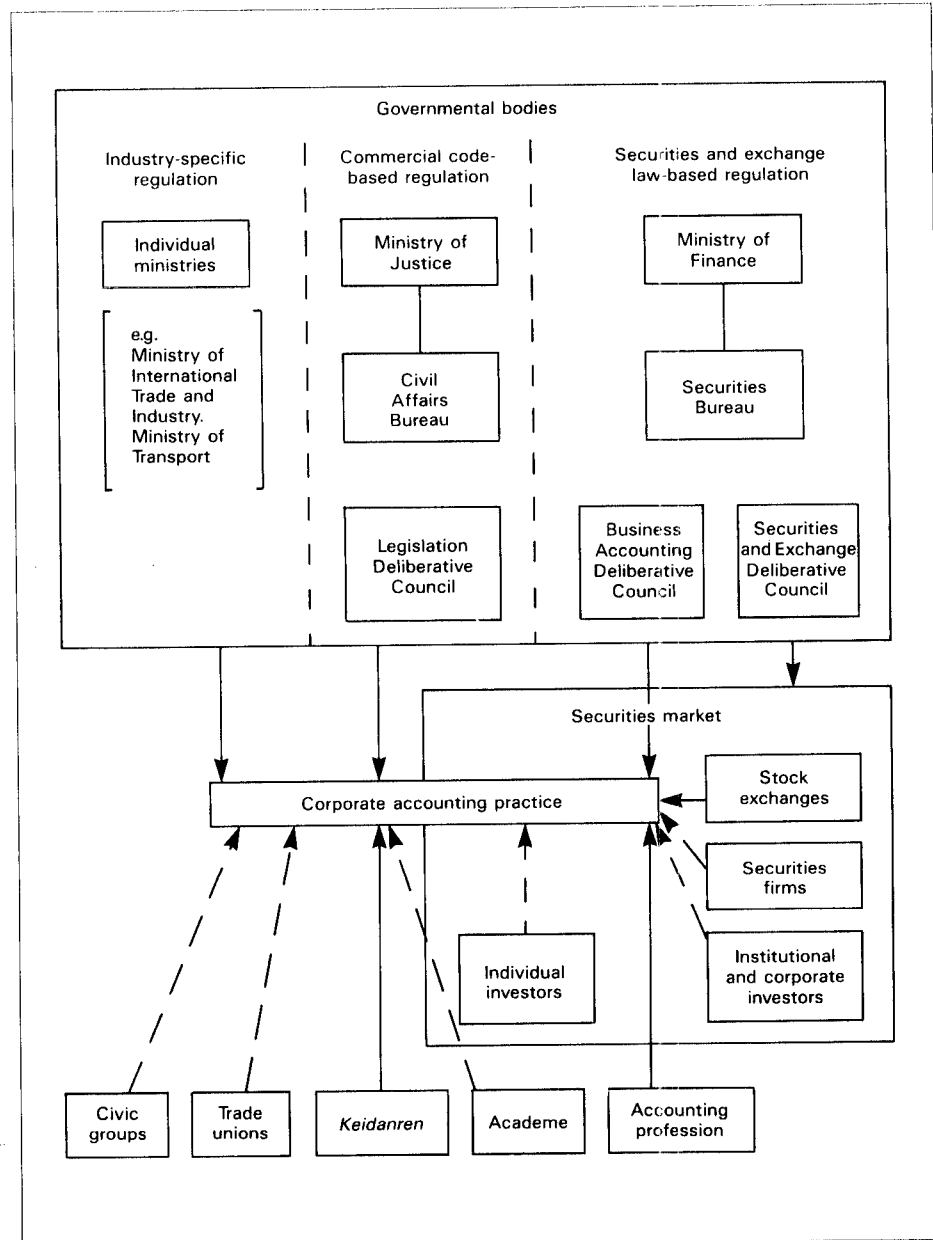


Figure 1.
The Geography of
Accounting Regulation
in Japan

in the Securities Bureau of the Finance Ministry. Two advisory bodies to the Finance Minister, the Securities and Exchange Deliberation Council and the BADC, are involved, respectively, in revising the Securities and Exchange Law and setting accounting standards. Overall regulation of the legal aspects of business activity is the domain of the Civil Affairs Bureau of the Ministry of

Justice. An advisory body to the Justice Minister, the Legislation Deliberation Council, has a committee charged with discussing amendments to the Commercial Code.

Under the dual regulatory framework, these two ministries and their advisory organs have pursued their own respective agendas, often resulting in unreconciled, if not openly contradictory, positions. Another impediment to an integrated regulatory machinery is that the accounting standard-setting for specific industries is under the auspices of the related ministries or agencies instead of the BADC. Hence, the BADC's potential function as a standard-setting body is undercut and parcelled out to a number of other governmental bodies without effective co-ordination.

