Cultural Legacies and Their Implications for Accounting and Accountability in Modern Japan

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Declaration

This thesis is my original research work and any contributions by others are clearly referenced.

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Abstract

Accounting is often perceived as a neutral tool to record and review the financial position of an organisation. However, past research indicates that accounting standards and practice strongly reflect the intentions and values of both national governments and individual organisations. This research investigates how the beliefs and values of Japanese businesses, their owners, managers and employees, have historically influenced their accounting and accountability. Confucian teachings, which encouraged high moral standards in all aspects of Japanese society, have been the major determinant of these values and beliefs since the Edo era (1603-1868). The research is conducted from a Foucauldian perspective within a critical accounting framework, using archival documents and semi-structured interviews. The Foucauldian perspective on power and disciplinary control is applied to understand the historical development of accounting and accountability in Japan where Confucianism is significantly embedded. Power relationships in Japan encouraged and maintained Confucian-based values which became fundamental norms for the achievement of the collective well-being of the nation. However, Confucian teachings have been sometimes misused to endorse fraudulent accounting practice in Japan as a result of the priority given in Confucian beliefs to protecting and obeying one's seniors. The recent Olympus scandal is investigated to show how Confucian teachings had impacted the Olympus company's accounting and accountability practice when they made significant financial losses in the late 1990s and 2000s. The research findings confirm that from the Edo era to the present day in Japan there has been a reflective relationship between accounting and accountability practices and Confucian values. In light of Japanese aspirations to internationalise their accounting standards and accountability, it is crucial for any Japanese organisation to take these findings into consideration when reviewing internal regulations on accounting and accountability.

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List of Abbreviations and Acronyms

Abbreviation and Acronym	Meaning
ASBJ	Accounting Standards Board of Japan
BOJ	Bank of Japan
CEO	chief executive officer
CFO	chief financial officer
CPA	certified public accountant
ESS	Economic and Scientific Section of the GHQ
FSA	Financial Services Agency
GAAP	Generally Accepted Accounting Principles
GHQ	the Supreme Commander for the Allied Powers
IAFC	International Federation of Accountants
IAS	Internationally Agreed Standards
IASB	International Accounting Standards Board
IASC	International Accounting Standards Committee
IFRS	International Financial Reporting Standards
IOSCO	International Organization of Securities Commissions
M&A	merger and acquisition
MEXT	Ministry of Education, Culture, Sports, Science and Technology
MHLW	Ministry of Health, Labour and Welfare
MOF	Ministry of Finance
PC	personal computer
PwC	PricewaterhouseCoopers
SCAP	Supreme Commander for the Allied Powers
SCAPIN	Supreme Commander for the Allied Powers Directives to the Japanese Government
SII	Structural Impediments Initiative

Japanese Glossary

Japanese word	**Definition**
Accounting Big Bang	A period when Japanese accounting standards were significantly revised to meet with strong demand from the US in the early 2000s
Bukeshohatto	Laws which controlled lives and behaviour of the *samurai* class in the Edo era
choai	Old fashioned word for accounting
danka	A household that financially supports a local Buddhist temple
ekidashi	Artificially generate profits by selling shares or stock to one's group companies
fucho	A type of secret language or code which was often used in accounting records during the Edo era
kakun	House laws for businesses, instructions by the head of a family
keiretsu	A group of allied companies; zaibatsu groups in the pre-Pacific War and newly formed groups
main bank	A bank which has strong relationships with a company in financing and giving advice on management, usually chosen from a same *keiretsu* group
mochiai kabu	Shares strategically held by allied companies
QC circle	Quality control circle is a voluntary employee activity in a workplace to ensure high quality outcome
samurai	Originally, warriors, but they became administrators and civil servants in the Edo era and they were at the top of the social hierarchy in the Edo era
ryogaeten	An exchange bureau in the Edo era
Tobashi scheme	Illegal financial transactions, concealing losses elsewhere e.g. a subsidiary account or external fund
zaibatsu	Conglomerates before the pre-Pacific War which dominated the Japanese economy (e.g. Mitsui, Mitsubishi, Sumitomo, Yasuda)

Chapter 1 Introduction

1.1 Research Objectives

The core concern of this research is how traditional beliefs and values derived mainly from Confucianism have impacted upon accounting and accountability practices throughout Japanese history. Confucian teachings, which are deeply embedded in Japanese society, have been the major determinant of Japanese business practices since the Edo era (1603-1868) (Bellah, 1985), in particular the nature of accountability obligations and the way in which these were fulfilled by accounting practices (Ogura, 2003; Maruyama, 2006). Foucault's ideas on power and disciplinary control are applied to understand the historical development of accounting and accountability in Japan.

Accounting is often perceived as an objective representation of events to record and understand the financial transactions of an organisation; the process of identifying, measuring and communicating financial information to allow informed judgments and decisions by users of the information (Atrill and McLaney, 2008: 482). However, even though documented figures in accounting records may look legitimate and transparent, they can involve far more than objective, technical and economic information (Puxty, 1991). Therefore, accounting is considered as value-ridden and reflects the objectives of numerous sections of society (Bigoni and Funnell, 2015; Funnell and Williams, 2014; Fleischman, 2013). Accounting is influenced by the authority with power. It serves and reflects the values of governments, organisations and individuals, which may conflict, and has the ability

to display the national values and business history of a country (Bigoni and Funnell, 2015).

A growing body of research has established that accounting systems reflect the social values and power in which they are embedded (Funnell and Williams, 2014; Bigoni and Funnell, 2015; Fleischman, 2013; Napier, 2006; Laughlin, 1987). Accounting has a strong association with power and, therefore, throughout history accounting has been considered to be a significantly effective tool to control society (Foucault, 1977; Bigoni and Funnell, 2015). This has been the experience in Japan where power relationships have influenced the belief system and values that have governed and disciplined Japanese business people throughout modern history. Thus, this thesis critically demonstrates the relationship between accounting and society in Japan, especially the influence of dominant religious values such as Confucianism on the lives of Japanese people.

Values incorporate the ethical ideals and fundamental beliefs of an individual or society while a belief system is the collection of beliefs which exist in a particular society or culture (Jary and Jary, 1991: 688). The beliefs and values that historically have been embedded within Japanese organisations and their relevance for accounting and accountability are the focus of this thesis. The belief system of Japan, heavily influenced by Confucian teachings and traditional religions such as Buddhism and Shintoism, impacted on every aspect of Japanese lives during the Edo era and subsequently into the modern era (Bellah, 1985; Maruyama, 2006). Although contemporary Japan is a secular nation, Japanese values are still based mainly upon Buddhism and Confucianism and the Japanese respect and preserve

elements of traditional values (Bellah, 1985; Zenke, 2004; Yasumaru, 2004).

Confucianism, which was introduced in Japan in the 6th century, originated in ancient China as a collection of teachings of the philosopher Confucius (BC551-BC479) (Bellah, 1985). Its teachings emphasise the importance of creating respectful ties and obedience between rulers and their subjects, and between parents and their children (Bellah, 1985). According to Confucius, living harmoniously is imperative and fundamental in order to become a respectful person (Gakuji 1-12).[1] It is important to note that Confucianism in Japan has been transformed by elements of Japanese Shintoism and Buddhism (Kitagawa, 1987; Bellah, 1985). As explicitly demonstrated in Chapter 3, the original Confucian teachings were purposefully selected and adapted over many centuries to suit the objectives of the Japanese government and its people (Watsuji, 1973). Confucianism referred to in this thesis is an adapted version which historically has been subtly adopted in workplaces in Japan, and still prevails in the 21st century (Yoshida, 2002, Gemmna et al, 2006).

This thesis establishes why Confucianism was originally chosen as an approved philosophical teaching by the Edo government (1603-1868) and explores the resulting enduring historical implications for modern Japan. The Edo government based its power upon Confucianism when ruling over its subjects (Bellah, 1985; Maruyama, 1969). The original Confucian teachings were configured and developed to give legitimate and subtle controlling power to rulers at the time in

[1] *The Analects of Confucius* is one of four significant textbooks on Confucianism containing twenty chapters with a number of quotes and stories taught by Confucius. It was written by Confucius' disciples around the 5th century B.C. (Hinton, 1998; Yoshida, 2002).

Japan. Positive outcomes include a productive work ethos generated over a long period and an enduring commitment to employers and society (Dore, 1987; Tu, 2000). At the same time, however, a potentially negative impact of the continued importance in Japan of imbued norms and values that are influenced by Confucian teachings were confirmed by recent accounting scandals in Japan.

This thesis examines the way in which traditional values, which are heavily influenced by Confucianism, have been developed and manipulated by successive governments. The research investigates how accounting and accountability have been affected by these traditional values from the Edo era to the early 21st century. Understanding the Edo era is crucial in order to appreciate how the values of Japanese business people were established under the feudal Edo government, *Edo Bakufu*. During the Edo era large business organisations that still exist today, such as Mitsui and Sumitomo, were founded and managed on the basis of values and work ethos developed through Confucianism (Miyamoto, 2007; Morishima, 1982; Okabe, 2012; Nemoto, 2013). By applying Confucian teachings it was customary for merchant houses to compose their own house laws, *kakun*, which prescribed how the business should be run and how accounting had to be managed (Miyamoto, 1964; Tsumura, 2014). According to surviving records, the importance of accounting and accountability was frequently stated and emphasised in prominent merchant houses, including a basic form of double-entry bookkeeping (Sakudo, 1979). This is further detailed in Chapter 4 where it is shown how Confucianism and power influenced accounting practice in the Edo era.

After Japan was opened to free trade at the end of the Edo era and the beginning of

the Meiji era (1868-1912), accounting suddenly became raison d`État','what makes it possible to preserve the state' (Foucault, 2009; Shimizu, 2010). Although the Japanese maintained traditional values, they had to Westernise business practice and accounting methods. For the Japanese, Western accounting practice was seen as a necessity to gain access to the international market, especially for large corporations who wanted to start business transactions with foreign countries (Tsumura, 2014). Subsequently, accounting in Japan reflected both the intentions of the Japanese and also pressure from Western countries, especially the United States of America (US) and the United Kingdom (UK). Since the Meiji era when Japan has been exposed to Western influence, Confucian-led values helped the Japanese to compete against external forces (Morishima, 1982; Maruyama, 2006).

In recent years, the subject of accounting and accountability has continued to be a necessary priority among the Japanese business people who pursue the globalisation of their businesses (Yonekura et al, 2012). Accountability is the act of defining the roles and duties of the directors and management by establishing an adequate monitoring process (Atrill and McLaney, 2008: 121; Hopt, 2013). With accountability, managers and their corporations are obliged to be responsible their managiment decisions and their actions (Roberts and Scapens, 1985). Any inadequacies in the accountability of managements are often exposed in leading Japanese corporations, of which the Olympus scandal in 2011 received particular prominence (Verschoor, 2012). This research analyses developments in accounting and accountability and recent accounting scandals in Japan through a Foucauldian perspective, which is underdeveloped in critical accounting research. This thesis investigates how Japanese values and beliefs, derived from Confucianism,

allowed accounting scandals to occur.

1.2 Research Contribution

The research findings provide both theoretical and practical contributions. They enrich critical accounting research where little attempt has been made to link Foucauldian perspectives to Confucianism in Japan. This is partially because accounting has always been considered by the Japanese to be a practical subject with limited room for philosophical consideration (Shimizu, 2010). In particular, contemporary accounting and accountability and their profound relevance to Confucian teachings are still under-researched. This thesis identifies subtle but deep relationships between power and accounting in modern Japan, using the Olympus scandal as a particularly prominent example. Thus, this research fills a significant gap in accounting knowledge and literature (Araya, 2010; 2011).

Findings of this research provide the opportunity to help Japanese organisations to enhance their management of accounting and accountability in the global context and, thereby, improve the credibility of their accounts internationally. Japan is one of the G8 nations and the world's third largest economy (Statistics Japan, 2016). Accordingly, its economic presence has a significant impact on global society and, thus, understanding the pervasive authoritative influence of Confucian teachings in accounting and accountability in Japan, and how business people are thereby self-disciplined, is crucial for Japanese corporations to survive in the global market. This can have positive and negative implications for modern business practices, which is expounded in Chapter 7. The significance of accounting has been

recognised globally as accounting standards have become more internationalised with the introduction of International Financial Reporting Standards (IFRS) (Kimura and Nishikawa, 2016). By identifying the hidden influence that ingrained Confucian teachings can have, the findings of this research have considerable potential to assist authorities in Japan, such as the Ministry of Finance (MOF). They would help MOF to review regulations that aim to promote more transparency in accounting and financial reporting. The findings of this research will provide non-Japanese organisations with insights into how Japanese business people have historically regarded accounting and accountability.

1.3 Brief Outline of Research Methodology

The research for this thesis has adopted a Foucauldian perspective, focusing on the concepts of power and discipline. A Foucauldian perspective allows the identification of subtle power relationships within society and organisations where power is defined as 'actions on others', actions rather than physical violence (Gordon, 1991: 5). This research examines the complex mechanism of power based upon Confucianism which is exercised to control people and society with accounting and accountability practices in Japan.

Foucault proposed that power-knowledge is something that makes individuals into subjects by forcing them to make sense of themselves by referring to various bodies of knowledge approved by those in power (Hoskin and Macve, 1986). Forces of power are expedited and manipulated by numerous bodies of authorised knowledge (Schirato et al, 2012: xxv). Foucault frequently refers to examples of pastoral

power in Western history, which was the dominant form of controlling power before the modern period. Pastoral power involves a permanent intervention by a pastor in a Christian church and his power covers the everyday conduct of his congregation, including the management of their lives, as well as their goods and wealth. It concerns not only the control over individual members of his parish, but also the community as a whole (Foucault, 2007; 154). The pastor would go into the soul and consciousness of his parishioners and absolute obedience from them would be required before the 17th century (Foucault, 2009: 154).

Foucault argues that since the Peace Treaty of Westphalia in 1678 modern nations have identified 'what makes it possible to preserve the state', namely 'raison d`État', as an intricate set of relationships between a number of elements (Foucault, 2009; Schirato et al, 2012). He claims that raison d`État' is equally dependent on the knowledge that enables us to follow and to self-discipline (Foucault, 2009: 165, 257). In disciplinary institutions people are normalised through various methods such as supervision, comparison, differentiation, hierarchisation, homogenisation and exclusion (Rabinow, 1984:195). For example, in the Edo era Tokugawa believed that the pastoral power of religious institutions had the ability to overturn the feudal regime if it was not carefully managed by understanding the history of Japan (Kitagawa, 1987). Thus, he and his government decided to take control of the lives of its people by managing Buddhist temples (Bellah, 1985).

Foucault states that different types of power operate in society: 'repressing power'; 'social contractual power'(contractual power) and 'disciplinary power' which is also referred to as 'normalising power' (Foucault, 1976). Repressing power derives

from a superior position of a nation such as monarchy or an institution where violence and coercion can be applied to make subjects obey. In this relationship of power it is fear which motivates people to conform. Similarly, social contractual power urges people to comply with laws using judicial power and enforcement (Foucault, 1977). In modern society, the government uses this power to imprison people when a law is breached. People comply with laws or social rules to avoid punishment in prison or being detained in a mental hospital, both of which involve losing one's liberty. Foucault gave particular significance to disciplinary power and normalising power, which result in the internalising of social norms and self-discipline. With a sophisticated observation mechanism, people are controlled and behave according to the intentions of a government or a ruler with power (Foucault, 1976). This type of power is further examined in Chapter 4 using historical examples such as the '*kakun'* documents in merchant houses in the Edo era.

The research uses both archival primary sources and previous research to demonstrate how contemporary accounting and accountability have historically developed in Japan. The research investigates the Olympus accounting scandal, as well as other business accounting scandals which earned international notoriety, in order to understand how Confucianism subtly prevails in present-day Japan through its self-disciplinary power as explicitly argued in Chapter 6 and 7. To better understand contemporary accounting and accountability practices, and their relationships with disciplinary power, semi-structured interviews were conducted with predominantly Japanese business people, most of whom were in senior positions. Findings from transcribed interviews are analysed and coded through a Grounded Theory method which was used to develop theoretical explanations of current accounting and accountability practices in Japan.

The full description of the methodology used is provided in Chapter 2.

1.4 Olympus Example

Olympus, one of the most well-known camera manufacturers in Japan, with sales of US$10.6 billion and with more than 30,000 employees worldwide, revealed a serious accounting scandal in 2011 (Verschoor, 2012; Abe et al, 2012). Olympus had concealed 135 billion yen, about 1.1billion US dollars, after the burst of the Bubble Economy in the early 1990s (Sasa, 2013; Higuchi, 2014). These financial losses were skillfully masked by successive Japanese presidents at Olympus with the assistance of external financial consultants (McGill, 2011). The losses were illegally written off and became invisible in Olympus' official accounting records by devising a number of special financial schemes called '*Tobashi'*, literally fly away. This was a scheme to conceal loss-making securities by selling them to a fund which is often created for this purpose and the *Tobashi* is sometimes extremely difficult for external CPAs to identify when auditing (Abe et al, 2012: 95; Watanabe et al, 2012). The '*Tobashi'* scheme is an illegal practice which for over twenty years Olympus used to disguise losses from failed investments by setting up a number of funds and transferred losses into them. The research findings indicate that Olympus has been a more controversial example of accounting practices and the understanding of accountability that Japanese businesses have adopted. Further details of their historical *Tobashi* schemes are discussed in Chapter 7.

Olympus was one of a small number of Japanese corporations who appointed a non-Japanese president, Michael Woodford. He was the first non-Japanese president to

identify and publicly expose wrongdoings in Olympus' accounting and accountability practices. After the historical losses were finally written off in 2010, Michael Woodford was appointed by the then chairperson and ex-president, Tsuyoshi Kikukawa, hoping Olympus could make a fresh start without any questionable debts from the past (Abe et al, 2012; Woodford, 2013). However, Woodford discovered the extent of the concealed financial losses through a minor business journal article based upon information provided by an internal whistleblower (Abe et al, 2012). When Woodford revealed these losses, neither the Japanese executives at Olympus nor the major media in Japan supported these disclosures. It would appear that Woodford was not supposed to know about the past accounting problems because he was not considered to be part of the inner circle of the top Japanese executives who were all long-serving employees. When confronted by Woodford, Kikukawa and other board members did not answer any questions about the historical accounting fraud nor showed any sense of being accountable, which made Woodford and Western shareholders extremely concerned about the financial stability of the company (Woodford, 2013; Abe et al, 2012).

The example of Olympus demonstrates an attitude of traditional Japanese business people who tend to trust people only within the same inner circle with common norms (Maruyama, 1969). Their accounting information was only shared among people in senior positions whose priorities and intentions influenced their accounting practices. Confucianism encourages the importance of social hierarchy and a close network of people (Maruyama, 2006). The Olympus case exposed the impact and culpability of deeply ingrained norms of Japanese business people, which this thesis unravels and critically analyses with a detailed examination of the history of the

values and practices which have characterised Japanese business from the Edo era to the present day. The Olympus case, where accumulated financial losses were concealed for decades, illustrates how traditional accounting and accountability had been practised within an organisation which tried to promote itself as a modern international corporation. This research identifies how people with power in Japan managed to control accounting and accountability practices through Confucianism.

1.5 Brief Outline of Chapters

The structure of the thesis has two main elements: investigation of how the Japanese developed traditional values and the implications of these for accounting and accountability practices. Chapter 1 states the objectives and contribution of the research, while Chapter 2 provides the research methodology and a literature review. Chapter 2 establishes the Foucauldian philosophical underpinnings of the thesis and justifies its research method and approach. In particular, Chapter 2 confirms the relevance for the thesis of Foucault's concept of power as demonstrated by prominent studies of the history of accounting and accountability. The chapter refers to past research on critical accounting which use Foucauldian perspectives and studies on Japanese social values influenced by Confucianism.

Chapter 3 examines how major religions and beliefs have been established in Japan and how they have been manipulated to influence the Japanese people. In particular, the chapter reviews the influence of Confucianism, Buddhism and Shintoism in Japan. The chapter investigates how these beliefs have historically and subtly affected business practice in Japan, focusing on accounting and accountability

practice. Since the 6th century Confucian teachings have been the foundation of values and beliefs in Japanese society (Maruyama, 1969; 1974; Bellah, 1985; Kitagawa, 1987). Confucianism in Japan has been shaped by the authority with power throughout modern Japanese history. Consistent with Foucault's theory of power, religious beliefs and values were not free from the influence of governments.

Religious power was the main concern of feudal rulers, including Ieyasu Tokugawa who founded the Edo government (1603-1868). Before the Edo era in Japan, Confucianism and Buddhism played a similar role as 'pastoral power' to benevolently guide people. However, the Edo government took away pastoral power from Buddhist temples, which then had great influence over the Japanese, in order to gain unconditional and permanent obedience from society (Bellah, 1985). To establish a strong feudal society Tokugawa made Confucianism the basis of the belief system of his regime (Bellah, 1985). Only approved schools of thoughts derived from Confucianism were allowed by the government. In addition to the social contractual power of the Edo government, disciplinary power which is encouraged by Confucianism invisibly prevailed to subject Japanese society (Foucault, 1977; Bellah, 1985; Maruyama, 2006).

The thesis investigates how the Edo government established a Confucian-led legal system and scholarly authority to control its subjects throughout the social hierarchy. Business people followed the example of high-ranking scholarly samurai warriors who studied Confucianism and behaved ethically according to Confucian instructions (Sakudo, 1979; Egashira, 1992). This resulted in a new system of power and supervision in Edo society, which is a particular focus of Chapter 3. The

belief system and values were shaped and enforced by the Edo government instead of directly from religious leaders. Once society agrees to norms, people voluntarily adhere to them, adopting strict self-discipline and watching each other to ensure everyone complies with the norm (Foucault, 1977). In the Edo era there was an official system of surveillance among local people to ensure the 'safety' of society, which helped to strengthen self-discipline among people (Yasumaru, 1974; Bellah, 1985). Normalising power worked effectively using Confucian teachings which also resulted in disciplining the Japanese with accounting and accountability practices.

Chapter 4 establishes how accounting rules were devised and developed by business people between the early Edo era in the 17th century and the early Meiji era in the late 19th century. The history of accounting from the Edo era provides insightful evidence of the development of accounting and accountability in Japan and the main influences on this development. During the Edo era, when there were no nationally agreed accounting standards, each merchant house devised their own business accounting rules (Kawahara, 1990). Accounting documents from the Edo era indicate that financial information was kept within a select number of employees within an organisation and that internal auditing frequently took place (Kawahara, 1990; Ogura, 1962). Research on accountability in the Edo era indicates that the significance of accounting and accountability was recognised by business people at that time and that accounting and accountability during the Edo era were substantially influenced by the traditional beliefs and philosophies of the period (Ogura, 1989, Sakudo, 1979).

At the beginning of the Meiji era, the Western accounting system began to have a significant impact on business people and organisations who wanted to promote foreign trade (Shimizu, 2010). Accounting was 'raison d`État' for the Meiji government to prevent Japan from being colonised by developed countries in the West (Foucault, 2009: 288; Kudo, 2015). The new government had to modernise the Japanese belief system and values in order to establish a firm status as a developed country and to become competitive. When the Meiji government started trading with the US and European countries, government officials encouraged large companies to use Western double-entry bookkeeping methods (Shimizu, 2010). Indeed, introducing Western business practices and accounting methods became a pre-requisite for Japan in its aim to become internationally competitive (Kudo, 2015; Someya, 1996). During the beginning of the Meiji era, the Japanese struggled with their embedded Confucian values against imposed Western business practices. Accordingly, accounting practioners from the UK, the US and Germany were invited to advise the Meiji government on modern accounting methods and other Western business practices. The thesis examines how changes in accounting rules and business environment were incorporated by businesses. The chapter includes examples from merchant houses in the Edo era and other surviving documents on accounting from the Meiji era.

Chapter 5 covers the time when imperialism was at its height in Japan between the late Meiji era and then after the end of the Pacific War in 1945. The chapter shows that, although Japanese society and its people were comparatively Westernised in the Meiji era, the government retained and nurtured Confucian-led values. They believed that strongly shared values were fundamental to the wellbeing of the nation,

especially when confronting the strength of powerful, developed Western corporations (Watsuji, 1973). Rigorous shared values based upon Confucianism were necessary to oppose powerful developed countries in the West throughout the late 19th century and early 20th century (Watsuji, 1973). Confucianism was manipulated to heighten nationalism among the Japanese and it was Confucian-led values that helped the Japanese to work collectively to establish a nation with its own strong sovereignty in Asia (Yasumaru, 1988). To understand how Western accounting was developed in Japan Chapter 5 presents examples from this period of accounting books in a corporation called Nihon Yusen and also the accounting rules published by the Japanese army. Nihon Yusen was one of the most prominent corporations and left comprehensive accounting records accessible to the general public (Hitotsubashi Univ., 2017a). Examples from Nihon Yusen indicate their development of accounting from the late 19th century to the end of the Pacific War.

Chapter 5 shows how the shifting balance of power between the Japanese governing elites and America affected accounting practices before and after the Pacific War. When the Pacific War was imminent in the early Showa era the improvement in productivity and cost accounting was repeatedly emphasised by military forces in Japan (Kubota, 2000; 2001). Although accounting standards on costing and auditing rules were established before the war, they were not appropriately practised due to a lack of qualified auditors and also a lack of interest in external auditing among business people in Japan (Kubota, 2001; Moroi, 2007). This was because Japanese shareholders tended to be members of allied companies, such as a *zaibatsu* group, and their inner circles. A *zaibatsu* was a conglomeration of family companies, such as Mitsui and Mitsubishi, in different industries and the *zaibatsu*

had significant economic and political power before the Pacific War (Udagawa, 2007). After the surrender of Japan in 1945 the US had enormous influence and authority to change the accounting standards in Japan and controlling power shifted to the General Headquarters, the Supreme Commander for the Allied Powers (GHQ) (Kikkawa, 2007). The GHQ was the driving force to impose modernised American accounting standards in Japan (Kubota, 2000a). During the post-war period z*aibatsu* groups were forced to be dissolved by the GHQ and the *zaibatsu'*s controlling power over the national economy was removed. The power of the GHQ overrode any previous authority such as traditional *zaibatsu* control.

In the decades after the war, the US Generally Accepted Accounting Principles (GAAP) were widely adopted by large Japanese businesses who wished to deal with US corporations and to be listed on the American stock market. However, research by Choi et al (1983) indicated that the Japanese did not interpret and apply the US GAAP as originally intended, that they did not entirely adopt American accounting standards. Instead, Japan established the Japanese Generally Accepted Accounting Principles (Japanese GAAP), which were influenced by similar American GAAP but modified to meet the intentions and interests of the Japanese government and businesses. The Japanese government insisted that it had to modify the American GAAP in order to meet the particular needs of Japanese industries (Tanaka, 2010). The chapter demonstrates how the belief system and values in Japan continue to influence contemporary accounting and accountability.

Chapter 6 examines how Japan rebuilt its economic strength after the defeat in the Pacific War and how Japan Inc. was established, partially through using the Japanese

GAAP between the 1960s and early 1990s. Traditional values incorporating Confucian teachings were crucial in order to establish employee relationships and to build Japan Inc. Solidarity and collective values were strengthened among the Japanese using Confucian teachings. Accounting was considered to be a useful tool to generate wealth among the Japanese (Ogura, 2003). The Japanese GAAP reflected the intentions and goals both of the Japanese government and industries which wanted to excel, especially in manufacturing products and selling them globally (Jansen, 2000). However, the continuing significant influence of traditional business customs often resulted in a number of corporations not prioritising accountability, of which several prominent examples are provided in the chapter.

Although accounting has evolved significantly since the Edo era, modern Japanese business and accounting practices are still considered to be influenced by traces of Confucian teachings (Chiba, 2009; Maruyama, 2006). In present day Japan corporations and their employees are expected to be loyal to their employers, to discipline themselves and collectively to work hard. Consistent with Confucian beliefs, for most employees in large corporations their company has been their 'second home' and, thus, they have an emotional attachment to them. This has helped corporations and their employees to establish a strong cohesive relationship which sometimes has resulted in the concealment of financial irregularities. The chapter evaluates the accounting and accountability of Japanese corporations using organisational examples and findings from interviews with business people and accounting specialists. The comment below by a senior Japanese manager indicates how the embedded traditional values still play a significant role in

accountability practices in Japan.

> Employees pretend that they know nothing even when they knew about a wrongdoing of their company. This is typical in any Japanese organisation. This is not only the case for accounting scandals. The Japanese are embedded with traditional Confucian teachings and its moral values. Yet, the Japanese do not necessarily challenge their seniors or companies' wrongdoings but instead let it go. Western people who join the organisation would probably speak up (Interview with Y, 2017).

Chapter 6 and Chapter 7 present organisational examples of accounting scandals and argue their indirect relevance to Confucian teachings. In Japan accounting standards were updated and tightened every time society experienced serious accounting scandals. These chapters consider contemporary accounting and accountability problems.

Chapter 7 further examines the development of accounting and accountability and their implications for business people in the late 1990s and early 2000s by presenting recent organisational examples where the relationship between accounting practices and social norms is made obvious by corporate crises. In recent years, as a growing number of modern Japanese corporations have had to deal with the intense exposure of international commerce the significance of complying with internationally agreed accounting standards has escalated (Tanaka, 2010). Investors of Japanese corporations are no longer '*keiretsu'* group companies only, the modern form of a *zaibatsu* group.

More disclosure of accounting information is demanded by shareholders and also by the public. Adopting new accounting standards, which usually reflect the political and economic requirements of a nation, has required substantial changes in corporate culture and business practices (Tanaka, 2010; Suzuki, 2012a, Shimizu, 2010). In

response to the recent global movement towards internationalisation of accounting standards in developed countries, Japan agreed to introduce International Financial Reporting Standards (IFRS) in 2016 and recognised the importance of complying with IFRS (Ogura, 2014). Examples from the newly introduced IFRS and their implications for accounting practices in Japan are also presented in the chapter.

The significance of recent accounting scandals are examined using semi-structured interviews in order to understand the difference between the traditional perception of accountability in Japan and accountability based on Western methods and standards and the implications this has for accounting practices. The US continues to influence the Japanese accounting standards and the global pressure for the introduction of IFRS has made Japan modify its own GAAP. The research also identifies unique business customs and practices in Japan and how they have made an impact on accounting and accountability. The chapter presents how Confucian values continue to affect the way in which accounting and accountability are perceived and managed. Evidence from accounting scandals in 21st century Japan, most importantly the Olympus case, highlights the continued influence of historic values.

Discussion and conclusions are presented in the final chapter, Chapter 8. The concluding chapter summarises the research and core findings. The findings of the research explain how the enduring belief system and values of Japan affected the development of accounting and accountability and their implications for contemporary business in Japan. The chapter also suggests a related subject for potential future research.

Chapter 2 Methodology and Literature Review

2.1 Introduction

This chapter establishes the research methodology and theoretical framework which underlines the main body of the thesis and identifies relevant studies, mainly in accounting literature. The research for this thesis has drawn upon extensive primary sources and previous research. A Foucauldian perspective, in particular his work on power and discipline, is adopted to analyse how accounting and accountability have been influenced by Confucian-led values between the Edo era (1603-1868) and contemporary Japan. The research reveals how power relationships are intertwined with traditional Japanese beliefs and how Confucianism became a major influence on business practice, most especially accounting and accountability in Japan (Foucault, 1999; Napier, 2006).

Drawing extensively upon Foucault's work, accounting scholars have unmasked the way in which accounting represents power relationships and provides a means of disciplinary power within an organisation and also within society (Hoskin and Macve, 1986; Miller and O'Leary, 1987; Bigoni and Funnell, 2014). Power is defined as a complex flow and set of relations between different groups and areas of society which changes with circumstances and time (Danaher et al, 2002: xiv). Foucault believes power is not simple or stays in the same place. Instead, power is exercised from innumerable points and in the interplay of non-egalitarian and mobile relations (Foucault, 1976: 94). Foucault conceputualised power as sets of skills and knowledge which must be mastered in order to achieve dominance in particular fields (Danaher et al, 2002: x). He expounds relations of power-knowledge as intricate matrices of transformations (Foucault, 1976: 99). This research identifies and

analyses the significance of accounting in the implementation of power and its relevance to accountability in Japan using surviving documents, organisational examples and interviews.

Disciplinary power operates through the calculated management of social life through norms and standards (Miller and O'Leary, 1987). The Edo government, and successive governments, in Japan directed its people to adopt Confucian-led values, guiding them to become virtuous and useful people in society (Maruyama, 2006; Watsuji, 1973). Elements of Confucianism still have a great impact on contemporary Japanese society, for power works most successfully when it is covert and implicit. As a mechanism of power, accounting subtly and effectively reveals the intentions of rulers and business owners (Funnell, 2013). Business people had to ensure that their businesses complied with the intentions of the Edo government otherwise their survival was at stake (Ogura, 1962).

Everyone in society is subject to disciplinary power to create social norms and to ensure that these norms are obeyed in the community (Foucault, 1976). Disciplinary power enables people in a community to monitor each other to ensure their norms are achieved and people are effectively monitored. In Japan, Confucianism has played a significant role in order to make disciplinary power effective. During the Edo era, laws and social norms were formed based upon Confucianism which became the basis of disciplinary power (Bellah, 1985). In the Edo era Confucian teachings provided the foundation for both disciplinary power and contractual power, which was given judicial enforcement. After the Edo era, the disciplinary power in Japan was further enhanced and established through standardised education and an employment system where surveillance was

formalised in modern society. Throughout the history of modern Japan Confucian teachings were modified to suit the intentions and objectives of the Japanese government and business owners in order to encourage people to work harder and be uncritically subservient to their employer (Morishima, 2004). The research identifies the implicit and historical disciplinary power of accounting and accountability practices and their implications for present-day Japan.

2.2 Research Methodology and Past Research on Foucault and Accounting

The ontological assumption of this research is that reality is socially constructed through power relations (Saunders et al, 2016). The perspectives and priorities of the authority with power are able to influence reality (Foucault, 2009). Reality is believed to be constructed through social interaction in which social actors create partially shared meanings and realities (Saunders et al, 2016: 130). Social phenomena are considered to be created through the perceptions and consequent actions of social actors (Saunders et al, 2016: 151). The epistemological assumption is that there is a strong relationship between knowledge, power and 'truth' (Foucault, 1976). Knowledge in society is decided by dominant ideologies (Saunders et al, 2016: 137). Foucault argues that power produces knowledge and, thus, power and knowledge directly imply one another (Foucault, 1977:27). He believes it is not the activity of the subject of knowledge that produces a corpus of knowledge but instead, the processes and struggles that create the power-knowledge interactions and determine the forms and possible domains of knowledge (Foucault, 1977: 28).

Power and its relevance to accounting and accountability have been examined by a number of accounting researchers. Power is significantly dependent on knowledge and, accordingly, a person with accounting knowledge could have considerable power (Bigoni and Funnell, 2015). People with accounting knowledge have more power within an organisation and have the ability to control financial information which could predict future business opportunities or estimate potential financial losses (Hoskin and Macve, 1986). In a study by Loft (1986) she also found that power itself has the ability to generate systems which produce knowledge. During the First World War, a group of elite professionals in the UK became involved with implementing legislation dealing with cost accounting with the intention of helping to prevent profiteering and to achieve a fair price for goods and materials in order to improve the efficient use of resources at a time of war. A similar scenario happened when Japan was preparing for the Pacific War under military control (Chiba, 2010b; Watanabe, 2011). Loft argues that accounting reflects the wider society and it bears a constitutive role. Her research indicates that knowledge and truth are part of the effects of power and, therefore, they are all intricately and complicatedly connected (Loft, 1986).

This research is based upon a qualitative research method, employing both primary and secondary data. An historical narrative analysis is applied to examine archival documents while semi-structured interviews took place to collect contemporary data. Collected data are analysed to understand the historical development and contemporary practices of accounting and accountability through a Foucauldian lens. Drawing upon the conceptual framework provided by Foucault in *Discipline and Punish* (1975), *The Will to Knowledge: The History of Sexuality1:* (1976) and *Security, Territory, Population: Lectures at the College de France 1977-78* (2009),

his perspective on power and discipline provide a well-recognised means to understand how in Japan power relationships reflect Confucianism and that social norms, accounting and accountability are closely intertwined (Foucault, 1977; 1976; 2009). The Foucauldian critical perspective interprets historical facts as a possible result of immensely complex relationships between power and governability (Bigoni and Funnell, 2015; Chikudate, 2002: 206). This relationship between power and discipline is extensively argued in the thesis to establish how Japanese business people historically have developed accounting and accountability by self-governing themselves, thereby reflecting Confucian-led values (Foucault, 1977; Bellah, 1985).

Foucault expansively argues that the emergence of disciplinary power overwhelmingly provided the means to control modern society and individuals. He argues that power produces a reality and a truth that favours the interests of those with greater authority (Foucault, 1977: 194). In the case of Japan, for example, to ensure that the Edo government maintained its authority and legitimacy, Confucianism provided the means to enable them to hold on to their power for over two hundred years. However, power is not always negative but instead, Foucault contends that power also has positive aspects which benefit society and business (Foucault, 1977; Hoskin and Macve, 1986). In modern society power changed its overt form of direct, often public, punishment to a more implicit demonstration by the disciplining of a target person (Foucault, 1977). Power is effectively utilised through the use of a faceless gaze that will eventually transform the whole social body (Foucault, 1977: 210) Pervasive power forces subjects to co-operate and convinces them to self-govern in their society or organisation (Hoskin and Macve, 1986). This can be witnessed in a panopticon type of prison where a supervisor is

able to observe all inmates without the inmates being aware that they are being watched (Foucault, 1977: 200). Each individual prisoner would be isolated from other prisoners and follow prescribed movements and exercises in their individual cells (Foucault, 1977).

Foucault asserts that individuals and groups of people can be governed by the equivalent of a shepherd or pastor in terms of their bodies, souls and behaviour (Foucault, 2009: 122). Traditionally a pastor was supposed to guide his followers and protect his flock of people. The relationship between the shepherd and his flock was seen by Foucault as similar to the practice of government and discipline in modern Western society (Foucault, 2009). According to Foucault, 'to govern' has had multiple meanings historically, including following a path, looking after someone and communicating with someone (Foucault, 2009: 121). 'To govern' also has a moral meaning such as guiding someone's soul and imposing a regimen of activity (Foucault, 2009: 121). In Western society in the past, extracting the truth from followers by a pastor at a time of confession was given prime importance; the acquisition of the truth represented pastoral power (Foucault, 2009). However, the Japanese equivalent of pastoral power and authority did not require the truth from their subjects as in Western society (Kitagawa, 1987; Zenke, 2004). For example, as long as the Edo government was able to maintain its feudal regime peacefully, extracting a regular confession was not considered to be important.

The government believed that by disseminating Confucianism, samurai warriors and ordinary people including business people would be obedient and diligent (Bellah, 1985; Zenke, 2004). Business people in merchant houses believed that their destiny

was to work hard and make profits, which in a long run they were able to contribute to society (Ogura, 2003). A number of business owners in the Edo era left analects to their descendants and employees to follow.

> Life is to work hard. When you work hard, you won't get poor. Work is the source of profit. When you work hard, naturally you will be able to obtain profits (Source: Written by Nakai Genzaemon the Second in Ogura, 2003: 41).
>
> Commercial business is to fulfil shortcoming in society through buying and selling, which is in line with Buddha's will (Source: Written by Ito Chubei in Ogura, 2003: 41).

Recording business transactions was compulsory to manage one's business and, thus, accounting methods were devised and operated in merchant houses. A more detailed discussion of accounting practice during the Edo era is provided in Chapter 4.

A considerable body of research has indicated that accounting represents a very persuasive way of controlling and administrating organisations and their employees (Miller and O'Leary, 1987). This research examines the form of power which operates, supervises and governs people within business organisations with the help of accounting. One focus is on the emergence of standard costing and budgeting between the 1900s and 1930s, a time when scientific management and costing were aligned to gain efficiency in managing resources. By deciding and calculating standard costing and budgeting, managers were able to identify the inefficiencies of workers and the possible use of other resources to benefit the business. Managers legitimately proposed norms and targets, which created calculable and governable men (Miller and O'Leary, 1987).

The knowledge and techniques of accounting, which are able to measure efficiency

in quantitative terms, enables the creation of calculable subjects whose productivity is the focus of their employers and the government. As a result, the notion of 'calculable man' became the internalised norm in society. In particular, it helped Japan to become a modern industrial nation in the late 19th century. Accounting plays a vital role in the calculation and advancement of productivity. In modern business, through the calculation of the productivity of target subjects, the government or organisation is able to control its employees and to promote productivity (Hoskin and Macve, 1986). Accounting is considered in Japan to be the means to promote its businesses and national wealth, as well as, to control individual employees and society as a whole. The introduction of modern accounting methods helped Japan to achieve its economic targets (Someya, 1996). However, there is a danger in the manipulation of accounting practices in the exercise of power through hierarchical relationships in an organisation. This is extensively examined in later chapters.

Hoskin and Macve (1988) investigated the records of the Springfield Armory using a Foucauldian perspective. Their study examined how piece-rate accounting gained its legitimacy and how disciplinary power influenced accounting and accountability. Accounting was used in the Armory to create norms for a 'calculable man' in order to enhance efficient productivity. As a result, a new type of deliberative and purposive 'managerialism' emerged and human accountability techniques were introduced (Hoskin and Macve, 1988). Power and knowledge have the ability to generate a new type of supervision, that includes accounting. Accounting allows legitimisation and normalisation within the organisation. In the Springfield Armory a supervisory eye or social gaze emerged through accounting

practices which promoted discipline among workers and, thereby helped them to form norms (Hoskin and Macve, 1988). The social gaze made workers, discipline themselves and behave according to the norms without being physically forced.

The full disclosure of accounting information is not usually available for ordinary workers, nor do they necessarily understand the mechanism by which they are being controlled by their managers (Foucault, 1977). The distribution of power in business organisations is not equally possessed by managers, accounting specialists and ordinary workers. Managers and accounting specialists have significantly more power than ordinary workers because of the considerably different amount of knowledge they are allowed to acquire and their position within an organisation's hierarchy. This enables managers to disclose only partial accounting information such as keeping details of a reserve fund which they deliberately conceal from ordinary workers. Their deliberate action may result in the implication that their company is not doing well. This would compel workers to feel pressured to improve their productivity (Saguchi, 2015) and, thus, they discipline themselves to accept lower wages in order to help the financial situation of the company. In this way, accounting practices have the ability to legitimately create surplus profits and to encourage workers to work harder.

Accountability involves providing and demanding reasons for conduct (Roberts and Scapens, 1985: 447). A company's accountability requires it to produce financial reports which are a fair representation of its financial position and activity. In modern society, organisations have a responsibility to all relevant stakeholders, including shareholders, lenders, employees, local community and society as a whole

(Crane and Matten, 2010). Accountable managers are expected to explain and take responsibility for their actions (Sinclair, 1995: 220). Sinclair (1995) also argues that there are discipline-specific meanings and perspectives related to accountability. For example, auditors tend to consider that accountability can be translated into numerical results whereas philosophers regard accountability as a part of ethics (Sinclair, 1995). Accountability is a morally significant practice, since it demands a person to enact discursively the responsibility for one's behaviour (Messner, 2009: 920). This generic meaning of accountability underlies the use of the notion in both the financial and management accounting literature (Messner, 2009: 920). Messner stresses the importance of identifying the limits of accountability in order to fully understand and foster sensitivity in conflicts and ethical issues which arise in business activity (Messner, 2009). Accountability also reflects social norms (Sinclair, 1995). For example, the level of accountability required in accounting practice was lower in the 1960s when CPAs' certifications were not legally required but it was socially acceptable at the time (Someya, 1996; 1997; Suemasa, 2002).