Some extra comment may be in order at this juncture on the special role played by deliberative bodies such as the BADC in Japanese policies and public administration. For most of the four and a half decades since the end of the Second World War, power has resided with a strategic triad formed by the perennially ruling (and conservative) Liberal Democratic Party, the bureaucracy and the business community (Masujima, 1974). Deliberative bodies serve a "useful" purpose in this context by reconciling different interests and forging at least a semblance of consensus. Comprising representatives of the business community, other interested parties (at times including trade unions), academe and the relevant professions, these advisory bodies participate, or at least go through the motions of participating, in the formulation of public policy and legislation on request from the related ministries. Positioned at the interface of public and private regulation, such deliberative bodies in effect play a significant part in legitimising the policy-making or standard-setting process and inducing the public to consent to the existing order.

Among the various agents of private regulation in Japanese accounting, the two noteworthy ones are the Japanese Institute of Certified Public Accountants (JICPA) representing the accounting profession, and the Japanese Federation of Economic Organisations, the main big business body known by its Japanese acronym of *Keidanren*.

The accounting profession is technically the primary agent of private regulation, responsible for verifying compliance with the accounting regulatory process under the Securities and Exchange Law through its audit function. In the Anglo-American context, the profession has historically assumed the role of standard-setting, alone or in conjunction with other parties. But in Japan, where the system of CPAs is a post-war novelty and where private autonomy is hardly conventional practice, the accounting profession has yet to come into its own. The JICPA does not wield much authority and its influence over accounting regulation and accounting standard-setting is limited at best.

Keidanren, on the other hand, exercises a formidable influence over accounting regulation as well as many other aspects of the political and socio-economic life of the nation. Widely recognised as playing the leading role among Japan's four major business organisations, *Keidanren* has continually brought its influence to bear on the accounting regulation process. It has consistently lobbied for deregulation both officially through its representatives sitting on every major

deliberative body, and unofficially through its cosy relationship with the ruling conservative party and the bureaucracy. And internationally, it should be noted, *Keidanren* has lobbied with a vengeance against what it perceived as intrusive accounting and disclosure requirements of the US Securities and Exchange Commission and the European Community. The latter case involves the still pending Vredeling proposals for employee consultation and information disclosure in multinational firms[5].

With regard to domestic accounting regulation, *Keidanren* publishes its "model format" for financial statements devoted to satisfying no more than the minimal disclosure requirements and thus serves to loosen accounting regulation in its application. That such a model format is published alongside official accounting standards and statutory rules in annual handbooks of accounting rules and, in effect, serves a normative function, provides a telling commentary on the nature of present-day accounting regulation in Japan.

That the big business lobby is allowed such measure of influence in Japan is predicated on the traditional partnership or co-operative interaction between government and business, which explains the apparent discrepancy between the ostensibly rigid regulation of accounting by the state and the actual tendency to allow business to exercise a wide margin of discretion in accounting matters. It was in fact this problematic aspect of Japanese life that instigated the earlier-mentioned critique by the accounting institution school that the legal regulatory framework as a whole performed both a capital accumulation function and an ideological legitimisation function (Oguri, 1988; Endo, 1983).

Factors behind the Japanese Regime of Accounting Regulation

This section examines some of the major factors behind the evolution of the present Japanese regime of accounting regulation.

The transition in primacy from accounting regulation based on the Securities and Exchange Law to one based on the Commercial Code can be attributed to at least two major factors. The first is the laggard development of the securities market, contrary to the initial design of the post-war reformers to render it the primary source of corporate finance. The second factor is the compelling influence of tax laws. Both of these factors figured prominently in shaping the contours of Japanese accounting regulation today.

Concerning the first factor, bank lending provided the primary source of corporate finance during the years of Japan's phenomenal post-war growth, stretching from the mid-1950s through to the end of the 1960s (Miyazaki, 1985). The securities market did expand quite rapidly at the outset, but subsequently took a back seat to bank lending, becoming resigned to a marginal, complementary role. This kind of financing arrangement accordingly called for a type of accounting regulation oriented towards protection of banks and other creditors, i.e. regulation based on the Commercial Code, rather than one with a securities market orientation. Although the securities market, notably the Tokyo Stock Exchange, has since grown in size and in fact swelled in the 1980s to have the largest market capitalisation in the world, it remains fraught with serious distortions. Major corporations and banks have formed *keiretsu*

groupings, with mutual shareholdings cementing the relationship among member companies (Okumura, 1984). This in turn has channelled an increasing proportion of outstanding shares into the hands of corporate and institutional investors, consequently marginalising the presence of individual investors who now account for less than 30 per cent of all shares outstanding. This, along with the oligopolistic hold on the equity market by the nation's four major securities houses, has impeded a more normal and competitive growth and functioning of the Japanese capital market (*Kinyu Business*, November 1988).