Accounting and accountability also have the ability to play an important role in the political domain. Radcliff (1998) examined how efficiency auditing by the Progressive Conservative government in Alberta, Canada, helped to secure their political power by having a significant impact on public opinion (Radcliff, 1998). The Progressive Conservative government, which won the election and took office in Alberta in 1967, had convinced voters that their management of the government would be significantly improved by implementing efficiency auditing (Radcliffe, 1998). Auditing was now considered to be a powerful source of knowledge which would allow individual people to monitor the accountability of their government

(Radcliff, 1998: 377). Thus, the accountability of the government in Alberta was exposed to greater scrutiny at the request of the public who believed in the power of auditing (Radcliff, 1998). The research into efficiency auditing in Alberta indicates that the operation of power to discipline derived from accounting and accountability, can be used in politics as an effective tool. Radcliffe argued that the operation of power to discipline can take place at all different levels, such as in a national government, local government, public opinion and the individual (Foucault, 1977; Radcliff, 1998). Accordingly, accounting practices and auditing are now considered to be disciplinary technologies and the result of the translation of governmental plans into policies (Lai et al, 2012:372; Rose and Miller, 1992).

2.3 Religious Beliefs and Accounting

The beliefs that have shaped Japanese society and their implications for accounting and accountability in Japan are the key concerns of this thesis. Accounting researchers have increasingly recognised the significance of religious beliefs for accounting practices and they have identified how accounting benefitted from these beliefs to become an effective tool in the exercise of power and control (Cordery, 2015). Jacobs (2005) and Neibuhr (2001) argue that accounting has profoundly and subtly had a sacred link to Christian organisations and contend that it is too simplistic if accounting practices are categorised as secular. For Christians, dealing with financial matters wisely is a fundamental attribute and, thus, accounting is considered to be a spiritual discipline (Jacob, 2005). However, accounting was deliberately suppressed in the Christian church because it had the potential to become a threat to the power and jurisdiction of the clergy (Jacob, 2005). Hence, the importance of accounting was not explicitly publicised among church members and a sacred-

secular dichotomy was deliberately reinforced (Laughlin, 1988; Jacob, 2005). Laughlin (1988) examined accounting systems of the Church of England and their wider implications for society. He concluded that the social context had the ability to shape the accounting practices of the Church of England when limited importance was given to accounting by the church (Laughlin, 1988). Although accounting played a significant role within the Church of England, it was not supposed to invade the 'sacred' area of these organisations, creating a clear sacred-secular dichotomy (Laughlin, 1988). Laughlin (1988) argued that the Church of England treated accounting as a secular subject in order to maintain their sacred identity and authority. Accounting was used to control lives of monks and each local church (Bigoni and Funnell, 2015).

The Roman Catholic Church, in particular, has left a significant amount of surviving accounting documents for contemporary researchers to analyse. A recent study by Bigoni et al (2013) has shown the importance of accounting information and practices when accountability was re-established during the 15th century within the Roman Catholic Church when the Pope instigated a major reform of the church, focusing on the Diocese of Ferrara in the north of Italy. Details of the relationship between accounting, governmentality and pastoral power in the Roman Catholic Church in the Diocese of Ferrara demonstrated that accounting was considered to be a vital tool in the Roman Catholic Church to maintain its pastoral power (Bigoni et al, 2013).

Although the majority of the research concerning the relationship between religious beliefs and accounting predominantly focuses on Christianity, there are also studies

on Buddhism, Judaism and other religious beliefs and their impact on accounting and accountability (Cordery, 2015). Gao and Handley-Schachler (2003) analysed how Confucianism, Buddhism and traditional Feng Shui beliefs impacted upon accounting practices in China over a thousand years. They argued that Confucian teachings had a significant influence on Chinese accounting systems which maintained the same single-entry bookkeeping method for centuries (Gao and Handley-Schacheler, 2003). This was partially due to the disapproval of commercial activity within Confucian teachings in China.

Accounting was regarded as a practical subject and accordingly, it did not attract a great amount of attention (Gao and Handley-Schacheler, 2003; Kitagawa, 1987). The Chinese perception of accounting and commercial activity, based upon their understanding of Confucianism, prevented them from advancing their own accounting systems because they believed profit-making was not to be encouraged. This was very different from Japan where, during the Edo era, the government created their own version of Confucianism which permitted active commercial advancement (Bellah, 1985; Ishida, 1975; Chiba, 1998). Their interpretation of Confucianism was not the same as in China. The Edo government modified Confucianism in such a way that their subjects would live and work according to the intentions of the government. This demonstrates how national norms reflected the way accounting and beliefs have been interpreted differently in individual countries. Accounting plays reflective and constitutive roles in society (Napier, 2006) and this research highlights the historical development of Japanese accounting.

2.4 Confucian Teachings and Japanese Society

Tu (2001) extensively reviews how Confucianism has been developed from classical Confucianism, Neo-Confucianism to New Confucianism, which became an integral ethos of East Asia. The historical background indicates that Confucius aimed to restore trust in government and to transform society into a moral community by cultivating a sense of human caring in politics and society (Tu, 2001: 12). Confucius preached that virtue and self-cultivation would bring moral excellence. *The Analects* consists of teachings and stories by Confucius and it was compiled by his disciples. Tu presents an example of how Confucianism was used for political governance, social organisation, and moral education during the Meiji Restoration in the late 19th century in Japan (Tu, 2000: 203). He argues that embedded Confucian values helped the Japanese to modernise and for its nation to flourish throughout the 20th century (Tu, 2000). A further detailed description of Confucianism is presented in Chapter 3.

The authority with power has the ability to promote particular national beliefs and to direct people to behave in a manner that will achieve national objectives (Foucault, 1976; Laughlin, 1988; Bigoni and Funnell, 2015). In Japan traditional values influenced by Confucian teachings have reinforced power relationships in society since the Edo era (Maruyama, 1969). Although Confucianism is a philosophy rather than a religion, its teachings have had a strong effect on beliefs and the expected moral standards in Japan for centuries (Bellah, 1985; Maruyama, 2006). Confucian teachings encourage followers to cultivate a range of virtues, including industrious working and filial-piety which requires respect for senior members of families and society (Butler-Bowdon, 2013; Boardman and Kato, 2003; Bellah,

1985). Confucianism emphasises the importance of building respectful ties between those in five important relationships: ruler-subject; father-son; husband-wife; elder-younger and friend-friend (Jansen, 2000). Reciprocity is also highlighted in Confucianism to ensure that one can expect a return from one's virtuous deeds (Bellah, 1985). These elements were especially highlighted by the Edo government in order to secure and govern their feudal regime. The Edo government understood the significance of normalising power and the effect of self-discipline in society.

Using Confucian teachings, the Edo government legitimised social hierarchy and a virtuous work ethos which became the foundations for a stable society (Ishida, 1975). Maruyama, whose extensive research and analysis still remains a significant reference in understanding Japanese sociology in the 21st century, has emphasised that the Japanese social structure was legitimised and reinforced by Confucian teachings (1969; 2006). Confucian teachings relied upon the power of normalisation in Japan by encouraging collective working and self-discipline (Bellah, 1985). At the same time, Confucian teachings stressed the differences in social classes and individuals which resulted in hierarchising people in Edo society (Foucault, 1984: Bellah, 1985). Even in modern Japan, the hierarchy within society and organisations are considered to be significantly important (Hofstede and Bond, 1988: Genma et al, 2006). Power relativities prevails and dominates the lives of many business people (Maruyama, 2004; Morishima, 2004).

Bellah (1985) conducted extensive research on how religions and beliefs historically shaped modern Japan in the Edo era by showing how Buddhism, Confucianism and

Shinto were intrinsically woven into the political intentions of the Edo government. Bellah demonstrated how the influence of the value system based on Confucian beliefs allowed society in the Edo era to grow into a modern industrial economy. His research, which is partially influenced by Weber's *The Protestant Ethic and the Spirit of Capitalism* (Weber, 1930, 1974) and Parsons' sociological theory (Parsons, 1928, 1929), provides a strong theoretical framework to understand the social structure of the Edo era and the modernisation of Japan (Bellah, 1985:xii). People would take for granted the hierarchy within their society and organisations, becoming more obedient to their employers and senior people as taught by Confucianism (Yoshida, 2002): *A monarch has to act like a monarch, a subordinate has to act like a subordinate; social hierarchy should never be overturned* (Ganen 12-11; the Analects of Confucius). The success of disciplinary power helped the social order to be maintained for over two hundred years during the Edo era (Foucault, 1977; Jansen, 2000). The importance of social hierarchy continues to be fundamental to business organisations in contemporary Japan.

Yasumaru's research elaborates the contextual background and the reason why the Japanese developed social norms such as being industrious, frugal, patient, devoted and pious (Yasumaru, 1974; 1988; 2004). These norms worked extremely effectively in Japan by using the belief that if one is poor it is because one had not worked hard. Individuals were compelled to feel that they had to work hard to maintain their dignity and living standards (Yasumaru, 1974:5). Yasumaru critically analysed how these virtues have been emphasised and promoted by society, which formed an effective mechanism for society, and thus those in power, to control people in Japan (Yasumaru, 1974; 1988). Although there were occasional revolts

by farmers and workers throughout modern Japanese history, the Japanese ruling class managed to govern the nation without any fatal revolutionary acts.

Social norms during the Edo era shared a number of similarities with Weber's *The Protestant Ethic and the Spirit of Capitalism* (Yasumaru, 1974). Business people believed firmly that only asceticism and diligence would remove any potential risk of losing their businesses and assets. Yasumaru (1974) states that individualism, greed and leisure were given negative connotations especially in Edo society up to the end of the Pacific war. Even after that time the government still highlighted the importance of maintaining traditional Japanese values (Watsuji, 1973). A great number of Japanese continue to hold traditional values based upon Confucianism and Buddhism, especially collectivism and respect for the social hierarchy (Maruyama, 1969; Yasumaru, 2004). Individualism is often perceived negatively and self-sacrifice is addressed as a noble act in society (Yoshida, 2002). The Edo government developed a social hierarchy within which business people generated wealth not only for themselves but also for their lords and the Shogun, the ruler of the nation.

Doi (1973) argues that the Japanese tend to treat people in the same inner circle, *miuchi*, very differently to anyone outside this inner circle, although they would be still polite to them. They expect members of the *miuchi* to implicitly understand the norms and intentions of their inner circle and totally depend on each other (Doi, 1973). Every inner circle establishes its own norms and creates a culture. Collective decisions are more welcomed than appreciating individual differences or asking opinions from other groups (Maruyama, 1969; 1974). In contemporary

Japan, business people continue to prefer unanimous decisions and, thus, tend to wait to see how things are done by their peers or competitors (Yasumaru, 2004). Closely united members within an inner circle create their formal or informal hierarchy and they respect its ranking order (Maruyama, 2006). The notion of *miuchi* can result in a cohesive work ethos but it can also cause the ostracism of non-members.

Confucianism is occasionally criticised for the little importance allowed for rhetoric or critical thinking, as in Hellenic philosophy (Weber, 1951). Being docile and harmonious was highly praised in Japanese society rather than initiating dialogues with your master, teacher or lecturer. After Confucianism was first promoted by the Edo government, people in the samurai class and wealthy merchants eventually internalised its teachings and they established norms by creating a number of house laws, which were a code of practice voluntarily put in place (Bellah, 1985). The government constantly monitored its subjects to prevent especially any rebellion by the elite, powerful samurai class. The Edo government was using Confucianism as a controlling mechanism which had made possible normalisation judgement within the society (Foucault, 1977).

Watsuji's (1973) research on the ideologies and ethos that have developed throughout Japanese history demonstrates how Confucianism was chosen to become the official source of moral standards and the legal framework in the Edo era. The combination of Confucianism and traditional beliefs shaped and established the Japanese version of Confucianism which prevailed for centuries in modern Japan (Watsuji, 1973; Maruyama, 2006). Watsuji (1973) and Maruyama (1969; 1974; 2006) identified significant philosophical works by prominent thinkers in the Edo

and Meiji eras and how they influence the general public in modern Japanese society. Their insightful consideration is frequently referred in this thesis when traditional beliefs and philosophies are discussed. Honour and reputation were given a high value which people had to establish and retain in their families for generation after generation, especially in the Edo era and Meiji era (Miyamoto, 2007; Yoshida, 2002). Anyone who did not conform to the norm was punished by humiliation and shame. The resulting loss of honour and reputation would have been very damaging to one's family and community (Miyamoto, 1964; 2007).

2.5 Interviews

2.5.1 Data Collection and Ethical Considerations

To understand how accounting and accountability are perceived and practised in the contemporary Japanese workplace and how Confucian-led values prevail among them, semi-structured personal interviews with business people and former practitioners were conducted. The interviews focus on perception and experience of participants (King and Horrocks, 2010). The interviews in this study explore participants' views on accounting and accountability practices in a workplace. A questionnaire was formulated to obtain participants' experience, knowledge, factual information and values (King and Horrocks, 2010). The questionnaire includes core questions that structure the direction and emphasises of the interviews, was sent in advance and the consent was agreed with each interviewee. Their experiences and viewpoints in accounting scandals and accountability practices were shared (See Appendix 1).

A purposeful sampling approach was adopted in which interviewees were selected

based upon their experience in Japanese corporations, accounting and accountability practices. The sample number of between twenty-five to thirty was decided based upon using criteria proposed by Creswell (2007) and Charmaz (2006) who recommend between twenty to thirty participants for the grounded theory approach. Obtaining a referral was extremely useful to find interviewees for this study as the topics involve sensitive issues such as scandals of their own companies (Saunders et al, 2016: 568). During the course of theoretical sampling, the saturation point arrived at twenty-eight were conducted in order to strengthen the validity of the theoretical categories. Theoretical sampling is to finalise theoretical categories by repeatedly investigating and analysing interview data (Charmaz, 2014: 345). Data collection and their analysis were carried out until the theoretical saturation point where no further theoretical category was reached (Charmaz, 2014: 345).

Twenty-eight interviewees agreed to participate in the study. Twenty-three out of the twenty-eight interviewees held managerial positions or were former managers. Interviewees came from a variety of industries including manufacturing, finance, service and accounting (See Table 2-1 and Appendix 2). All the interviewees readily agreed to share their insights and experience in this research as long as their anonymity was preserved (Table 2-1). Interviewees include an ex-executive banker who worked for financial institutions in both Japan and Britain, an executive banker who used to work for an ex-*zaibatsu* corporation, a Japanese ex-managing director working in the UK and a division manager of the same company in Japan. In addition, current and ex-employees of large Japanese manufacturers participated in interviews to share their experiences. Interview participants also include certified public accountants (CPAs) who experienced auditing operations for large

corporations in Japan and accounting researchers who had extensive experience in observing and investigating internal accounting information of large corporations and SMEs in Japan. All participants had a broad international exposure and were also able to compare Japanese examples with Western standards. The most senior participant was 70 years old and the youngest was 26 and the average years of business experience is stated in Table 2-1.

Table 2-1: Sectors of Interviewees

Sector	**Number**	**Average business experience (years)**
Manufacturing	8	23
Finance	3	15
Service	5	17
Accounting specialists	8	20
Others (consulting, researchers)	4	23
Total	**28**	**Total Average 19.6 years**

The interviews took place between July, 2015 and March, 2018. Twenty six interviews were face-to-face interaction and another two interviews were conducted through the Skype video conference. These two Skype interviewees later agreed to have supplemental meetings with the author to further discuss issues about their views on accounting and accountability in Japan. Apart from one exception, interviews were conducted outside of the participants' workplace. One participant refused to be tape-recorded because he met the author within his office building, and thus he allowed only a written memo. The rest of the interviews were tape-recorded and transcribed, which were then translated into English by the author for analysis (See Appendix 3 for a sample).

Each interview session was highly interactive and research participants' views and insights were allowed to emerge for the study. The information obtained was later

analysed through Foucauldian perspectives and the format was based upon Grounded Theory approach, which is further elaborated in the following section. Interviews were carefully planned to ensure reliability and to prevent interviewers' bias. To reduce the total amount of interview time interviewees were able to prepare their responses. Although a list of questions was provided for the semi-structured interviews, interviewees were able to talk freely on accounting and accountability issues and they also had the opportunity to consider the relevance of these to Japanese society and beliefs. Some interviewees spent more time on specific topics about which they felt particularly strong. For example, an interviewee who was in the banking industry was keen to explore accountability incidents which she had experienced and other interviewees also extended their time to explain their personal experience of questionable accounting and accountability practices in their current or former workplaces.

Owing to the nature of the interview topic, which may contain confidential information, the anonymity of interviewees is strictly protected. All interviewees were co-operative and they were very positive about discussing the topic on their beliefs, accounting and accountability in present day Japan. The intense nature of the interview permitted an in-depth exploration of particular topics and experiences (Charmaz, 2006). Interviews were conducted to establish the interviewees' understanding of how contemporary accounting and accountability in Japan were perceived and to reinforce the findings from archival sources from different periods. Interviews were especially helpful in discovering how traditional beliefs and values might implicitly affect the business world. The interviewees' accounts of social norms and contextual backgrounds are analysed to establish how they dealt with

concerns with regards to accounting and accountability.

The process of data collection was directed by the theoretical constructs adopted from Foucault, most especially his concept of disciplinary power (Foucault, 1976; 1977). The data collection was conducted through an ongoing process that involved multiple stages (Bryman and Bell, 2011). In order to alleviate the power dynamics with the interviewees or skepticism felt by the interviewees about their confidentiality, the entire interview process took considerable time. In some cases, before the face-to-face interviews were held, the author spent months to build trust and rapport with interviewees in advance by email, telephone conversations and preliminary meetings. Preliminary research on interviewees' organisations such as their history and main businesses were carried out to ensure an effective outcome. This helped the interviewees feel confident and reassured about being interviewed by the author, especially when they spoke about sensitive historical accounting problems in their organisations or in their old workplaces.

Interviewees provided a wealth of practical knowledge and personal opinions on the subject of the thesis. Collectively, they had extensive experience and knowledge about accounting and/or accountability in business and gave insightful comments for the research. The interviews included discussion of Japanese accounting fraud cases which had to be examined within the context of Japanese business history and accounting practice. The average interview lasted for two hours but, in most cases, the interviewees strongly expressed their willingness to continue discussions on accounting, accounting scandals and accountability after the recording device was switched off. After the completion of interview sessions, the data was

supplemented with additional emails and conversations with interviewees which were also analysed using the grounded theory approach. The information obtained from non-verbal communications was also included in the field notes to reinforce the validity of interview data.

Interviewees consistently emphasised how important it is for Japanese business people to internationalise and improve accounting and accountability practice. Interviewees from long established corporations witnessed the strong hierarchical relationships within their organisations, which they believed to be a cause of some of the recent accounting scandals. This will be further demonstrated and argued in later chapters. Some of them shared confidential accounting issues from within their organisations, some details of which were allowed to be published in this research as long as identities are protected. Interviewees were able to expand the realm of their discussions under this format. Interview data identified insightful truths about the workplace and discovered the challenges of accountability when dealing with company accounts. Interviewees were extremely enthusiastic about discussing how accountability should be improved in Japanese corporations.

The most significant concern raised by interviewees was the fact that the traditional business values have not completely disappeared in many Japanese organisations. Most interviewees believed that embedded values derived from Confucianism would prevent them from questioning or opposing their seniors when they encounter a potential accounting problem. Non-Japanese interviewees who have had business experience with the Japanese commented that they witnessed the submissive attitude of their Japanese colleagues towards their bosses. Non-Japanese participants soon

realised the importance of hierarchical relationships within an organisation once they joined Japanese corporations. They also sensed a 'polite' division between their Japanese colleagues and themselves as non-Japanese. The formers' workload expectation and the degree of loyalty to the company were greater. This viewpoint is further elaborated in Chapter 6 and Chapter 7 on 'inner circle' members in Japanese corporations.

2.5.2 Conceptualisation based upon Grounded Theory

Grounded theory methods entail systematic but flexible guidelines for collecting and analysing qualitative data (Charmaz, 2014: 1). In this research, the grounded theory approach is applied to examine the interview data and textual documents such as accounting records and correspondence. Coding was conducted based upon grounded theory to extract core concepts and theoretical dimensions as used by Charmaz (2006; 2014). This approach also provides researchers with a guide to understand the business world they research and a method for developing theories to comprehend research objects (Charmaz, 2006:10). It is considered highly useful, especially when dealing with open-ended and emergent interviews (Charmaz, 2006). Interviews provided opportunities of interaction whilst focusing on the topic of accounting and accountability influenced by Confucianism (Charmaz, 2014).

Interviews were highly interactive and, therefore, they allowed research participants' views and insights to emerge. This is called constructivist grounded theory which uses inductive data to construct abstract categories through an interactive process (Charmaz, 2014: 15). Charmaz's constructive grounded theory claims a researcher is part of the research object. In the present research, this has enabled the researcher to discover what has been occurring in accounting and accountability in Japan

(Charmaz, 2006; 2014). Interviewees' discourses included their concerns and justifications of past events while their taken-for-granted assumptions in accounting and accountability were revealed for the analysis. Interviews were flexible and allowed the author to discover discourses and to pursue emerging ideas and conceptual issues (Charmaz, 2014).

One of the most crucial practices in grounded theory is coding (Glaser, 2000; Charmaz, 2006). Codes emerged as interview transcripts and archival information were analysed. The coding helped the author develop theoretical categories and analyse them. According to Glaser, (2000) and Charmaz (2006), there are two phases in coding: first-order coding and focused coding. First-order codes and theoretical categories were created by identifying statements from interviewees (Glaser, 2001). Those statements which were the views and experiences of interviewees were formed into first-order codes and then reviewed in order to create theoretical categories. The first-order codes were consolidated in order to be conceptualised and to form more focused and aggregated theoretical dimensions (Charmaz, 2006). Transcription files were scrutinised to highlight what interviewees were arguing and their assumptions about accounting and accountability in the workplace. Transcriptions were line-by-line coded to identify broad situational factors that influence the attitude of Japanese business people (Creswell, 2007; Charmaz, 2006). Line-by-line coding is used to give a name for each line and it is extremely useful for identifying tacit assumptions and implicit meanings (Charmaz, 2006: 50). NVivo 11, computer-assisted qualitative data analysis software, was used to ease manual tasks associated with the coding process (Bryman and Bell, 2011: 593).

Focused coding is the second major phase in coding and is more conceptual than line-by-line coding (Charmaz, 2006: 57). By going through a vast amount of data with the initial coding, the analysis and conceptualisation were implemented to generate focused codes which are also called theoretical categories. In examining theoretical categories, more abstract theoretical dimensions were identified. Arrows in Table 2-2 show that a few theoretical categories reach one aggregate theoretical dimension. Constant comparison of statements was conducted to reach theoretical elaboration of the category that emerged to establish 'Aggregate Theoretical Dimensions' (Charmaz, 2006). Theoretical sampling was applied to refine and to develop theoretical categories which were initially considered. Aggregate theoretical dimensions formulate a cohesive conceptual set when explaining taken-for-granted assumptions about accounting, accountability and beliefs among Japanese business people. Discussions on contemporary accounting practice of the thesis reflect the analysis of interviews using the grounded theory. The data from participants indicate that Confucianism is embedded in contemporary Japan but it was significantly implicit. It is also evident that the majority of participants felt strongly about the necessity of changing traditional business practice.

Table 2-2: Overview of Interview Data Structure

Examples of First-Order Codes	**Theoretical Categories**	**Aggregate Theoretical Dimensions**
Statements about collectivism in Japanese organisations; 'Harmony in a group is important. I would do what I am told to prevent an unpleasant conflict'; 'Not many people question their bosses.' The hierarchy within the organisation is really important;	Collectivism within Japanese organisations	Traditional values influenced by Confucianism prevail deeply in society and its disciplinary power
Statements about traditional values; 'Japanese traditional values are deeply ingrained in my mind.'; 'Following traditional values is important.'; 'Religious rituals are still very much practised in Japan.' 'We practice Confucian teachings in our daily lives without explicitly realising they are Confucian teachings.'	Traditional values are implicitly ingrained in society	
Statements about membership of the inner circle (nakama-uchi); 'I know there is a polite but clear division between Japanese members of staff and non-Japanese members within a company. Their expectation was different.' 'I have seen discriminatory treatment towards non-Japanese members of staff' 'There was a very strict hierarchy in the organisation and you were not supposed to question what you were told'.; 'If you work for one company for a long time, you would be trusted and have more chances of promotion..' ; 'It is important for your boss to like you in order to be promoted.'; 'We didn't share embarrassing financial information with external people. We'd rather conceal it.' 'My boss protected the job security of his immediate subordinate even when the economy was bad.'	To draw a clear line between inner circle members and external people	
Statements about employment system and work ethos; 'I am a Japanese salaryman, so I cannot come out of my office before 10 or 11 pm during weekdays.'; 'Board of directors in Japanese corporations tend to be long-serving ex-employees. They are proud to serve the same company.'; 'Japanese work ethos is very unique and you don't see similar employment systems in other countries.'	The Japanese employment system helps organisations to discipline their employees	

Statements about beliefs; 'I do attend religious ceremonies and regularly visit the graveyard of my ancestors. I know they look after me from Heaven.'; 'Confucianism is ingrained in my behaviour. Perhaps, most Japanese agree with me.' 'I am not a very religious person but I regularly go to a temple to pray. You should do the same when you are in Japan'. 'My moral standards are probably based upon Confucian teachings although I never thought about it.' 'My values are formed based upon my upbringing and what I learnt from my parents. I think Confucianism is the backbone of my values.'	Embedded beliefs and Confucian teachings	
Statements about relationships with one's organisations; , 'When I quit the job, I felt so guilty and I felt like my marriage to the company ended. I was so emotional.'; 'I am Japanese and the expected amount of work is different. I want to work harder and longer than my British counterparts and I am proud of it.'	Emotional attachment to one's organisation	
Statements about accounting scandals; 'I was not surprised when I heard about the Olympus case.'; 'Olympus should not have appointed a foreign president'. 'Japanese board of directors would not oppose the intentions of a Japanese president.'	Difficulty of preventing accounting frauds (internal)	Difficulty of preventing accounting frauds
Statements about accounting standards; 'Accounting standards including IFRS are getting more complicated and it becomes more difficult for non-accountants.'; ' Accounting knowledge is considered to be very specialised and not for ordinary people.';	Accounting knowledge is limited to a group of people	
Statements about external auditors; 'Auditors did nothing. They just signed it off.'; 'It is very difficult for outsiders including auditors to detect carefully concealed financial losses.'; 'As long as auditors receive fees from their clients, it is very difficult to be critical.'	Difficulty of preventing accounting frauds (external)	
Statements about internationalisation of business practice and accounting; 'Western corporate governance was lacking in the Olympus case even though they appeared to be highly Westernised.'; 'The US influence is still immense but we are not necessarily following what they requested.'	The system of Corporate governance existed but was not practised fully	Conflicting values (traditional values vs. global expectation

Unlike Objectivist Grounded Theory research, the Constructivist Grounded Theory assumes that there are multiple aspects of the facts presented. Researchers are constructing data through interaction rather than data discovery (Charmaz, 2014).

It must be noted that the resulting theory is an interpretation rather than positivist fact (Charmaz, 2014: 235) and observers' values, priorities and positions affect resulting views and perspectives. The research is carried out in order to understand historically situated data through interpretation. It allows participants' views and voices which are integral to the analysis whereas Objectivist Grounded Theory is to value neutrality, passivity and authority of the observer (Charmaz, 2014: 236). Therefore, a Constructivist approach is often criticised by Objectivists claiming that the theory is heavily based on the researcher's view. In order to avoid shortcomings from subjectivist views, the author attended a series of qualitative research training sessions and investigated a vast amount of primary and secondary sources to substantiate the research findings.

2.6 Sources and Historical Narratives

To investigate Confucian-led values and their implications for the Edo era and the Meiji era, a variety of primary sources and secondary sources were consulted in this research (Nishikawa, 1719; Fukuzawa, 1873; Hutton, 1788, Translated by Yoshida, 1878; Namba, 1943). The critical study of sources, '*Quellenkritik'*, was conducted and the most reliable and relevant to this study were selected (Moses and Knutsen, 2012: 121). The primary documents being investigated in this research include: bookkeeping records of *Yusen Co. Ltd*; house law documents (*kakun*) on accounting and accountability, textbooks on accounting and ethics. House law is a private document of rules in each prominent merchant house from the Edo era and it is often based upon Confucian teachings. In order to examine perspectives on Confucianism in modern Japanese businesses, accounting and accountability practices information on Japanese corporations and government was taken from their

corporate websites (Watanabe et al, 2012; Kyocera, 2015; Rakuten, 2017) and governmental websites (Bank of Japan, 1945; Bunka, 2015; MEXT, 2015a, 2015b, 2015c).

Most importantly, the National Diet Library in Tokyo, which stores collections of archival accounting, business history documents and textbooks, provided access to the significant amount of surviving documents on the accounting and economic history of Japan. In addition to documents written by the Japanese, the library also stores original documents issued by the GHQ, which left large volumes of instructions regarding accounting and accountability (SCAPINs, 1945a; 1945b; 1951). Furthermore, a significant number of translated textbooks on double-entry bookkeeping methods and financial reports and instructions by the GHQ are electronically stored in the National Diet Library.

Other libraries and museums such as the Mitsui Museum (Mitsui Museum, 2018) and The Library of Economics, University of Tokyo (Tokyo University Economic Library, 2017) store a number of original accounting records from various historical periods, some of which are presented as examples in this thesis. Most significantly, the Mitsui Museum has an extensive amount of original documents from the Mitsui merchant house in the Edo era and also past research archives which are publicly available (Mitsui, 2017; 2018). Additionally, Hitotsubashi University Library stores historical accounting records of Nihon Yusen, a large ex-*zaibatsu* shipping corporation which was founded in the Meiji era (Hitotsubashi University Library [Hitotsubashi Univ.], 2017a, 2017b, 2017c, 2017d). To show the development of their accounting practice, samples from Nihon Yusen's documents are presented in

Chapter 5.

Secondary sources were heavily consulted when investigating documents written in the Edo era because they were written using traditional brush writing and often applying secret codes of language (Ogura, 1962; Kawahara, 1977; Someya, 1996; Shimizu, 2010). This made it extremely difficult to decode without special training and, thus, existing highly reputable academic findings such as Ogura (1962); Kawahara (1977); Miyamoto, (1980; 1982); and Nishikawa (1984) were consulted in order to identify beliefs, accounting and accountability practices in this research. Table 2-2 summarises significant documents from the Edo era which were examined in this study.

Table 2-3: List of Significant Documents Originally Published in the Edo Era (including translated version) Examined

Year of Publication	Name of document	Type of Document	Note
1620s-1650s	*Collection: Teachings of Razan Hayashi* (Ishida, 1975)	Confucian teachings of the Edo era	Confucian teachings in the Edo era
1638	Balance sheet in *Tomiyama merchant house* in 1638	Balance sheet in the Edo era	Accounting practice
1710, 1714 and 1718	Mitsui *Oomotokata* Financial Snapshot Summary (Nakahara, 1992c)	Translation of accounting documents	Accounting practice
1719	*Chonin Futokoro* (Nishikawa, 1719, 1898)	Joken Nishikawa's teachings (see Chapter 3)	Confucian teachings
1722	*Sochiku Isho* (Mitsui, 2017)	House law of Mitsui merchant house	Confucian teachings and business practice
1739	*Tohi Mondo* (Ishida, 1739, 1935)	Baigan Ishida's teachings (see Chapter 3)	Confucian teachings
1802, 1835,	*Goshu Nakaike Choai no Ho* (Ogura, 1962)	Translation of accounting documents	Accounting practice and Confucian teachings
1852	*Shiroki Ya Kingin Deiri Cho* (written in secret language, *fucho*) (Tokyo University Economic Library, 2010)	Cashbook of Shiroki Ya business (See Chapter 4)	secret language and accounting

Ogura (1962) carried out extensive research on original accounting documents from the Nakai family business in the Edo era (Table 2-2). The Nakai accounts include elements of double-entry bookkeeping (Ogura, 1962; Kawahara, 1977). Kawahara's research proved that several families including the Nakai and Ono in the Oumi region had also adopted a basic version of double-entry bookkeeping (Ogura, 1962; Kawahara,1977; Ogura, 1989; Ogura, 2003; Egashira, 1992). Ogura's research also encompassed the belief system and values of business people in the Oumi region. Under strong Buddhist influence, merchants from the Oumi regions left historical evidence of being ethical and diligent (Ogura, 2003). Ogura's

translation of accounting records of the Nakai merchant house in the Edo era, which were written in old Japanese, is used to analyse how Confucian teachings and Buddhism influenced business people. They are further examined in Chapter 4.

Figure 2-1: Front Covers of Accounting Records from the Edo era (from the left hand side: cashbook, current journal, ledger, procurement book) in the Nakai merchant house in the Edo era (18th century)

Source: (Ogura, 2003: 95)

Nishikawa examined accounting archives from the Mitsui merchants between 1710 and 1730 in his research (Nishikawa, 1993) and from the beginning of the Meiji era (Nishikawa, 2010). He described how they, as a basic form of a holding company, managed and improved accounting records throughout their business history (1993; 2010; 2012). The Mitsui merchant house developed their accounting system continuously after the business was started in the 1670s (Hayashi, 1983). Nishikawa's (1993) investigation of the Mitsui merchant house and their accounting system provides substantial evidence about the Japanese double-entry bookkeeping methods in the Edo era. The Mitsui business has evolved over centuries, firstly as Mitsui Bussan, and is now one of the largest conglomerates in Japan in the 21st century (Mitsui, 2018). Nishikawa (1993) states that the founder and the heirs of the Mitsui company strongly promoted the significance of accountability within the

Mitsui business. Yamaguchi (2011) detailed how Mitsubishi, a *zaibatsu* from the Meiji era, transformed its accounting methods during the early part of the Meiji era when Mitsubishi was established. Accounting records by the Nakai and Mitsui merchant houses are examined in detail in Chapter 4.

The *kakun*, or house laws, documents reflect how Confucianism was interpreted by and taught amongst business people in the Edo and Meiji eras (Iwasaki, 1914; Sakudo, 1979; Hayashi, 1983; Egashira, 1992). Table 2-4 below presents examples of articles in the Mitsui *kakun*, which were specific about forbidden dealings (Mitsui, 2018). The *kakun* documents are extremely useful to evaluate how business people in the Edo era understood and applied Confucianism in their lives.

Table 2-4: Extract of the Mitsui merchant house *kakun* published in 1722

- Be frugal and do not spend excess expenses;
- Do not carry out any speculative dealings;
- Do not accept an invitation from a customer without informing a sales clerk or manager;
- An employee should not borrow money or become the guarantor of anyone's debt;
- Select a talented employee and identify his strengths and promote him accordingly;
- Do not carry out unreasonable dealings which would be unsustainable and damage our business;
- Carry out ethical business dealings.

Source: (Hayashi, 1983: 118-121, Mitsui, 2018)

Takahira Mitsui, the successor and the eldest son of Takatoshi Mitsui, the founder of the Mitsui business in the late 17th century, wrote a series of rules called Souchiku Isho. These *kakun* articles were left for Mitsui descendants and employees to follow in order to sustain Mitsui's businesses for a long period of time (See Table 2-

4 and Figure 2-2) (Hayashi, 1983; Nishikawa, 1993). Both Takatoshi Mitsui and his son Takahira, explicitly stated that anyone who worked for their business must practice Confucian teachings where honesty, politeness, trust, respect and wisdom are sought (Ogura, 2003; Nakahara, 1992a). The founding members of the Mitsui merchant house were extremely conservative and wrote numerous guidelines about how to sustain the business and how to manage accounts (Morita, 1983; Nakahara, 1992a). Successful businesses also depended on how they were able to comply with government policy relating to business dealings and good management of accounts.

Figure 2-2: The *Kakun* Booklet from the Mitsui Merchant House in 1722

Sources: (Mitsui, 2017).

The articles in the Mitsui *kakun* were similar to the house laws of other merchant houses (Ogura, 2003). The prescribed details of the *kakun* recognised that some employees had in the past mismanaged the business. Chapters 3 and 4 examine the *kakun* documents and their implications for businesses and their accounting practices. Documents from the Meiji era are written in contemporary formats and, thus, more accessible to researchers. Nihon Yusen, one of the oldest shipping companies from the Meiji era has stored a significant amount of accounting documents from the past. Yamaguchi (2000) and Nishikawa (1979b) conducted wide-ranging research on Nihon Yusen and explain how the company developed its accounting methods.

Chapter 5 later includes several pages of Nihon Yusen's past accounting books to illustrate the development of their accounting practice.

Historical documents were examined to identify concepts and viewpoints of people living in the relevant period. These concepts were further analysed by applying a Foucauldian perspective of power and discipline in order to arrive at theoretical categories. Accordingly, theoretical categories are created which eventually developed into aggregate theoretical categories as in Table 2-2. The identification of the link between Confucianism and accounting practice is not obvious, especially in modern documents published after the Pacific War because Japan became significantly more secular due to strong influence by the US and a new Constitution. Semi-structured interviews were crucial in order to identify implicit traces of Confucianism in recent business practices.

2.7 Conclusion

This chapter has established the methodological underpinnings of the research. The chapter also introduces prominent literature relevant to this research. The thesis uses a Foucauldian perspective to understand how Japanese accounting and accountability have been influenced by Confucianism. In particular, Foucault's ideas on power, knowledge and discipline are used. The combination of socially embedded Confucian teachings and power relationships viewed by Foucault is key to understanding critical accounting and its historical development in Japan. Power relationships created by the authority with its subjects at a particular time in Japan are examined through primary and secondary resources. Power relationships

intervene through Confucian teachings, which results in unique norms among Japanese business people. Confucian teachings helped the Edo government at the beginning of the 17th century to strengthen its regime substantially and to establish values among the Japanese (Tu, 2000; Boardman and Kato, 2003; Ogura, 2003). Subsequently, the profound influence of Confucian teachings has been embedded among the Japanese from generation to generation (Maruyama, 2006; Watsuji, 1973). The following chapters further examine significant beliefs and values among Japanese business people from the Edo era to the current day and how they have affected the development of accounting and accountability.

Chapter 3

Beliefs, Shared Values and Business People in Japan

3.1 Introduction

This chapter examines the belief system and social values established in Japan from the Edo era (1603-1868) to the contemporary period and their subtle influence on business, accounting and accountability practices. The chapter starts with the background of three main belief systems in Japan, Confucianism, Buddhism and Shintoism and how they became a part of national beliefs. Confucianism, Buddhism and Shintoism have had a significant impact on business people from the Edo era to Japan in the 21st century. Religious beliefs and values in different societies have always profoundly influenced business practices (Weber, 1930, 1974; Bellah, 1985). Teachings derived from Confucianism, Buddhism and Shintoism in the Edo era, including Shingaku philosophy, Bushido and the *kakun*, house laws, are illustrated to understand the work ethos of the Japanese. The chapter demonstrates how these teachings and values were historically used by past rulers and governments.

A religion is a unified system of beliefs and practices related to sacred conduct (Durkheim, 1915:47). It is expected to provide a meaningful set of ultimate values on which the morality of a society can be based (Bellah, 1985: 6) and it is also the unifying principle of human society (Hamilton, 1995: 22). A religion entails fellowship and communion to create shared values among its followers. In Japan, Buddhism and Confucianism have been the most significant sources of beliefs since the 5th century. Prince-Regent Shotoku (573-621 A.D.) promoted the concept of

wa, harmony, among the Japanese people by amalgamating the indigenous Shinto belief, Buddhism and Confucian teachings (Kitagawa, 1987). Thereafter, these three have been the main sources of beliefs in Japan (Boardman and Kato, 2003; Todeschini, 2011; Weber, 1951). The co-existence of Confucianism, Buddhism and Shintoism was approved as long as these beliefs helped the government to control its subjects effectively. This was possible as the Japanese have long held a polytheistic view of religion (Bellah, 1985). The notion of polytheism was officially approved by Iemitsu Tokugawa, the third Shogunate of the Edo government and a grandson of Ieyasu Tokugawa (Imanaka, 1965). The Japanese were controlled through the polytheistic belief system which was carefully established by the Edo society (Maruyama, 1969; Bellah, 1985). Religions were regarded as a means of moral exhortation in Japan and the masses were often reassured by religious customs in the Edo era (Bellah, 1985).

Registering with both local shrines and temples is still the case in present-day Japan, according to a government survey in 2015 (Bunka, 2015). Although contemporary Japanese are secular, traditions derived from religious rituals are still practised in daily lives (Jansen, 2000). This was particularly applicable before Japan adopted scientific findings from the West in the late nineteenth century (Kitagata, 1987). Accounting records of business people in the Edo era show that generous amounts of offerings were regularly made to different shrines and temples, not simply because it was a tradition, but also in the hope that this actions would bring them wealth and good health (Egashira, 1992; Ogura, 1992).

Buddhist temples were politically influential in the 16th century and, as a result, they accumulated considerable wealth (Zenke, 2004). However, the Edo government took strict control of religions at the beginning of the 17th century to remove significant pastoral power from them in order to monopolise control over its subjects (Kitagawa, 1987). Confucianism was chosen to be the most influential philosophy and it was enforced by the Edo government. Although not in the original form which was introduced from China and Korea, it continues to implicitly influence Japanese society (Maruyama, 1974, Ishida, 1975). Understanding Confucianism in Japan is fundamental to appreciating how its teachings significantly influenced religions and lives of Japanese business people for centuries.

3.2 Beliefs and their impact on the Japanese: Confucianism

3.2.1 Arrival of Confucianism

Confucianism, which was originally established by Confucius in the 5th century B.C. in China, has remained one of the most influential teachings in Japan (Tu, 2000; Bloom and Solotko, 2003; Ornatowski, 1996; Rotundo and Xie, 2008; Butler-Bowdon, 2013). It was brought into Japan through Chinese and Korean scholars during the 5th century A.D. and became very popular among rulers, aristocrats and government officers in Japan (Kitagawa, 1987). It teaches people how to behave in their daily lives and how to perceive everyday life. There were a number of schools of thought in Confucianism, some of which were seen to be more relevant to the Japanese. The early form of Confucianism is often called Classical Confucianism, which was widely studied by the majority of Japanese scholars in the 5th century (Bellah, 1985). In later centuries there was a new interpretation of Confucianism called Neo-Confucianism which was developed in the Song dynasty

(910-1279) in China (Tu, 2000:195). Zhu Xi, the prominent Confucianism thinker from the 12th century in China, left a profound impact on Neo-Confucianism (Lam, 2003). Neo-Confucianism was imported into Japan during the 12th century and adopted by scholars and war lords. Later, Neo-Confucianism in Japan was further modified and theorised by adding elements of traditional Japanese beliefs (Kitagawa, 1987). Ieyasu Tokugawa, the founder of the Edo Bakufu government (the Edo government), chose the most useful school of Confucianism as an approved belief of the nation.