One consequence of this anomaly has been the relatively low payout ratio. Payout ratios for the period April 1987 to March 1988 averaged 29 per cent for Japanese companies compared with average ratios of 53 per cent in the United States, 54 per cent in the United Kingdom, 50 per cent in West Germany and 38 per cent in France. Hence, major Japanese firms retain a high percentage of their income instead of distributing it as dividends to shareholders (*Asahi Shimbun*, 17 September 1988). The firms have been relatively unconstrained in their pursuit of capital accumulation without much of the shareholder pressure for greater short-term payoffs.

The above features have meant that a Securities and Exchange Law based on an assumption of normally functioning securities markets and designed to induce firms to disclose relevant accounting information, has found the Japanese securities markets inhospitable terrain. Considering the odds against the Securities and Exchange Law-based system of accounting regulation, it was quite logical for the Commercial Code-based system to move in to fill the regulatory void.

The second important factor promoting the primacy of Commercial Code-based regulation is the fact that a regulatory regime centring on the Commercial Code was viewed as essential from the standpoint of taxation policy and its administrators within the Finance Ministry. It will be recalled that the Ministry of Finance also administers the Securities and Exchange Law. As a crucial vehicle in the government's economic policy for facilitating capital accumulation, Japanese tax laws have lavished on major corporations opportunities for minimising their tax burden, starting with the Special Taxation Measures Law enacted in the 1950s. Meanwhile, the Corporate Income Tax Law required that tax returns be computed on the basis of financial statements prepared in accordance with the Commercial Code. Hence, legitimisation of the preferential measures provided by the tax laws required first that corresponding provisions be written into the Commercial Code; and second, that such a Commercial Code supplant the Securities and Exchange Law-based regime as the main source of Japanese accounting regulation.

It was no accident, then, that on the occasion of the landmark 1962 revision of the Commercial Code signalling its newly found ascendancy over the Securities and Exchange Law, the Code adopted, among other things, a dubious category of allowances called *tokutei hikiatekin*, literally 'specified allowances', which represented a transposition of tax law-approved allowances specifically designed to conceal reported profits and hence accumulate capital. As a result of this measure, as many as 16 different types of tax-exempt allowances and provisions

found their way into corporate financial statements along with an additional set of taxable, discretionary provisions (“provision for construction of research laboratories” and “provision for events marking the corporate semi-centennial”, for example), all of which served to accelerate the process of retaining profits within the firm (Kakurai, 1973; Endo, 1980).

Thus, the dependence on bank lending in corporate finance and the orientation of tax laws geared to capital accumulation — two important factors that enabled Japanese business expansion and economic growth — concurrently served to nudge accounting regulation away from the Securities and Exchange Law towards the Commercial Code. The centrality of the Commercial Code and the attendant formula of regulation by the state apparently proved to be a more “natural” regulatory arrangement in view of the aforementioned affinity between business on the one hand and political and bureaucratic leadership on the other.

In retrospect, that has more or less been the way of life for Japanese capitalism ever since its late-nineteenth-century inception, when the fledgling central government made it its prime business to initiate, nurture and protect a nascent business community. In formulating its economic policy, the government was concerned first and foremost with ways to allow businesses to grow. Hence, the natural inclination in official policy was to provide protection and preferential treatment for the champions of Japanese business. When applied to the realm of accounting, this general rule would logically call for a type of regulation which, though couched in statutory terms, allows the choice of conservative accounting methods and serves as an instrument of the national policy of capital accumulation. Accordingly, accounting rules which, in effect, facilitate avoidance of regulation are internalised in the legal regulatory framework.

Prospects

The dual legal structure of Japanese accounting regulation presided over by the Commercial Code is now faced with the need to accommodate itself to the move towards international harmonisation of accounting and reporting standards, in which the dominant influence can be identified as an approach of extensive disclosure for the benefit of the securities market.

In 1977, preparation and disclosure of consolidated and interim financial statements were already institutionalised within the Securities and Exchange Law-based regulatory framework. A possible introduction of segmental reporting is currently under discussion. These steps towards greater disclosure have been spurred by foreign influence accompanying the stepped-up internationalisation of Japan’s economic and business activity and hence of its accounting practices.