Ieyasu Tokugawa was a student of the prominent Confucian scholar Seika Fujiwara (1561-1619) who taught the Cheng-Zhu School of Principle, a major sect of Confucianism (Maruyama, 1974). Fujiwara's teaching attracted a number of students who were war lords drawn from all over Japan, one of whom was Ieyasu Tokugawa (Kaneya, 1975). Fujiwara wrote a series of ethical reminders to prominent war lords and business people during the late 16th century and the beginning of the 17th century (Ishida, 1975). Conducting fair dealings with customers or subordinate soldiers and sharing profits with stakeholders in order to obtain long-term profits were examples of his preaching (Boardman and Kato, 2003). Fujiwara was also commissioned to compose business rules for merchant houses based upon Confucian principles. The following passage is an extract of a business principle from a successful trading house, the Suminokura merchant house in Kyoto, created with the help of Fujiwara in the late 16th century.

> The objective of trading is to achieve mutual benefits for both sides. It is wrong if you win over your business client and only you get profits. It has to be a win-win situation. You may think your profit is not sufficient but eventually your long-term profit will be ample (by being fair). Your business profits must be in line with humanity and justice (Translation of Takimoto, 1929).

Only ethical and fair business activities are approved by Confucianism, which was the basis of accountability expected in Japan. A number of merchant families in the Edo era adopted Confucian teachings when training their employees (Miyamoto, 1982; Egashira, 1992). Business owners in the Edo era generally agreed with Confucian teachings which emphasised the importance of propriety, loyalty to one's seniors/parents, righteousness, integrity and piety (Bellah, 1985).

Before the Edo era there were constant wars among fiefdom lords. However, when the Tokugawa regime conquered the entire nation and established the Edo government in 1603, the samurai no longer needed to be engaged in warfare. In order to sustain the peaceful regime, Tokugawa needed to make samurai warriors loyal to their fiefdom lords without becoming rebellious (Imanaka, 1965). There were almost 260 regional fiefdoms during the Edo era and every fiefdom had regional samurai warriors who worked for their lord (Ohishi et al, 1967). They were expected to hold absolute loyalty towards their regional fiefdom lord and also to the Edo government. Tokugawa believed that Confucianism would be ideal for samurai warriors to follow because it would teach them to be loyal to their superiors. Thus, Confucianism-led values which included Bushido were introduced and used as a tool for the Edo government to control its subjects.

3.2.2 Expansion of Confucianism

Ieyasu Tokugawa chose Neo-Confucianism, the Cheng-Zhu School, as the foundation for law and order in the Edo society (Bellah, 1985). Tokugawa wanted to establish and strengthen the feudalistic society. Confucianism approved by the Edo government was based upon Zhu Xi's interpretation, to which scholars and the Edo government added elements of Buddhism and Shintoism, to establish the Japanese interpretation of Neo-Confucianism (Kitagawa, 1987; Lam, 2003; Tu, 2000). National beliefs were established based upon the aims of the Edo government, thereby confirming that power has the ability to create knowledge and social norms (Foucault, 1976). Confucian teachings were considered to be the most appropriate option for the Edo government because they encouraged feudalistic social hierarchy and loyalty towards seniors.

Unlike the Hellenic philosophy of the West, Confucian teachings required that followers were not supposed to be critical or to speak up against their seniors or authority (Weber, 1951). Confucian teachings encourage people to be virtuous and to work hard for society and their employers without asking for rewards. Confucian teachings which strongly supported feudalism and obedience to authorities were ideal for the Edo government which wanted to legitimate and secure their family-run government to rule the population. This would help to ensure that there would not be any rebellious action in society (Bellah, 1985). In this thesis, unless otherwise stated, the term Confucianism will refer to the Japanese interpretation of Neo-Confucianism.

Ieyasu Tokugawa hired Confucian scholars and Buddhist monks who were able to establish the philosophy that legitimised his regime (Maruyama, 1974; Bellah, 1985).

Razan Hayashi (1583-1657), a reputable student of Seika Fujiwara, was appointed as an executive advisor by the Edo government to theorise and compose laws based on Confucian teachings in the early 17th century. This helped the government to establish and sustain a strong feudalistic regime without feudal conflicts for the next two hundred years (Takenaka, 1998; Boardman and Kato, 2003). The Edo government needed Confucianism in order to legitimise the Tokugawa regime (Maruyama, 1969; Watsuji, 1973). Razan Hayashi inherited Fujiwara's interpretation of Confucianism and he further theorised it in order for Tokugawa's subjects to apply Confucianism to their daily and business lives (Ishida, 1975). The belief system and values using Confucianism were established and controlled by the Edo government to maintain a peaceful, obedient nation.

Confucianism in Japan was modified and interpreted to suit the objectives of the Edo government. Hayashi, who wanted to reduce the influence of Buddhism, added elements of Shintoism to Confucianism as he believed that both sets of teaching shared common features (Imanaka, 1965; Zenke, 2004). He developed a theory called 'Jouge Teibun no Ri' (the Law of Unchangeable Classification) to emphasise the importance of harmony and loyalty to parents and superiors (Bellah, 1985; Ishida, 1975). Hayashi helped the Edo government to structure a legal framework that recognised different social classes. His interpretation of Confucianism successfully legitimised the Edo feudal system to create a social norm where people in different classes were encouraged to show contentment and obedience towards the Edo government (Takenaka, 1998; Bellah, 1985). His teaching emphasised the importance of respecting and faithfully serving one's lord and to avoid unscrupulous business practices (Ishida, 1975). Notably, the laws for samurai, *Bukeshohatto*,

were devised to control the daily life of samurai warriors who were also encouraged to study Confucianism and were expected to become role models (Ishida, 1975). For example, one of the earliest *Bukeshohatto* laws instructed high ranking samurai warriors to self-regulate themselves and to self-cultivate their intellectual and physical ability to become a role model of society (Takenaka, 1998). The *Bukeshohatto* also restricted the power of regional fiefdom lords by imposing detailed rules on their marriages and travel. Acquiring virtue and self-cultivation is a norm influenced by Confucianism, which helped the Edo government to establish trust and to transform society into a moral and obedient community (Tu, 2000). For the ruling Tokukaga family, Confucianism was crucial to firmly create a long-lasting regime (Bellah, 1985).

The Confucian scholar, Hayashi, worked for three consecutive generations of the Tokugawa Shogun family who eventually established a concrete foundation of national values and beliefs for government during the Edo era. Confucianism was adopted in the Edo era as a useful the tool to mould people into docile bodies (Bellah, 1985; Foucault, 1975). Other Confucian scholars of later years such as Ansai Yamazaki (1619-1682), Sorai Ogyu (1666-1728), Eiken Kaibara (1630-1714) and Hakuseki Arai (1657-1725) were also influential and helped the government to take control of the samurai class and the general public (Imanaka, 1965; Maruyama, 1974). The Edo government disseminated Confucian teachings through qualified scholars and preachers. Confucian teachings also encouraged collective thinking and promoted the idea of salvation which was originally a Buddhist idea (Bellah, 1985). Individuals had to consider the happiness and prosperity of their group and were to avoid any rebellious act which might upset their communities. All

Confucian philosophers were highly regarded by the government. Any teachings which might criticise the regime were not approved. One prominent example includes the Confucian philosophers from the Wang Yangming school who were persecuted because their teaching endorsed individual happiness and individualistic ideas rather than promoting collective happiness (Imanaka, 1965).

All belief systems during the Edo era had to comply with the political objectives of the government, providing a constant surveillance mechanism that incorporated tip-offs and a collective liability system (Maruyama, 1976). The Edo government carefully manipulated the national ideology based upon Confucianism which needed to include limited freedom of speech (Maruyama, 1974). The belief system and values of the Edo era, which were heavily influenced by Confucian teachings, became the established norms among the samurai class (Bellah, 1985). The rest of the population including merchants followed the examples of the samurai class and then people internalised social norms and disciplined themselves to act upon the intentions of the government (Bellah, 1985; Tu, 2000). Accordingly, business people in the Edo era voluntarily attended private schools to learn Confucianism and applied its teaching to their business practices (Foucault, 1975; Egashira, 1992; Adachi, 1974). For example, the Mitsui merchant house from the Edo era left accounting records of sick pay and other welfare expenses in which it is clear that they sought to treat their employees equitably and fairly (Hayashi, 1983).

During the Edo era the government had absolute authority and, therefore, the power to confiscate a business. This meant that, for their survival, business owners had to fully understand the intentions of the Edo government. Thus, it was often the case that business owners hired Confucian scholars to advise them on their business

management (Kaneya, 1975) and a number of prominent merchant families in the Edo era were encouraged to play the role of social entrepreneurs based upon Confucian teachings. Successful business people felt obliged to contribute part of their assets to society, which pleased the Edo government (Miyamoto, 1982). For example, the Kounoike merchant house, following Confucian teachings, donated substantial amounts of money to civil engineering and land development (Miyamoto, 1982). The Kounoike merchant house also invested in a major development in a remote area of Osaka, where the place name of Kounoike still exists in remembrance of their extensive civil engineering projects in the Edo era (Miyamoto, 1964; Miyamoto, 1982). The Edo government wanted to ensure that wealthy merchants would spend their earnings on local infrastructure and, thus, they could not accumulate too much economic power which could become a threat.

Confucian teachings left a positive impact on the conduct of business people and society in the Edo era. Being harmonious and obedient were highly valued qualities and praised by Confucianism, which was effective in securing the stability of the Edo feudal system (Kaneya, 1975; Ishida, 1975). Japanese society welcomed peace after years of feudal conflicts and civil wars at the beginning of the 17th century and, thus, Confucian-led values were positively received by the general public (Bellah, 1985). Confucian teachings were believed to be an ideal source for establishing a strong and cohesive nation. This had particular importance for the samurai class who were in the top of the social hierarchy and supposed to act as role models in society (Bellah, 1985).

The samurai class who were revered for their discipline was supposed to be respected by the rest of society. Business people in the Edo era wanted to become more noble figures like the samurai warriors and, therefore, they studied and practised Confucian teachings (Genma et al, 2006). Bushido, 'a way of samurai warriors', an ethical code of practice for the samurai class, was derived from Confucianism during the Edo era. (Nitobe, 1899, 2007; Fukawa, 1983). As samurai warriors were at the apex of the social hierarchy, they were privileged and honoured in the Edo era. At the same time, they were expected to have a sense of duty to society and to be self-disciplined, following Confucian teachings (Nitobe, 1899, 2007). The samurai class was dissolved when the Meiji Restoration took place in 1868, but Bushido teachings were still studied and discussed in society (Genma et al, 2006). Bushido teachings attract the attention of the general public in modern Japan because of their sophisticated moral philosophy (Nitobe, 1899, 2007; Genma et al, 2006). In the Edo era, following the example of samurai warriors brought a sense of pride and satisfaction for business people and people who were in the lower rankings of the social hierarchy (Miyamoto, 1982; Egashira, 1992). A number of business owners in the Edo era left house rules in their *kakun* documents which often reflected Confucian teachings.

> Be honest, Work hard, Be Patient, Be self-disciplined, and be collaborative
> (Source: House Rule of Takata in Ogura, 2003: 66).
>
> Devote yourself to your bosses before you (an apprentice) learn writing and arithmatics for business (Source: Kakun of Sumitomo Merchant House in Sakudo, 1979: 102)

Business people created norms based upon Confucianism and self-governed themselves to fulfil their social role (Bellah, 1985; Ogura, 2003).

3.3 Beliefs and their impact on the Japanese: Buddism

3.3.1 Import of Buddhism

Buddhism has been a dominant religion in Japan (Kitagawa, 1987:203) after being imported from China and Korea in the 6th century when it was accepted by the Japanese government as a part of its national religion which helped them to stabilise the nation (Watsuji, 1973; Zenke, 2004: 7, 8). The government welcomed this new religion and encouraged people to practise it because Buddhism was considered to help suppress civil wars (Kitagawa, 1987; Zenke, 2004: 7, 8). During the 6th and 7th centuries in Japan harmony among the community was emphasised instead of continuous conflicts amongst the clans (Kitagawa, 1987). Japanese people have been traditionally tolerant towards foreign deities as long as they helped the nation maintain order in society (Kitagawa, 1987; Benedict, 1946, 2005; Bunka, 2015). Practising indigenous Shintoism with foreign-origin Buddhism and Confucianism at the same time has never raised serious issues in Japan (Kitagawa, 1987; Bellah, 1985).

The Edo government also approved Buddhist teachings in which one's conduct will reflect one's life after death. The concept of reincarnation was broadly accepted during the Edo era which made people think twice about their conduct (Kitagawa, 1987). Therefore, Buddhism was understood as a means to instruct superstitious people to behave morally (Bellah, 1985). The Japanese were traditionally persuaded to believe that they would be rewarded or punished by deities or Buddha, depending on their behaviour (Bellah, 1985). People in the Edo era tended to believe that if one deceived someone, one would be punished and sent to the *Jigoku*, hell (Kitagawa, 1987; Zenke, 2004: 88). In an age devoid of the authority of science, business people in the Edo era respected indigenous Japanese deities and the Buddha

(Egashira, 1992). In addition to laws and regulations, this fear of being punished by deities made business people and families reluctant to conduct dishonest, unethical dealings (Bellah, 1985; Egashira, 1992). The Edo government supported a number of prominent Buddhist temples and rituals to demonstrate their piousness and to set the example for all Japanese, whatever their social class.

Like Confucianism, Buddhism in the Edo era was no longer based on its original version. By the time Buddhism arrived in Japan it had been transformed from the original form which had developed in India (Kitagawa, 1987). Buddha, the founder, taught the original concepts of the Buddhism in the 5th century BC. In Japan it was eventually transformed by adding a variety of elements to attract peasants and town people who did not receive any form of formal education in Japan (Ishida, 1975). Examples include the existence of dead people's spirits and salvation (Kitagawa, 1987). Buddhism, when it was introduced in Japan around the 6th century, also adopted elements of Confucianism that advocated piety (Ishida, 1975). Buddhism in Japan has had various sects but ordinary people are only taught simplified narratives, rarely accessing the original profound doctrines of Buddhism (Ishida, 1975).

Buddhist temples gained considerable economic and political power by attracting worshippers and donations from all levels of society (Zenke, 2004). When Buddhist temples increased their presence in the 16th century, Buddhist monks became a political threat towards the then influential samurai leader, Nobunaga Oda (Kitagawa, 1987). Therefore, he was determined to eradicate the power of Buddhist temples by sending a clear message that religions were able to exist only when they helped lords to govern their regions. The religious conflicts between

Oda and Buddhist temples had a significant impact on Ieyasu Tokugawa who established the Edo government (Kitagawa, 1987). Throughout Tokugawa's regime the government was very cautious about the power of religions. Therefore, they only approved religions which could help them to retain political power. Tokugawa knew religious power could endanger his regime, so the Edo government ensured that religion would be strictly controlled (Ishida, 1975). Thus, he and his government carefully redefined the role of Buddhist temples in society in order to give them a different type of power and authority.

In the Edo era Buddhist temples were made to become quasi-municipal offices to oversee local residents; religious influence was intentionally replaced by administrative roles (Bellah, 1985). They obtained administrative power over local members whose addresses, birth, marriage, adoption and death certificates were meticulously registered by their local temples (Kitagawa, 1987). In this way, the Edo government established a surveillance mechanism whereby every member of a local village or town was observed by local temples and their monks. Buddhist temples were given the exclusive right to conduct funerals and other memorial services for their registered members, called '*Danka',* and Shinto priests conducted other ceremonies such as blessings (Egashira, 1992; Zenke, 2004). Buddhist monks were consulted by local people and they helped local people to reconcile when problems occurred (Miyamoto, 1964; Miyamoto, 1982). Local temples were financially supported by their registered members and temples became a part of the social welfare system in towns and villages (Aoyama, 1986). Although they acted like parishes in the UK and kept records, they were more secular than Western clergy (Zenke, 2004).

The system of surveillance by Buddhist temples provided the means for the Edo government to identify and monitor the local population and its households. It was an economical observation method and a type of disciplinary technique for the Edo government to ensure that there would be no rebellious acts within communities (Foucault, 1984). Every member of society had to be registered at a local temple and they would respect instructions and rules decided by senior members of the community and its temple (Bellah, 1985; Kitagawa, 1987). This coincided with Confucian teachings to respect senior members of one's society. The Edo government created a controlled society where the authority knew the identity of every member of society, thereby making it extremely difficult to rebel against the government. Everyone was watching his/her neighbours' behaviour who, therefore, would follow social norms approved by the government or the leader of the community (Miyamoto, 2007: 49). This secular relationship with local Buddhist temples did not have to go through dramatic religious reform as in Western Europe. Therefore, many people in contemporary Japan still maintain an amicable relationship with their local temples and a more relaxed form of the Danka system still exists (Zenke, 2004; Bunka, 2015).

The relationship between temples and their local residents was not exactly the same as the Christian priesthood and their congregation during the medieval period in Europe, where priests expected confessions from individuals (Foucault, 1999). According to Foucault, this gave enormous controlling power to religious organisations in Europe (Foucault, 1999). European priests had the authority to preach to their congregations about how to reveal people's consciousness. By contrast, Buddhist monks since the Edo era have not insisted on extracting one's the

truth from one's conscience like the Christian priests. This was because the Edo government did not grant full authority and power to religious leaders; the government did not want to lose controlling power over their subjects. The Edo government considered that if people psychologically depended on Buddhist monks too much they might feel that monks were superior to the Edo government. The hierarchy of power had to be maintained and the Edo government was supposed to be the highest ranking and, thus, monks were not allowed to have the same excessive power as they used to have during the 14th century. Instead, monks were given by the Edo government a role of supervising local residents to ensure that they obeyed laws and social norms (Bellah, 1985). The Edo government had to hold significantly more power than any Buddhism temples and Shinto shrines to maintain its reign.

3.3.2 Buddhism and Merchant Houses

According to accounting records in the Edo era, business owners had close relationships with local religious organisations (Egashira, 1992; Bellah, 1985). For example, business people carried out regular religious rituals and attended traditional sacred festivals hoping these actions would bring them more business (Fukawa, 1983). Accounting books from merchant houses in the Edo era show that religions played a significant role in the daily lives of business people, with frequent donations given to local shrines and temples (Egashira, 1992). Local shrines and temples had a strong influence over their local residents and business owners were often acting as committee members of these religious institutions. This did not mean merchant houses were particularly religious. Rather, donations were also used as a way to advertise their businesses and they felt social pressure to be involved with local

religious institutions (Egashira, 1965; Adachi, 1974). They wanted religions to help them become successful businesses. Names of donors were often shown temporarily or more permanently on carved posts in temples and shrines, which created positive images among people in society. There were limited ways a business could publicise its products and, thus, having their name put in the donors' list in a local shrine was a way to disseminate the good name of a business and to receive recognition from society (Egashira, 1965; Adachi, 1974). Successful Edo business people often donated money to their favourite shrines and they volunteered to help at religious festivals, hoping the priest would pray for them and their business (Egashira, 1992: 93-94). Priests were allowed to pray for them, though they did not have any political power (Bellah, 1985).[2]

There have been a variety of Buddhist sects, some of which were more popular among business people than others (Aoyama, 1986). Zen Buddhism was particularly influential among business people because this sect encouraged its followers to work harder and so become financially prosperous (Fukawa, 1983). This notion was well received by the Edo government and business people because pursuing economic wealth became an approved conduct (Bellah, 1985). Working hard in order to earn financial rewards was considered to be virtuous in society and people were encouraged to be diligent. Another dominant sect during the Edo era was Jodo-Shinshu, which was widespread among merchants in the Oumi region near Kyoto (Bellah, 1985). Oumi merchants opened businesses in the city of Edo, Kyoto and other large towns. Their mottos are often quoted, even in the 21st century, as 'Sanpo Yoshi', which literally means 'business must be beneficial for all three

[2] Chapter 4 details examples of the donation record of the Nakai merchant house.

parties: business people, their clients and society' (Bellah, 1985; Ogura, 2003; Suehiro, 2011). Business people from the Oumi believed their motto would bring them profits and ensure a sustainable business. Their belief system was reinforced by Jodo-Shinshu Buddhism, which was also influenced by Confucian teachings (Bellah, 1985).

Japanese business people from the Edo era perceived religion as a part of their customary daily life without asking too many philosophical questions (Maruyama, 1974; Bellah, 1985). Confucianism also suggested people should not question, but obey authority or business customs (Sakudo, 1979; Egashira; 1992; Bellah, 1985). While some business people may have been more devout than others, their main goal was to sustain their businesses for future generations. They were conservative and building up trust in society was extremely important for them, especially when carrying out business on credit. Without a refined contract law, business people in the Edo era relied on Buddhist and Confucian teachings for creating norms in trading and for efficient business transactions (Genma et al, 2006). Trust was essential among business partners and clients to maintain sustainable business relationships (Bellah, 1985; Tu, 2000). Buddhism and Confucianism were considered to be moral references for many business people during the Edo era, providing the means to discipline themselves and to create their own norms for self-regulation. Business owners also needed Confucian and Buddhist teachings when managing and training their employees in the Edo era. This included treating employees as pseudo-family members which has been a distinctive attribute of numerous organisations in Japan throughout modern history. The shared beliefs have helped the Japanese to

collectively pursue national and individual wealth and to build a strong country (Ishida, 1965).

When the new Meiji era started, Buddhism was temporarily persecuted because the new government wanted to dismiss old values and reintroduce Shintoism as the national religion (Watsuji, 1973). However, worshipping ancestors in individual families continues in present-day Japan and many local Buddhist temples have been able to survive with the help of local residents (Kitagawa, 1987; Komuro, 2000; Agency of Cultural Government of Japan, 2017). Although the country is significantly modernised, large traditional organisations, consistent with traditional beliefs, tend to treat their employees as extended families, offering long-term job security and life-time membership in the organisation (Durlabhji, 1993; Abe et al, 2012).

3.4 Beliefs and their impact on the Japanese: Shintoism

Shintoism is another important religion in Japan, which was not scholastically theorised until the 18th century (Kitagawa, 1987). Shintoism, which literally means 'a way of deities', is a collection of folklore and regional faiths and beliefs which have existed since prehistoric Japan (Kitagawa, 1987). Shintoism contains physiolatry, the belief in deities residing in mountains, seas and their natural surroundings. Shintoism traditionally did not have structured teaching or holy scripture as in Buddhism and, thus, the ideas of Shintoism were often criticised and described as rather primitive and folkloric before the end of the Edo era (Kitagawa, 1987). Due to the polytheistic views in Japan, Shintoism was merged with Buddhism in the Edo era. Thus, there was no clear distinction between Shinto

deities and Buddhist deities (Yasumaru, 1988). Shinto shrines exist in every region and it is still customary for the Japanese to support both Shinto shrines and Buddhist temples at the same time. In the Edo era Shinto shrines often kept statues of Buddha (Yasumaru, 1988).

Shintoism was also modified in order to harmonise with Confucianism, reflecting the intentions of the government in the Edo era (Ishida, 1975). This encouraged people to consider that there was no clear distinction between these two beliefs. The chief Confucian scholar in the Edo government, Razan Hayashi, created a theory that there was a strong association between Confucianism and Shintoism (Kitagawa, 1987). He preached that Confucianism shared significant teachings with Shintoism. Another prominent Confucian scholar, Ansai Yamazaki (1619-1682), also combined Shintoism and Confucianism, using common features such as 'Hotoku' (repaying the indebtedness or accumulating virtues in Heaven) (Kitagawa, 1987). For the Edo government, as long as they were able to sustain their ruling power, Shintoism was also an approved religion. It was not until the late Edo era that Shintoism was to be slowly separated from Confucianism and Buddhism (Kitagawa, 1987; Winston, 1983, 1984).

In the mid-Edo era, Norinaga Motoori (1730-1801), a scholar established Shintoism as a distinctive religion (Kitagawa, 1987). Motoori carried out extensive research on traditional Japanese literature and poetry, encouraging his students to learn about wisdom from the past (Ohishi et al, 1965; Kitagawa, 1987). This is called *Kokugaku*, a study of the nation (Ohishi et al, 1965). He argued that the nation did not need to depend upon foreign religions or philosophy such as Buddhism or Confucianism (Ohishi et al, 1965; Kitagawa, 1987). Motoori insisted that the

Kokugaku was the religion best suited to the Japanese people. However, it must be noted that Confucianism and Buddhism had already profoundly and implicitly influenced Shinto beliefs by the time the *Kokugaku* was theorised by Motoori. Based upon the *Kokugaku*, a number of samurai warriors became more nationalistic before the Meiji Restoration in 1868 (Bellah, 1985). The Meiji Restoration took place in Japan to revive the authority of the Imperial family as the political leader in Japan. Towards the end of the Edo era, the Edo Bakufu government was dissolved by groups of revolutionary Samurai warriors in response to the failing economy and poitical unrest (Bellha, 1985).

After the introduction of the *Kokugaku*, Shintoism became significantly more organised and constructed formal sets of teaching by introducing textbooks such as *Kojiki*, 'Accounts of Ancient Matters' (Bellah, 1985). Some of the Shinto deities were linked to the ancestors of the Japanese Imperial Family, which legitimised worshipping the Emperor in the Meiji era (Kitagawa, 1987; Winston, 1983, 1984). This was later used by the Meiji government to establish an emperor cult and nationalistic ideology in order to create national cohesion. The Meiji government considered it was important as an internationally recognised country to have an approved national religion (Watsuji, 1973). Thus, Shintoism was appointed as the national religion and the emperor cult was established by the Meiji government (Watsuji, 1973). The Emperor became the head of Shintoism (Maruyama, 1969). Shintoism significantly incorporated Confucian teachings in order to help legitimise the new government and to maintain social order (Maruyama, 1969; Hirschmeier and Yui, 1981). Absolute loyalty towards the emperor and his nation was emphasised as a part of self-discipline at that time, which was a manipulation of Confucian

teachings. The Japanese felt compelled to sacrifice themselves for the emperor (Watsuji, 1973; Maruyama, 2006).

Traditional beliefs and values based on Confucian teachings continued to be the means to survive in the controlled society before and during the Pacific War. People had little freedom of speech and, thus, they rarely had a chance to argue critically philosophical and political issues in public (Maruyama, 1974). The country was controlled under an authoritarian regime and traditional Confucian-based values were enthusiastically applied to the daily lives of the Japanese (Yasumaru, 1974; Yasumaru, 2004). Before the end of the Pacific War Japan was an autocratic society, with the special police force called '*Tokko'* who would arrest any rebel suspect (Yasumaru, 2004; Maruyama, 2006). Masahiro Yasuoka (1898-1983) and Shumei Ohkawa (1886-1957) came up with 'Japanese Spirit Ideology', which became a strong competing power to the socialist ideas which emerged during the Taisho era. Their idea was strongly supported by the government in order to control the nation (Yasumaru, 2004).

Like Confucianism, Shintoism was controlled and modified to conform to the intentions of the Meiji government. People had to follow what the government or their superiors instructed them to do. When Japan lost the war in 1945, the Japanese government had to relinquish its sovereignty to the Allied Forces and the GHQ officers gained power and dictated how society was controlled (Jansen, 2000). They abolished most of traditional customs in Japan and introduced Western systems (Jansen, 2000). Although Shintoism was not terminated, its significance in the political domain was diminished because the new Constitution introduced after the war prohibits national religions but freedom of belief is guaranteed.

3.5 Edo Business People and Religions

3.5.1 Business Philosophy in the Edo era

Confucianism profoundly influenced business people in the Edo era. Following the examples of the samurai, business owners were attracted to learning Confucian teachings. Although there was no compulsory education system for ordinary people, a number of private schools were opened in cities and large towns to teach Confucianism and arithmetic (Najita, 1987; Miyamoto, 1982). Their main teachings included that it was important to accept one's social position as a calling by Heaven (Miyamoto, 1982; Egashira, 1992). A calling was decided for each individual and everyone had to be thankful about their social position. This also reflects the Buddhist idea that one's current social position was the result of one's deeds in a previous life (Imanaka, 1965). Hence, fulfilling Heaven's will, such as working hard in business and being obedient, was extremely important to ensure that one would be rewarded in Heaven (Egashira, 1992). When people in society followed Confucian teachings, the government did not need to worry about potential rebels or destitution in society. Everyone was supposed to be content with their social position and to work hard (Maruyama, 1969; Watsuji, 1973). Thereby, the Edo government indirectly controlled people through Confucian teachings.

Confucian teachings and Buddhism had reflective relationships in Japan and their teachings influenced society as a whole (Bellah, 1985; Kitagawa, 1987). For example, business people in the Edo era were taught that being pious and diligent would impress Heaven, and so Buddha would help their business become more successful (Bellah, 1985). The concept of reincarnation from Buddhist teachings was widely believed and successful people were hoping to be reborn as a wealthier

person in the next life (Kitagawa, 1987). Business people also believed that their descendants would be prosperous and be protected by deities if they lived morally (Kitagawa, 1987; Bellah, 1985; Ogura, 1989). Thus, successful business people during the Edo era encouraged their family members and employees to be devout and hard-working not only for the business but also for their off-spring (Egashira, 1992; Sakudo, 1979). For most Japanese people in the Edo era, their understanding of being religious meant following customary religious traditions in order to become more prosperous and healthy in this world and also in the next life (Miyamoto, 1982; Adachi, 1974). Under a strict feudalistic regime of the Edo government, Confucian teachings provided a guidance to business people on how to balance between earning profits and acting equitably (Miyamoto, 1964; Egashira, 1992).

In a similar manner to samurai warriors, business people during the Edo era also disciplined themselves to attain social norms by learning Confucianism (Bellah, 1985). A number of scholars and private tutors were hired by business people and Confucian teachings were interpreted and developed by them for employees. One of the most popular teachings created for business people and town people was called Sekimon Shingaku by Baigan Ishida (1685-1744) (Takenaka, 1998). Teachings of Sekimon Shingaku were based upon Confucianism but also contained Buddhist and Shintoism teaching (Takenaka, 1998). Ishida's teachings emphasised the importance of conducting business with self-esteem and integrity (Takenaka, 1998; Genma et al, 2006). Ishida's philosophy was extremely popular and his disciples spread his teachings through many parts of Japan in the 18th century and the first part of 19th century. Shingaku was not a religion; it was rather a collection of

teachings (Shibata, 1971). One example, a citation of *Tohimondo,* written by Ishida in 1739, states:

> Once a quality product is offered, a customer will abandon any negative thoughts and will appreciate the quality of the product (Translation of Ishida, 1739, 1935: 26).

Ishida advised business people to sell high quality goods to make their customers feel satisfied (Takenaka, 1998). In the passage below, he suggested that business people should also gain intellectual knowledge and so become respected. Through Confucianism and teachers like Ishida business people learned to be ethical and to acquire accountability in their businesses (Chiba, 2009a).

> If a merchant did not bother to educate himself, he would accumulate profits from questionable sources, which will then result in the termination of the family business line in the end. If he really cared for his descendants, he would expand his knowledge on business philosophy and then he and his family would prosper (Translation of Ishida, 1739, 1935: 26-27).

Another example of business education was the *Kaitokudo* School, which was opened in Osaka, a city renowned for its highly sophisticated commercial activity with thousands of merchant houses in the Edo era (Najita, 1987). The *Kaitokudo* School was a very basic form of business school, the students of which were often managers and clerks from merchant houses sent to learn humanities and arithmetic. Their training helped to improve the public image of business people and to encourage business people to establish trust and integrity in commerce. A simple form of banking existed and payments by cheque had started which required a high level of mutual trust in the Edo business society. Accordingly, Confucianism and Buddhism were extremely important and beneficial for business people to set commercial standards and business morals (Egashira, 1992; Takenaka, 1998).

The *Kaitokudo* School taught business people the importance of studying Confucianism in order for them to carry out their business ethically and sustainably. The school taught people to acquire high moral standards like those of the samurai warriors (Najita, 1987; Takenaka, 1998). Prominent business people in the Edo era understood the significance of credibility to leverage their equities and to expand their businesses (Chiba, 2009a). Hence, it required maintaining a high level of moral behaviour in business which, in turn, would bring more business opportunities. According to surviving documents, their goals were long-term prosperity and sustainable businesses, which encouraged their employees to avoid unethical and unsustainable dealings. They disciplined themselves to study and implement Confucian teachings in order to sustain their businesses (Bellah, 1985; Adachi, 1974). It must be noted that some business owners were not conducting businesses as recommended by Confucian teachings and lost their licences as a result. The examples of failed business owners were often referred to teach business owners to prevent failure (Hayashi, 1983; Najita, 1987).

There were also small private schools called '*ko*' with tutors (Miyamoto, 1980). These educational establishments were popular among town people who were keen to learn Confucian-led teachings. One tutor was Joken Nishikawa (*Kyuu Rinsai*) who wrote a popular textbook in 1719 called *Chonin Bukuro* (Townpeople's Bag), which taught ethical principles by using stories and history (Nishikawa, 1719, 1898; Genma et al, 2006). He also adopted Confucian teachings in his book which encouraged town people to work diligently and to live frugally. Nishikawa taught business owners to become more civilised and self-confident. By drawing upon examples from the past he discouraged them from making large profits from their

business activities. The book told business people to understand their place and their role in society, occasionally referring to deities from Shintoism and Buddhism (Nishikawa, 1719, 1898). His book also encouraged readers to live their life based upon Shintoism which contains Confucian teachings.

> Shintoism teaches austerity. Austerity is a form of honesty. When (people) become luxurious and extravagant, an evil deed exists there. It is important for intelligent people to do good by stealth (Translation of Nishikawa, 1919, 1898: 52, 78).

In addition to Japanese business people in the Edo era being constantly reminded of the importance of ethical dealings based upon Confucian and Buddhist teachings, they were encouraged to gain arithmetic skills at private schools (Najita, 1992). Lecturers of *ko* schools also convinced their students that merchants activities were making valuable contributions to society, making them feel proud (Najita, 1992). Business people also wanted to learn about Confucian teachings and apply them to their daily lives to ensure that the government would not take away their business licence. Confucian teachings and their application to the daily lives of business people helped them to internalise social norms and to obtain a higher social status (Foucault, 1975; Bellah, 1985; Takenaka, 1998). Carrying out business with integrity, which became a social norm in the Edo era, also influenced accounting and accountability practices (Ogura, 1989; Egasira, 1962; Sakudo, 1979; Ogura, 2003). Ruthless and unethical business people were rejected for membership of business guilds and lost credibility for generations (Miyamoto, 1955). This was one of the reasons why successful business people devised the *kakun*, in order to avoid such occurrences.

The deliberately immobile society promoted by the government as a means of controlling the population made people in the Edo era become more conscious about their own reputation in society (Ogura, 2003). Generations of people in the Edo era were forced to stay in the same local areas for generations when the law in the Edo era prohibited free movement of people. Losing one's business licence or one's credibility would have led to embarrassment and being ostracised in society for many years, which people wanted to avoid. This was the social 'gaze' which implicitly monitored business people and, thus, they tried hard to comply with social norms (Bellah, 1985; Foucault, 1975; Najita, 1992). The Edo government encouraged successful merchants to work hard to contribute to the national economy (Takenaka, 1998). From the perspective of the Edo government, the existence of business people was vital to the nation because they were the driving force in developing the economy and so creating the wealth for the nation. The market economy flourished, especially in large cities like Osaka and Kyoto. Hence, the economic power of business people significantly increased in the Genroku period (1688-1704) of the Edo era and this continued for the rest of Edo era in several merchant houses including the Mitsui (Takenaka, 1998). The increase of business volumes during and after the Genroku period was evident in accounting documents from a number of merchant houses including the Tomiyama and the Kounoike merchant houses (Kawahara, 1977).

3.5.2 *Kakun*: Family Law and Business Practice

The *kakun*, the family law of merchant houses in the Edo era based on Confucian teachings, gave important written guidance for people working in these merchant houses (Ogura, 1989; Kiseki, 1986; Sakudo, 1979). Every merchant house

composed its own *kakun* to discipline its family and employees. Everyone in each merchant house shared values and beliefs like a large extended family. The *kakun* covered a broad range of house rules in merchant houses which prescribed how a business should be run. The importance of accounting was decisively stressed in surviving documents of the *kakun* in merchant families (Sakudo, 1979; Hayashi, 1983; Egashira, 1992). The *kakun* always reminded their employees and family members to be vigilant when handling financial matters and lending money (Sakudo, 1979; Ogura, 1989). The *kakun* also admonished people for spending business expenses on luxury goods or entertainment. To economise, business expenses were expected to be constantly monitored by the manager of each branch (Sakudo, 1979). With work ethics instructed by the *kakun*, business people in the Edo era shared the belief that all needed to work hard and live frugally. A number of articles on financial practices were stated in the *kakun* of Nagasaki Branch of the Sumitomo merchant house (See Table 3-1).

Table 3-1: Extracts of the *kakun* from the Nagasaki Branch of the Sumitomo merchant house in 1721

House rules of Sumitomo Family (Extract) issued in 1721
[Rules for business activity] • Do not deal with illegal merchandise[3]; • Do not include sightseeing during a business trip; • Do not ask suppliers for any gift or favour. Do not receive any bribe from suppliers or from business associates; • Do not include leisure activity expenditure in the business account; • Avoid extravagant spending and wear cotton kimono clothing. This also applies to senior members of staff. • Doing business privately is strictly forbidden and anyone who breaches the rule will be severely punished; • A business decision must be made through discussions with relevant members of staff.
[Rules for employees' daily life] • The shop must open at 6 am and close at 10 pm. Everyone must adhere to these hours. Everyone is required to obtain permission to leave their post; • Any form of gambling is forbidden; • For economic reasons, eat simple meals and the drinking of alcohol is forbidden; • Do not let prostitutes stay in the premises.

(Sakudo, 1979: 82-90)

These emphasise the need for family members and employees to be thrifty and to obey the rules of the merchant house. These *kakun* articles reflects Confucian teachings which encouraged self-discipline, ethical business dealings, honesty and devotion to the merchant house, collective agreement, disciplined daily life and the maintenance of morality (Sakudo, 1979; Miyamoto, 1980). The *kakun* was not just

[3] Illegal goods included the Christian bible.

a reminder but, instead, it was a binding contract within a merchant house. It drew punishment if rules were not obeyed (Ogura, 2003).

> If house rules were not obeyed by anyone who is appointed as the head of the business, he must be forced to retire, relinquishing all rights (source: house rules of Nakai Kyoto Branch in Ogura, 2003: 112).

Employees were expected to work hard to improve their business skills as well as to serve their masters. Employees needed to follow these rules to avoid disciplinary punishments, which included difficulty in finding a new job due to social immobility and social embarrassment in losing a job (Morita, 1983). Employees were promised that if they were obedient they would be protected with life-long employment and by the welfare system provided by their employer (Miyamoto, 1964). Employers gave sick leave to sick employees and looked after them equitably as Confucianism recommended (Morita, 1983). Business owners were acting like pseudo fathers of their employees and, thus, as fathers were obliged to take care of their family members according to Confucian teachings (Adachi, 1974). Merchant family members and employees were encouraged to be docile by always respecting their seniors or parents. Therefore, business people during this period established disciplinary techniques using hierarchical observation and normalising judgement through the use of the *kakun* (Foucault, 1975: 170; Miyamoto, 1964). Discipline is the specific technique of a power that regards individuals both as objects and as instruments of its exercise (Foucault, 1975: 170).

The surviving *kakun* documents from various merchant houses include rules on the management of financial issues and keeping accounting books (Miyamoto, 1964; Adachi, 1974; Arada, 2003). The *kakun* often referred to the significance of accurate financial records and accumulating capital for the family business (Sakudo,

1979). Rules for dealing with accounting records were particularly emphasised in the *kakun* in the Edo era, and accounting records were treated with a high degree of confidentiality (Miyamoto, 1964; Sakudo, 1979; Ogura, 2003). For example, the *kakun* of the Sumitomo merchant house stipulated that only trusted members of the staff should regularly count cash and confirm the amount of cash on their premises (Sakudo, 1979). Account books had to be verified regularly by a selected senior member of staff to prevent any mistakes or missing accounts.

Power resided with accounting knowledge and information in these hierarchical organisations where employees in lower ranking positions did not have access to financial information (Ogura, 1962; Foucault, 1975). Accounting information represented the power of people who had access to it. The *kakun* of the Kounoike family in the 18th century also preached the importance of accurate accounting and appropriate accountability (Miyamoto, 1964). The Kounoike's *kakun* detailed how owners should pass their business and their assets to the next generation and, therefore, their intention was to sustain their business for future generations (Miyamoto, 1964).

Power to control business and its accounting was legitimised by introducing the *kakun* during the Edo era (Foucault, 1978: 86). More broadly, the *kakun* documents were effective when applying Confucian teachings in business situations. This is what Foucault terms the internalisation of norms and self-governance (Foucault, 1975; Radcliff; 1998; Funnell et al, 2017). These *kakun* documents were written based upon Confucian teachings which were the source of legitimisation in the Edo society (Watsuji, 1973; Maruyama, 2006). With the use of the *kakun*, power intervened subtly in merchant houses during the Edo era. By obeying senior

members and following the *kakun*, employees became subject to power and norms. According to Foucault, power is tolerable only when it exists implicitly and power works more effectively when individuals cannot identify the face of power (Foucault, 1976). Thus, individuals do not become rebellious but, instead, they would internalise social norms and conform to the intentions of the authority without raising questions.

The hierarchical relationships in merchant houses created an asymmetry of power (Funnell et al, 2017). However, the asymmetry of power had positive aspects. Employees, who felt obliged to be loyal to the owner of the business, following Confucian teachings were treated like pseudo family members and life-long employment was almost guaranteed. The existing *kakun* from the merchant house in the Edo era indicated that employees were trained and given opportunities to improve their job skills (Adachi, 1974). Employees were expected to work hard for the business and to obey their superiors no matter what. Although contemporary Japan has progressed significantly since the Edo era, the basic concept of power relationships in a business organisation continues to exist in the hierarchical relationships of organisations (Hamada, 2008).

3.6 Re-defining shared beliefs in the Meiji Era

When the Edo government ended in 1868, the new Meiji government also needed to justify the re-establishment of the government and strengthen the solidarity of the nation (Yasumaru, 2004). At the beginning of the Meiji era, government officials tended to dismiss traditional values and tried to introduce Western values and education. However, they eventually realised that the Japanese need a shared creed

which help them to work collectively and achieve national goals (Yasumaru, 2004). The Meiji government reinstated the significance of keeping traditional values influenced by Confucianism and Shintoism, despite a growing number of people studying Western philosophy and Christianity (Ohishi et al, 1965; Zaike, 2004). The new government had to have solidarity and cooperation from its people in order to fight against Western countries who might try to colonise Japan. Japanese officials had seen and heard about colonised Asian countries and the humiliating consequences of the Opium War in China (1840-1842) (Jensen, 2000). Therefore, they felt strongly about the importance of being politically and economically independent (Ishida, 1965). This was very similar to what Ieyasu Tokugawa did to establish shared values for uniting the nation when he was in power at the beginning of the 17th century. The Meiji government soon realised embedded values were significantly influential and could not be removed from the Japanese. To provide this strength, the government chose Shintoism as a state religion which was heavily influenced by Confucianism (Maruyama, 1969).