Even the Commercial Code was revised in 1981 to accommodate more extensive disclosure requirements — a clear commentary on the inadequacy of the uniquely Japanese system of accounting regulation described above in meeting the challenges of internationalisation. It is important to remember, however, that demands for such extensions in corporate disclosure were essentially of foreign origin, not an indigenous product of the Japanese securities markets. Pressure from forces outside the financial community, such as trade unions and civic groups, does exist but is hardly adequate to force changes

in the legal framework. So, despite the *pro forma* extension of disclosure requirements to keep Japan in line with international trends, doubts persist as to whether the regulatory authorities are willing and/or able actually to give effect to the requirements, when the Finance Ministry's Securities Bureau has to operate on a skeleton staff of 130 compared with a legion of 2,000 at the US Securities and Exchange Commission.

The problems in Japanese accounting regulation cited above are a reflection of the systemic characteristics of the political and socioeconomic life of the nation. More elaborate enquiries into accounting regulation and international comparisons are needed to outline possible directions for regulatory reform. The authors believe that a certain combination of public and private regulation is necessary and desirable. Neither exclusive regulation by an all-powerful state nor exclusive dependence on private sector self-regulation through the market mechanism and private contractual relationships among business entities is likely to provide an adequate solution. Under any regime of accounting regulation, the presence of a working mechanism of accountability would seem to represent a crucial factor. In order to establish accountability *vis-à-vis* the society at large, there must on the one hand be a civil society observing an equitable relationship of rights and obligations for all, while on the other hand the society must devise some kind of regulatory mechanism to harness and guide accounting behaviour.

Notes

1. A clear definition of the concept of accounting regulation is not available. Parker and Previts (Previts, 1987, p. 1) note that: "Regulation is a powerful and complex social device which is difficult to comprehend". Although a range of views exists on the concept of accounting regulation, the present article draws primarily on the work of Tinker (1984, 1985), Taylor and Turley (1986), Merino and Niemark (1982) and Puxty *et al.* (1987).
2. Kazuo Miyagami is generally credited with having established the accounting institution concept and imparting a major theoretical influence (Miyagami, 1952, 1959, 1965, 1969, 1979). Diverse tendencies subsequently emerged in the process of the concept's evolution and contributed to a lively debate (cf. Endo, 1986; Oguri, 1987, 1988). Major participants to the debate include Asaba (1975), Endo (1980), Kakurai (1973, 1978), Kanda (1971), Tsumori (1972, 1973, 1982), Nishimura (1977) and Shikita (1969). In addition, Nakamura (1969) and Takatera and Daigo (1979) are among those who have identified accounting policy as representing the dynamic aspects of the accounting institution and have analysed the economic and ideological functions of accounting policies.
3. The Financial Accounting Standards were initially referred to as *A Statement of Business Accounting Principles*, and were based on *A Statement of Accounting Principles*, prepared for the American Institute of Certified Public Accountants by Sanders *et al.* (1938).
4. As of July 1986, the Business Accounting Deliberation Council had 39 members. Thirteen were selected from academia (nine from accounting, three from law and one from tax), nine from the business community (three from the Federation of Economic Organisations or *Keidanren*, two from banks and four from non-banking corporations), six from the Japanese Institute of Certified Public Accountants (JICPA), three from the Tokyo Stock Exchange, two from the Securities Analysts' Association, two from economic journalists, and the remainder were from the Ministry of Justice, the Securities Dealers' Association, the Japan Federation of Tax Accountants Association or *Nippon Zeirishikai Rengowakai* and the National Association of Small and Medium Enterprises (Choi and Hiramatsu, 1987).

5. Kuwabara (1983) provides an account of *Keidanren's* lobbying efforts *vis-à-vis* the Securities and Exchange Commission. Regarding *Keidanren's* intervention to neutralise the European Community's Vredeling proposals, *Keidanren*, "Vredeling Hoan ni kansuru Iken" (opinion on the "Vredeling Proposals"), *Keidanren Geppo*, September 1982, outlines the business group's official position, while Tsugio Ibayashi, "Vredeling Hoan ni tsuite" (On the Vredeling Proposals), *Kigyō Kaikei*, Vol. 36 No. 2, February 1984, represents a commentary on the issue by a ranking *Keidanren* official. Another article by a *Keidanren* official, Yoshimasa Kubouchi, "Kokuren ni okeru Hi-kaikai Joho no Shingi Jokyo ni tsuite" (On the State of UN Deliberations Concerning Non-accounting Information"), *Keidanren Geppo*, June 1981, explains *Keidanren's* policy towards the discussions taking place under the auspices of the United Nations working group on international standards of accounting and reporting for transnational corporations.

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