The standard of business morals at the beginning of the Meiji era was declining, mainly because of the collapse of feudalistic restrictions from the Edo era (Watsuji, 1973; Maruyama, 2006). The authority of the Edo government and its high officials was negated and, thus, society had temporarily lost moral standards (Maruyama, 2006). There were many fraud cases in trading[4] during the Meiji era and unethical business dealings were often reported (Satow, 1968). Declining standards of accountability raised concern in society in the Meiji era and the reintroduction of ethical teaching was strongly advocated (Yasumaru, 1988). The movement of

[4] Fraud cases included selling very poor quality materials to customers (Satow, 1968).

moral education was rigorously promoted by prominent industrialists and thinkers such as Shigeki Nishimura (1828-1902) and Eiichi Shibusawa (1840-1931) (Watsuji, 1973; Jansen, 2000). When authoritarianism became more dominant in Japan, both the military and the government encouraged companies and people to work together like one big family under the Emperor (Morishima, 1982). Large companies in Japan during the early 20th century were run under nationalistic and collectivist ideologies based upon Confucian teachings, claiming that they were like families (Udagawa, 2007). By doing so, large companies hoped that they could appease their employees when they faced occasional protests instigated by workers who studied communist ideology imported from the newly formed Union of Soviet Socialist Republics (USSR) after 1917 (Udagawa, 2007). Companies were also encouraged to offer life-long employment and fringe benefits to their workers as a token of loyalty (Hirschmeier, 1964; Morishima, 1982). Employees who felt that they were valued as members of a family were motivated to work harder. They would devote themselves to senior members of the organisation and considered them as 'family members' because filial piety was one of the most significant teachings of Confucianism (Tu, 2000).

Publishing books on ethics became popular in the Meiji society, one of which was called *Futsu Hayagakumon*, to teach ordinary Japanese people how to be loyal towards their employers and to work ethically (Fujimiya, 1906). This book, as seen in Figure 3-1, indicates that employees of the Meiji era were still required to be obedient and to follow orders from their employers without criticism. They had to understand that they were in a more inferior position than their employers and customers. Employees were supposed to be humble and submissive at the

workplace and in society. Composing the *kakun* of one's business was still very common among influential business people in the Meiji era and ordinary people were often encouraged to study their *kakun* in order to become better business people (Iwasaki, 1914).

Figure 3-1: Code of Conduct for Employees, Servants and Apprentices

Translation of the above page: Hokonin kokoroe (Code of Conduct for Employees, Servants and Apprentices)

-: Do not rebel against one's employer;
-: Do not argue with one's colleague;
-: Behave well;
-: Do not be idle;
-: Be careful about fire;
-: Don't miss any appointment;
-: Wake up early in the morning;
-: Do not waste any consumables;
-: Do not hide one's mistake;
-: Do not lie;
-: Do not make a complaint about food and drink;
-: Do not go out to waste one's time;
-: Treat customers well;
-: Respect one's employer/master.

(Original and Translation of Fujimiya, 1906: 209)

A number of nationalist political organisations were formed between the Meiji era and the early part of the Showa era and every Japanese was expected to contribute to society (Maruyama, 1969; Irokawa, 1970). The collectivist ideology was the norm

and for individuals to pursue their happiness was considered to be a selfish act (Maruyama, 1969; Irokawa, 1970). This, however, placed the Meiji government in a dilemma. They wanted to keep traditional Japanese values for strengthening the nationalism but at the same time they had to adopt Western values in order to prove to the Western powers that the Japanese were highly sophisticated (Ishida, 1965). There was a contradiction between traditional Confucianism values and Western values where individuals' rights gained more protection. The Japanese people were constantly told a phrase as a form of propaganda derived from Confucianism called '*Chuukun Aikoku'*, 'devotion to one's sovereign and country', especially between the Meiji era and the initial part of the Showa era (Maruyama, 2006). This had a major impact on the values of Japanese nationals and how companies and their accounting were managed (Irokawa, 1970; Maruyama, 1969; Yasumaru, 2004). Military forces in Japan created accounting rules in order to gain a stable supply of military goods. During the height of militarism before the outbreak of WWII, military forces imposed cost accounting on their suppliers (Moroi, 2007; Chiba, 2010b). Detailed investigation is presented in Chapter 5. Employees were expected to work diligently for their companies and these companies were to ensure that they managed their financial affairs for the prosperity of the nation (Maruyama, 1969). Confucianism continued to exist within the Japanese which helped them to nurture national identity and solidarity throughout their working lives.

3.7 Confucian Influence in the 21st Century

When Japan lost the Pacific War, the GHQ strongly imposed Western values that included a democratic ideology. It was the end of the deification of the Emperor.

Also, the abolition of feudalistic society, the aristocracy and the class system was executed (Jansen, 2000). While many Japanese people were pleased with the newly imposed egalitarian values and more freedom of speech, it did not mean that the traditional values were completely abandoned by Japanese society. The Japanese still advocated and practised values influenced by Confucianism, such as respecting senior members of society and organisations (Morishima, 1982). The newly formed government also understood that using Confucian teachings would encourage the entire population to work hard to rebuild the country after the war (Maruyama, 1969). During the period of rebuilding Japan after 1945, embedded Confucian values helped the nation re-establish its moral and work ethos.

Japan has constitutionally become a secular country since the end of the Pacific War. People have become less superstitious and some religious protocols such as conducting religious festivals within business premises and using a fictional lucky date have become more redundant (Jansen, 2000; Sawai, 2007). However, traditional embedded values of Confucian teachings and business customs are still evident in contemporary Japanese society and business (Dollinger, 1988; Yasumaru, 2004). A great number of people still visit shrines and temples on memorial days to carry out ceremonies (Morishima, 1982). The latest ethics textbook for junior high school pupils encourages its readers to work hard for society and to thank one's parents and grandparents (Ministry of Education, Culture, Sports, Science and Technology [MEXT], 2015a). The textbook also emphasises the importance of social harmony and collaboration, deriving its underlining philosophy from Confucianism (MEXT, 2015a). The following passage is an extract from an ethics textbook published for 13-15 year olds pupils in contemporary Japan.

In these contemporary textbooks the notion of respecting other members of society and working collectively taken from Confucian teachings is translated into the modern pupils' life. A number of stories and quotes are used to emphasise Confucian-led teachings in textbooks of ethics. For example, a direct quote of Ekiken Kaibara (1630-1714), a well-known Confucian scholar from the Edo era, is used to teach politeness and orderly society.

> Proprieties[5] are just like a bank in a river. If there is a bank, a river won't burst. If there are proprieties, atrocious incidents won't occur by Ekiken Kaibara (Translation of MEXT, 2015b:53).

Contemporary textbooks also encourage their readers to understand the significance and benefit of fulfilling one's role in society and working collectively. These teachings are very similar to the content of the *kakun* and books in the Edo and Meiji eras. Parents, leaders of communities, teachers and seniors refer to these teachings when giving instructions to juniors in present-day Japan. The emphasis of modern Japanese textbooks on traditional moral values can be seen in the following example:

> By belonging to a group and society and fulfilling your role, you will be able to improve your strengths. This will be the best chance for you to improve yourself through experiencing difficulties and working hard to resolve them (Translation of MEXT, 2015c:168).

Relationships between employees and their employers, and also clients and their contractors, continue to be based mainly on Confucian teachings rather than on contractual relationships. Successful business leaders in contemporary Japan still consult and practise Confucianism in their management. There are a number of prominent examples of how Confucian-led values were ingrained among prominent business people after the Pacific War. One of the renowned business leaders,

[5] 'Proprieties' in the quote mean rules of conformity to social norms and ethical rules.

Konosuke Matsushita (1894-1989), the founder of Panasonic, devised the company's management and operations policies using Confucian-led values (Yasumaru, 2004). He persistently emphasised the importance of fairness in business dealings and strong personal relationships between employees and customers (Yasumaru, 2004). His policy stated that when one became a member of the Panasonic business house, one would be treated as a pseudo family member (Ohara, 2003). Matsushita also insisted that affiliated retailers should be treated in a benevolent manner as if they were a part of the 'Panasonic family', resulting in them exhibiting allegiance and promoting the Panasonic brand.

Panasonic once offered a high level of company welfare, including company housing and allowances, before the pressures of global competition became fiercely compelling in the 2000s (Ohara, 2003). Like many other traditional large companies in Japan, Panasonic guaranteed life-long employment and the company was considered as an employee's second home. The idea of reciprocity from Confucianism, as in 'you were expected to show your loyalty to the company and the company would look after you', still implicitly prevails in many business organisations (Morishima, 1982). One's boss is to act like one's pseudo-father and absolute obedience is widespread. However, the results of this power relationship was not always negative. Confucian-led values helped employees at Panasonic and many other leading Japanese companies to improve work process and to produce high quality goods for sales in the global market (Morishima, 1982; Ohara, 2003).

A more recent example of an influential business person with strong Confucian beliefs is Kazuo Inamori, the founder of Kyocera and DDI Ltd. He is a devoted Buddhist who strongly promoted his business philosophy based on traditional

Confucian and Buddhism values. Beliefs which have been the major influence on Inamori are the same as Baigan Ishida's teachings in the Edo era (Ishida, 1739, 1935). When Inamori manages businesses, he openly expresses the significance of accounting and high business ethics (Kyocera, 2015; Inamori, 2000). He has been running private business classes called *Seiwajuku*, lecturing his students on equitable business management and devotion to the greater good. He encourages his followers to apply teachings from Confucianism and Buddhism in business management (Inamori Foundation, 2015). *Seiwajuku* has a group of about 9,200 members, including owners of large and medium private companies in Japan and other countries such as China (Inamori Foundation, 2015). Inamori teaches his followers that companies are able to be financially successful without being ruthless and greedy. The cases of Inamori and Matsushita signify how Confucian-based beliefs have been embedded in contemporary Japanese business practice and people.

Mitsutoyo, an engineering company which produces high precision measuring devices also uses Buddhism with elements of Confucian teachings in their mission statement. Their mission statement emphasises their desire to make the world a better place for everyone through supplying high quality measuring devices (Mitsutoyo, 2019). The statement clearly declairs that the company is a place for employees to cultivate their ability and to improve their skills (Mitsutoyo, 2019). Before manufacturing a high quality product, the company must create a good person as an employee. Mitsutoyo's approach is holistic and they do not just mean engineering skills, but instead, they encourage employees to build solidarity by understanding company values. Mitsutoyo has detailed prescribed company rules

which balance Confucian-led values with the real world in order to prevent nepotism among inner circle members (Mitsutoyo, 2019).

It is evident that Confucian-led values generate a number of positive outcomes such as a cohesive and orderly society. However, they can be used negatively in business. Some employers take advantage of Confucian teachings to conveniently and selectively manipulate their employees. Based upon the reciprocity idea from Confucianism, employees would expect that their efforts to be rewarded in the near future and, thus, they would work hard to please their employer (Morishima, 1982; Oguri, 2014). Employees in Japan tend to work long hours without being fully compensated, believing that their contribution would pay off in the long-term (Sugimura, 2015; Morishima, 1982).

A large number of businesses in Japan continue to offer fringe benefits such as life-long employment, company housing and other welfare benefits (Meyer-Ohle, 2009; Morishima, 1982). In return, employees are often expected to offer free overtime and to give up their annual holidays (MHLW, 2015; Meyer-Ohle, 2009; Morishima, 1982). Group consciousness and collectivism that have been long practised in the Japanese business context mean that employees are expected to sacrifice their individual rights to their employers and society (Bloom and Solotko, 2003; Morishima, 1982). The majority of employees in large corporations in Japan, like Panasonic, would expect job security even when the economic climate is negative. However, due to the growth of severe global competition and investors' demands, maintaining the high level of fringe benefits has become difficult for Japanese companies that are competing in the global market (Hamada, 2008).

Reciprocity does not work equally. In Japan people and organisations with power tend to gain more because they are able to manipulate Confucian teachings to pursue business interests. Notably, global competition has made Japanese management seek greater profits for shareholders, rather than for employees. Confucian-led values are manipulated to encourage employees to work harder, sometimes leading to employees proactively breaching rules to achieve collective targets, which can result in negative outcomes such as accounting frauds (Jennings, 2015; Hamada, 2008). This is clearly against the original Confucian and Buddhist teaching when management is abusing these traditional values (Abe et al, 2012). Respecting people in higher positions would prevent their subordinates from challenging them or being critical. Respecting seniors and being obedient to one's superiors at work are still highly regarded gestures in 21st century Japan (Genma et al, 2006).

Even in present-day Japan the majority of workers still hesitate to push for their rights, which is against Confucian teachings, and they would rather sacrifice their private time than work less (Nemoto, 2013; Nikkei, 2016). This is emphatically supported by interviewees for this thesis who work in Japan. They consistently referred to the way in which large contemporary Japanese corporations emphasise the importance of collective decisions in the 21st century, to be obedient to one's seniors as emphasised in Confucianism (Watsuji, 1973; Tu, 2000). This, however, could cause a potential problem if people refuse to speak up when they see any shortcomings or mistakes of their bosses. This has been especially obvious with accounting practices in Japan as auditors may not be too critical when examining their clients' accounts (Bloom and Solotko, 2003). Confucian teachings overruled their professional judgement in certain cases. The succeeding chapters further

elaborate the historical relationship between Confucian-based values and accounting and accountability.

3.8 Conclusion

Historically, Confucianism, Buddhism and Shintoism are the three main belief systems which have had an effective and pervasive influence in Japanese society. Their teachings were often modified and combined by a long succession of governments in order to subjugate the Japanese. The teachings implicitly influenced behaviours of people who then monitored their own behaviours. In the Edo era Confucianism was chosen as the controlling mechanism used by the Edo government (Bellah, 1985; Jansen, 2000; Morishima, 2004). The Edo government established an effective surveillance system using Buddhist temples which had a major role in creating a society of self-disciplined people. During the Edo era, business people legitimised their business activities and profit making through Confucian and Buddhist teachings. Baigan's philosophy, Shingaku, and the Jodo Buddhism sect taught that earning money was a benevolent activity which helps society and people in general (Davis, 1989; Morishima, 1982). Employees were disciplined using Confucian teachings to become obedient workers (Bellah, 1985; Egashira, 1992).

The majority of people agreed with and followed the 'adjustment' feature of Confucianism, adjusting themselves to the world rather than having a desire to transform the world (Weber, 1951). Once one becomes a docile body, it is hard to challenge the status of those who determine social values and priorities (Foucault, 1975). The Edo government adopted a method which affected the psychological

states of their people in a society where Confucian teachings became the imbued moral standards among the Japanese business people.

Surviving *kakun* documents of large merchant houses indicate that business people in the Edo era also established business ethics and accounting systems which were affected by Japanese beliefs derived from Confucianism, Buddhism and Shintoism (Genma et al, 2006; Ogura, 1962; Egashira, 1992; Kawahara, 1977). The *kakun* which Confucian scholars were commissioned to compose were provided voluntarily by business owners in order to prosper commercially (Miyamoto, 1964). Consequently, Confucian teachings were practised in the working lives of business people directly and they were indirectly imposed upon them by the government (Ogura, 2003). The Edo business people internalised norms from the *kakun* which was heavily influenced by Confucianism and disciplined themselves in order to win approval of the government and society. Accordingly, Confucian teachings were used by the Edo government to influence their subjects to discipline themselves.

Traditional beliefs have always impacted business and accounting practices throughout modern Japan (Bellah, 1985; Maruyama, 1969; Tu, 2000; Lam, 2003). The feudalistic regime of the Edo government that established the feudal system in society, required that businesses were to be operated according to rules governed by the highest class, the samurai warriors. People in lower-ranking positions of the social hierarchy tended to obey people in higher positions without raising any questions. Imbued Confucian teachings criticised speaking back to one's seniors, which has never completely disappeared in contemporary Japan. Those in authority did not rely mainly on physical force to get people to obey. People

internalised norms which were originally intended by the government which employed Confucian teachings (Foucault, 1975; Maruyama, 1974).

It has been over seventy years since the end of the Pacific War, during which Japan has advanced greatly in industry, technology, culture and society. The country is secular but traditional values derived primarily from Confucian teaching are deeply rooted in Japan and its people (Bellah, 1985; Yasumaru, 1988; Yasumaru, 2004). Primary schools teach ethics based upon Confucian teachings and the moral standards of the Japanese continue to be based upon Confucianism and Buddhism (Bunka, 2015; MEXT, 2015a; Bellah, 1985). There are many positive outcomes for business from the traditional business ethos such as loyalty and high morals from both employers and employees. A number of successful business owners continue to practice Confucian and Buddhist teaching when conducting their business in contemporary Japan (Inamori, 2000; Yasumaru, 2004). Contemporary business leaders often consult Confucianism when guiding and managing their employees. However, there is a danger in abusing the sense of employees' loyalty by senior members of modern corporations when they are exposed to fierce global competition and have to meet challenging financial targets. This could potentially lead to accounting manipulation which resulted in financial scandals to protect the interests of the company, which is further discussed in later chapters (Jennings, 2015; Abe et al, 2012). The impacts of Confucian teachings and values on business and accounting practices in the Edo and Meiji era are further examined in the following chapter.

Chapter 4

Accounting Practices and Accountability in the Edo era and the early Meiji era

4.1 Introduction

This chapter critically examines Japanese accounting and accountability between the 17th century and the late 19th century and how the belief system and social norms influenced them. This, as shown in the previous chapter, was the time when national values were established. The Edo era (1603-1868) enjoyed a long period of relative peace which helped the development of the national economy and the establishment of entrepreneurial merchant houses (Sakudo, 1970; Tsumura, 2014; Ogura, 1962). Their surviving accounting records confirm the strong relationship of accounting practices with religious teachings as well as with business activities. In the subsequent Meiji era (1868-1912), Western management and accounting practices were adopted by many merchant houses, some of which grew into large international conglomerates such as Mitsui and Sumitomo (Hayashi, 1983; Nishikawa, 1993). After the Edo era a concept of a public corporation and capitalism borrowed from the West inspired a number of entrepreneurs who set up new enterprises such as Kanematsu (Hirschmeiser and Yui, 1981). For these new companies, the successful adoption of Western accounting methods was a pre-requisite. This chapter establishes how traditional values influenced accounting and accountability practices in the Edo era and the early Meiji era (Tsumura, 2014; Nishikawa, 1993b).

Historically in Japan accounting had been given significant importance in both public and private organisations (Nakase, 1990; Tsumura, 2014). The earliest accounting books of the Japanese Treasury were recorded in the period of Emperor Yuraku's[6] reign beginning in 460AD, long before the Edo era (Kawahara, 1977). The accounting methods were gradually developed under the governance of Emperor Yuraku and the Treasury was mainly managed by migrants with accounting knowledge from China and Korea using single-entry bookkeeping methods (Kitagawa, 1987). The accounting department of the government was kept as a specialist area and its knowledge was considered to be linked to the power of the political leader. The inspection of accounting records, namely auditing by the government, was officially commenced in 797AD, thereby confirming that the importance of financial management for a government has been recognised in Japan for a long time (Nakase, 1990). The Edo government also stressed the importance of accounting and created a position called *kanjyogata*, an accountant, in order to maintain accounting records and the financial health of the government (Nakase, 1990).

During the late 16th century, a growing number of people were able to gain access to business opportunities when a market economy with fewer regulations was promoted by influential war lords, notably Nobunaga Oda (1534-1582) and Hideyoshi Toyotomi (1537-1598), just before the beginning of the Edo era (Hirschmeier and Yui, 1981). Ieyasu Tokugawa (1543-1616), the founder of the Edo era and the Shogun, had brought an end to feudal disputes and insecurity in 1603. When the Edo era started, people were beginning to enjoy access to a variety of goods and

[6] In Japan, the emperor governed the nation before the 12 Century, and then became a more symbolic figure after the samurai warrior class became more powerful and administered politics.

services (Yokota, 2002). A number of shrewd merchants in the Edo era eventually expanded their family businesses into larger business entities, which were called merchant houses (Miyamoto, 2007). Large merchant houses opened branches in cities such as Edo (currently called Tokyo), Osaka and Kyoto. Recording business transactions in a systematic manner was imperative for them (Kitajima, 1962; Ogura, 2003). Some merchants originally in retail business further expanded their business scope into banking with the funds they had accumulated (Hayashi, 1983). With the growth of commercial activities, accounting records played an increasingly significant role in the Edo era (Hayashi, 1983; Ogura, 1962; Egashira, 1962). The surviving documents from merchant houses show how they kept reminding their employees about the importance of keeping accurate accounts (Ogura, 1962; Sakudo, 1979).

Religious organisations such as shrines and temples had a strong connection with local business people in the Edo era. Thus, donations to them were essential business expenses (Bellah, 1985). Buddhist temples played the role of a quasi local government office and they were important to local residents including business people. Shrine priests also conducted various religious rituals for local people. Showing respect by donating money to shrines and temples reassured business people that their businesses would prosper. Values influenced by Confucianism and Buddhism enabled business people to internalise social norms and the importance of accountability in the Edo era (Maruyama, 2006). Confucian and Buddhism teachings promised happiness and prosperity for one's descendants and in one's next life. This was an effective way to govern business people in the Edo era

as successful business people continued working hard and remained submissive to the government (Bellah, 1985; Foucault, 2009).

4.2 Accounting in the Edo Era and the Market Economy

In the Edo era merchant houses realised that it was vital to keep track of their overall business transactions. Surviving accounting records of merchant houses show how they financed their capital and how they spent their income. Several different types of accounting records, including a cashbook, stock record and balance sheet to trace various financial transactions were issued by prominent merchant houses (Shinpo, 1971). Single-entry bookkeeping, at first, was commonly adopted by many merchant houses to record the inflow and outflow of money in businesses (Okazaki, 2005; Hayashi, 1983). When starting up a business, keeping a daily ledger was basically sufficient. The ledger, called *daifukucho*, of which a copy of a typical front page is shown in Figure 4-1, recorded daily transactions of the business with a writing brush (See Figure 4-1) (Ogura, 2003). It was often hung at the manager's desk in the retail shop during the day time and then taken to the back office for calculating the total sales of each day (Kawahara, 1977).

Figure 4-1: A sample of a ledger, Daifukucho, written with a brush

(Source: Historical Village of Hokkaido, 2017)

At the beginning of the Edo era, most accounting records only recorded income and expenditure on the same sheet of paper like a memo (Ogura, 1962; Kawahara, 1977). One of the oldest existing ledgers in the Edo era, *Tashiri Cho* from the Tomiyama merchant house in the Ise region, was compiled between 1615 and 1640 (Kawahara, 1977) (See Figure 4-2). The Tomiyama family started a kimono business and later opened the *ryogaeten*, an exchange bureau, in 1725. Their surviving accounting records indicate that they annually calculated their total assets until they closed down their business in 1808 (Kawahara, 1977) (See Table 4-1). Table 4-1, *Tashiri Cho* from the early phase of their business, provides a simple snapshot from the record of annual assets but did not contain other detailed financial records. With the *Tashiri Cho*, the Tomiyama merchant house was able to view a summary of their capital and profit (See Table 4-1; 4-2).

Figure 4-2: *Tashiri Cho* Ledgers of Tomiyama merchant house in the Ise region

(Source: Tomiyama Merchant House Accounts compiled by Kawahara, 1977)

Table 4-1: *Tashiri Cho* Tomiyama merchant house

Year	Capital Equity (Silver unit: kan ; monme; bu) After 1630, the unit of currency was changed to Gold, using ryo ; monme; bu	Net Profit or Net Loss (Silver unit: kan ; monme; bu) After 1630 (Gold unit: ryo ; monme; bu)
1615	10 kan 541 monme	Business started
1616	15 kan 322 monme 7 bu	4 kan 781 monme 7 bu
1617	21 kan 812 monme	6 kan 489 monme 3 bu
1618	24 kan 52 monme 7 bu	2 kan 240 monme 7 bu
1619	No record	No record
1620	33 kan 123 monme 6 bu	9 kan 70 monme 9 bu
1621	41 kan 479 monme	8 kan 355 monme 4 bu
1622, 1623	No record	No record
1624	56 kan 486 monme 6 bu	15 kan 7 monme 6 bu
1625	No record	No record
1626	62 kan 309 monme 7 bu	5 kan 823 monme 1 bu
1627-1629	No record	No record
1630	1,300 ryo	250 ryo
1631	1,319 ryo	19 ryo
1632	No record	No record
1633	1,012 ryo	307 ryo in deficit
1634	1,145 ryo 1 bu and silver coins (9 monme 4 bu)	133 ryo 1 bu (There is missing information in their calculation.)
1635	1,197 ryo 3 bu	52 ryo 2 bu
1636	1,313 ryo 1 bu	115 ryo 2 bu
1637	1,189 ryo 1 bu (There was miscalculation of 2 bu in the original document.)	123 ryo 2 bu in deficit
1638	972 ryo 1 bu	217 ryo in deficit
1639	829 ryo	143 ryo 1 bu in deficit
1640	668 ryo	161 ryo in deficit

(Source:Tashiri Accounting Records of Tomiyama Merchant House compiled by Kawahara, 1977: 11)

Tomiyama's records show that their accounting methods were still basic. Although they were using multiple types of accounting records to show capital and profits, these were not systematically verified and their records did not appear to produce a profit and loss statement (Kawahara, 1977: 23-27). In addition to the accounting records above, several years of *sanyo cho* (literally, calculation notebook), which is similar to the contemporary balance sheet, have also survived in the Tomiyama family. Their *sanyo cho* balance sheet in 1638 contained information on their assets, liabilities and net assets, but did not show detailed expenses (Table 4-2) (Kawahara,

1977). Details of debtors, creditors and stock were mainly recorded. The financial information suggests that the Tomiyama merchant house carefully recorded business transactions from 1624, when they started a money exchange business and issued cheques (Kawahara, 1977). Their *sanyo cho* shows that they logged the financial transactions carefully in order to create an annual financial summary (Kawahara, 1977).

Table 4-2: Balance sheet in Tomiyama merchant house in 1638

Assets	**Liabilities**
Account receivable (other regions) 782 ryo 1bu	Note payable (cheque) 73 ryo 3 bu
Account receivable (Izawa area) 122 ryo 1 bu	Salary payable (Mr. Ichita) 24 ryo
Account receivable (Yamanaka) 48 ryo	Salary payable (Mr. Gonhichi) 44 ryo
Inventory (rice, soya, wheat,others) 91 ryo	Salary payable (emplyees) 30 ryo
Inventory (tea) 35 ryo	(assets – liabilities=net assets (972 ryo)
Inventory (coins, cotton) 11 ryo 2 bu	
Petty cash 14 ryo	
Cash 40 ryo	
1,144 ryo	1,144ryo

(Source: Tomiyama Merchant House Sanyo Cho Accounts compiled by Kawahara, 1977: 23-26)

Although the Tomiyama businesses gave considerable significance to accounting, their accounting methods were rather unsophisticated compared with ones from the Nakai and Mitsui merchant houses in the late 18th century (Kawahara, 1977). Tomiyama did not adopt double-entry bookkeeping methods. Double-entry bookkeeping, as a systematic way of recording transactions in a ledger, records a flow of value between the accounts (Thomas and Ward, 2009: 126). It is able to ensure the accurate recording of the total amount of each type of income and expenditure, the value of the assets owned by the business, and any debt the business owes (Thomas and Ward, 2009: 127). Their accounting methods adopted a single

entry bookkeeping system and they were able to verify their financial transactions everyday without the help of the double entry bookkeeping methods.

Without established national accounting standards, individual businesses gradually established their own accounting practices during the Edo era (Ogura, 1962). If there was any legal dispute, only accounting records in a bound form were legally accepted as evidence in the Edo era (Ogura, 1962). Prominent merchant families such as Nakai and Mitsui maintained a relatively high level of accountability in accounting practices because they owned exchange bureaus (Kawahara, 1977). For example, the Mitsui merchant house worked with the Edo government which commissioned them to supply goods and to exchange gold currency for silver. Gold currency was mainly circulated in the Edo region while business transactions were often carried out in silver currency in other commercial cities such as Osaka and Kyoto regions (Kawahara, 1977). To achieve this, an exchange bureau was necessary to do business between the eastern and western parts of Japan. Thus, Mitsui and other merchant houses opened exchange bureaus in the main commercial cities (Hayashi, 1983). The growth of businesses meant greater complexity in their business activities and, therefore, an appropriate recording system for their financial transactions was required.

Accounting information was managed only by the most trusted employees in each merchant house and it was considered to be confidential (Ogura, 1962). Accounting records were written with brush using the *fucho* language, a type of secret language or code (See Figure 4-3). For example, a kimono retailer was using a word for ‘river’ when recording the number, ‘ten’ and a word for ‘bottom’ when recording the number, ‘eight’ (Fujimiya, 1906:210-212). To avoid forgeries,

numbers were often written in more complicated Chinese kanji characters rather than using simple kanji for numerical characters. For example, in Japan a kanji meaning the numeral '1' is written '一' but the other kanji '壱' was used to express the numeral '1' in order to prevent forgery. By adding other strokes, '一' can be modified to '二' (two), '三' (three) or even '十' (ten) in numerical characters. Thus, more complicated forms of kanji such as '弐' (two), '参' (three) or '拾' (ten) were used to express numbers in the Edo era (Ogura, 1962). The annual accounting reports were bound in such a way that no one was able to replace pages or remove unwanted records (Ogura, 1962; 2003).

Accounting information was treated as secret and accessibility limited by using the *fucho* language which was only available to selected employees (Kawaraha, 1977). A cash book of a successful merchant house, Shiroki Ya in the late Edo era, shows a typical title page to the accounts (Figure 4-3). The front page of their accounting records of January, 1852, uses the term *kichijitsu* 'a lucky date' instead of using the actual publishing date, which indicate that business people in the Edo were superstitious. The other figure below (Figure 4-4) contains actual accounting information. Both documents were written in *fucho* and, thus, it is extremely difficult for outsiders to decode.

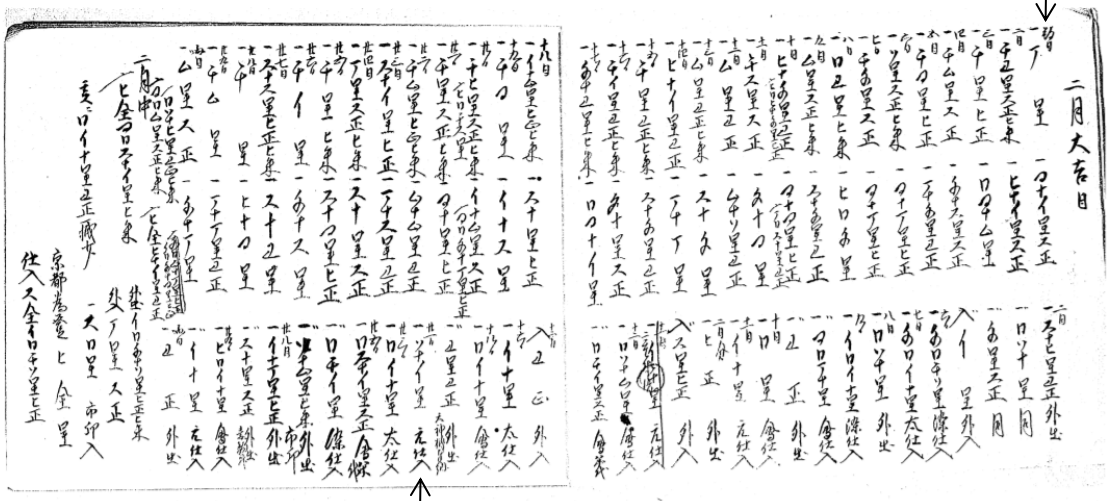
Figure 4-3: Kingin Deiri Cho (Cashbook) of Siroki Ya Merchant House in 1852

Cash Book
Kaei 5 nen, (1852)
January lucky day

(Source: Tokyo University Economic Library, 2017)

Figure 4-4: Kingin Deiri Cho (Cashbook) written in fucho language at Siroki Ya Merchant House in 1852

February, 1,
details were written in *fucho* words



February 21,
Procurement information partially using *fucho*

(Source: Tokyo University Economic Library, 2017)

The secret knowledge of accounting belonged to owners and executive members of merchant houses, those who had power within the organisation. Indeed, accounting knowledge was a way to gain access to power in the organisation (Foucault, 1975; Funnell, 2005). With use of the secret language and traditional brush writing, it was also difficult until recently for modern researchers to decode old accounting records (Ogura, 1989).

During the Edo era the nature of accountability expected by merchant houses was made clear with the *kakun*. Merchant houses individually created codes of practice or family law, the *kakun*, with which they controlled their family members and employees. The *kakun* and other documents from merchant houses indicate their strong relationship with religious teachings. Another merchant house called the Takada stated on the first page of their ledger: 'humbly pray to Shinto deities and Buddha and follow Confucian teachings' (Ogura, 2003: 66). The management of accounts to ensure the prosperity of one's business was a fundamental component of the *kakun* in any merchant house (Sakudo, 1979; Adachi, 1974; Ogura, 2003).

Detailed prescription of house rules acted as a security for business owners to protect their business and accumulated family wealth. Business people internalised the intentions of the Edo government and disciplined themselves and their employees. The *kakun*, therefore, was written not only for people within the business but also to demonstrate to the government how obedient business people were in society. Respecting one's seniors and business customers, ensuring harmony in the workplace and in society, encouraging continued self-development and self-discipline, promoting frugality, and banning unethical business or speculative dealings are some examples from their family law (Egashira, 1992). Their *kakun*

also encouraged family members and employees to be industrious and to continuously learn new skills which reflect Confucian teachings (Miyamoto, 1964).

People were also expected to respect the hierarchy of society and the merchant house where they worked. Successful business people in merchant houses had to demonstrate their modest lifestyle and humble attitude in order to avoid any criticism from the samurai class who were at the apex of the social hierarchy (Hayashi, 1983). In a feudal society maintaining the social hierarchy and the samurai's dignity was extremely important. The intentions of the Edo government were disseminated among owners of merchant houses who internalised social norms. Apart from the usual business activities, the Nakai merchant house promoted local welfare activities and tried to conduct business ethically based upon Buddhism and Confucian teachings (Egashira, 1992). Accounting played a significant role to help their business prosper and to discipline managers of a merchant house to oversee the financial position. The list of donations by Nakai demonstrates that the merchant house tried hard to comply with articles of the house law which encouraged virtuous conduct in society for successful and prosperous business in the long term (Egashira, 1992).

4.3 Credit Transactions and Accounting in the Edo era

With the encouragement of the Edo government the market economy had become significantly advanced by the early 18th century, of which the rice market was a particularly prominent part. It was a period when credit transactions and securitisation of future goods became more common (Nakahara, 1990; Hamori et al, 2001). The securitisation of rice and currencies significantly increased the need for

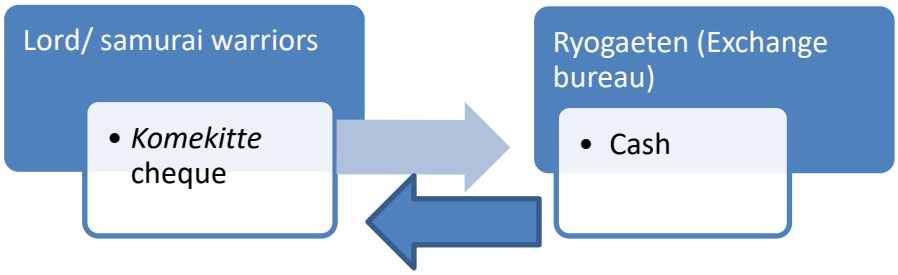
the detailed recording of transactions and enhanced accountability within merchant houses. The rice futures market was beneficial for merchants because they did not physically handle rice by using 'a rice cheque'. A rice cheque, *komekitte*, was issued for samurai warriors to gain access to cash without physically bringing rice to the rice exchange office. It was circulated and became a common method of settling transactions (Kawahara, 1977) (See Figure 4-5).

Figure 4-5: Photos of Cheque and *Komekitte*:

From the left:
Cheque:Hizen (current Saga) Han (1750)
Kome kitte: Okayama Han (1793)
Kome kitte: Kurume (current Fukuoka) Han (1813) (Source: Osaka Municipal Library, 2010)

Instead of sending cash from Edo city to Kyoto and Osaka, business people preferred credit settlements (Nakahara, 1990). With the circulation of rice securities, the transaction, transportation and storage costs for rice were considerably reduced. Farmers were able to secure their profits before their crops were harvested and lords were able to receive money using the rice cheques as collateral (See Figure 4-6) (Hamori et al, 2001). The securitisation was possible because trust in the economic system was derived from Confucianism which was the basis for business morals in merchant houses (Miyamoto, 1964; Egashira, 1992).

Figure 4-6: Transaction of *Komekitte* between Lord/samurai warriors and *Ryogaeten*



Rice was a form of tax and samurai warriors received rice from their lords as income (Hamori et al, 2001). Ultimately, lords and their samurai needed to exchange rice for gold or silver at money exchange bureaus, which were owned by prominent merchant houses such as Mitsui and Kounoike (Miyamoto, 2007). A selected number of exchange bureau that they were expected to work in co-operation with the government were granted an official status, *Okawasegumi*, by the government (Shinpo, 1971). By intervening and regulating the financial market the government did not let private merchants monopolise profits.

The Edo government and the Confucian-led social norms in the Edo society ensured that the government's authority was always effective and the hierarchical social order was preserved, which business people respected even though their financial position was greater than the samurai warriors. Samurai warriors frequently borrowed money from these exchange bureau based upon expected rice receipts as their annual income, using rice cheques as their collateral (Hayashi, 1983). All credit transactions had to be accurately recorded for future cash payments and receipts. High expectations of accountability enabled the credit economy to work efficiently. This was reinforced in the Edo society through constant reminding and education with Confucian-based training such as private tuition of *Shingaku* and *kakun* documents (Adachi, 1974; Ogura, 2003; Hamori et al, 2001). Particularly, business

owners were keen to discipline themselves in order to internalise social norms and to maintain a successful business (Egashira, 1992).

The introduction of the rice futures market enhanced business transactions with the use of credit and cheques, which now became a significant part of the commercial activity of large merchant houses from the middle of the Edo era (Hamori et al, 2001). These changes depended upon establishing credibility, business rules and accounting methods needed to reflect the more complex nature of credit transactions in business. Thus, surviving accounting records from this period indicate that successful merchant houses devised accounting methods to provide a more reliable, accurate record of their businesses (Ogura, 1962; Hayashi, 1983). They realised that accurate accounting records enabled them to forecast potential business growth and to precisely understand their current financial status (Kawahara, 1977). Towards the middle of the Edo era, some merchant houses adopted the basic double-entry bookkeeping methods in order to account for more complex business transactions with multiple businesses using credit facilities and cheques (Ogura, 1962).

Merchant houses throughout the Edo era recorded their accounting transactions every day in order to manage their businesses (Mitsugi 1986; Kiseki, 1986). The management of accounts was given a high priority in merchant houses such as Mitsui and Kounoike (Miyamoto, 1964; Sakudo, 1979; Hayashi, 1983). The Kounoike started using the very basic Japanese double-entry bookkeeping methods, the *Sanyo Cho*, using multiple books in 1670 when they were appointed as an official money exchange bureau in Osaka (Shinpo, 1971; Kawahara, 1977). When Kounoike obtained the official status as an exchange bureau from the Edo government they had to develop efficient rules for bookkeeping to enhance their accountability (Kawaraha,

1977). This was when the *Sanyo Cho* accounts were established to record their lending and borrowing.

Accounting methods in prominent merchant houses became more refined according to the development of a business and also when their business dealt with the government (Ogura, 2003). The accounting records of the Kounoike revealed that their loan business was extremely lucrative, especially before the early 18th century, but after that their lending interest rate dropped from 12 per cent to 6 or 7 per cent (Abe, 2007; Kiseki, 1986). This was due to an adverse economy and lenders, including the samurai class, could no longer afford high interest rates in the latter part of the Edo era (Kisei, 1986). Their *kakun* persistently reminded managers and employees to be prudent about their expenses and to keep accurate accounts and undertake stocktaking (Miyamoto, 1964). For the Kounoike merchant house, accurate accounting records were crucial to trace their debtors especially when the profit margins became narrower.

4.4 Japanese Double-Entry Bookkeeping in Prominent Merchant Houses in the 18th and 19th centuries

4.4.1 The Nakai Merchant House

Towards the end of the 18th century, a number of prominent merchant houses started using double-entry bookkeeping methods in order to record complex transactions (Ogura, 1962; Tsumura, 2014). Accounting records from several merchant houses from the Edo era indicate that an early format of double-entry bookkeeping, namely the Japanese double-entry bookkeeping method, was invented by merchant houses (Shinpo, 1971; Kawahara, 1977). However, despite little evidence, the Dutch

influence cannot be completely ignored because the then Shogun, Yoshimune Tokugawa, permitted the trading of Dutch books in 1720, which could include accounting texts as long as they were not Bibles or anything to do with Christianity (Dejima Museum, 2016).

The Nakai merchant house, one of the most successful merchant houses from the Hino area in Oumi, has left a significant quantity of financial records and historical diaries from the middle of the 18th century to the Meiji era which included a type of double-entry bookkeeping (Shinpo, 1970; Kawahara, 1977 Ogura, 1989). The Nakai merchant house started their business by trading kimono cloth and medicine, but eventually they expanded the scope of their business to include pawn shops and sales of local specialities (Egashira, 1962). Apart from the Nakai merchant house, there were other merchant houses from the same region that left similar double-entry bookkeeping records (Shinpo, 1971). Examples include the Yao family, the Tonomura family, the Nishikawa family and the Yamanaka family (Suenaga, 2011). Thus, the basic Japanese double-entry bookkeeping methods were common to a number of merchant houses in this region, although there is no evidence that these accounting methods were publicly promoted.

Business documents from the early period of the Nakai business in the 18th century indicate that private expenditures in their business accounts were included, which would not be allowed in modern businesses (Shinpo, 1971; Tsumura, 2014; Ogura, 1989). In 1747, during the early stage of the business, the Nakai merchant house included some of their private wedding expenses in their accounting records, a practice that was not common in the later stage of their business (Ogura, 1989). The wedding expenses amounted to thirty gold-ryo which was the equivalent to the

annual profit of the business in this period (Ogura, 1989). The owner of the business was presumed to consider that he was a part of business entity and, thus, did not separate his personal affairs from the business.

Accounting documents of Nakai confirm that maintaining faith in approved deities and the Buddha was encouraged by the Edo government (Egashira, 1992). Table 4-3 provides a list of donations from the Nakai merchant house in the Edo era. From their accounting records it is clear that donating money to temples and shrines was regarded as a necessary expense of a merchant house during the Edo era. Ledgers and diaries from the Edo era demonstrate that business people were superstitious and followed religious rituals hoping that their business would survive in an uncertain future (Egashira, 1992; Ogura, 1962).

Table 4-3: Examples from Accounting Records of Donations

Year	Donation to	Amount
1835	Mizuguchi Yamamura Ten Shrine	10 Ryo
1835	Kawahara Jokoji Temple	76 Ryo
1835	Oushu Maesawa Saiganji Temple (for Buddhism Scripts)	12 Ryo 2 Bu
1835	Oushu Maesawa Saiganji Temple (for the facility of the temple)	20 Ryo
1836	Oushu Maesawa Saiganji Temple (for Buddhism sculpture)	25 Ryo

(Source: Accounting Records of the Nakai Merchant House compiled by Egashira, 1992: 93)

The amount of money they donated was sometimes a large part of their annual profits, which suggests business people in the Edo era had a strong interest in keeping good relationships with religious organisations and local communities. For example, the then owner of the Nakai merchant house in 1812 donated two hundred Ryo, which is approximately equivalent to 120,000 US dollars, to repair the bridge in a major road (Takenaka, 1998: 615). Conducting charitable activities including

repairing roads and cultivating abandoned land was believed to be benevolent in the eyes of Heaven (Egashira, 1992; Takenaka, 1998).

As the study of natural science had not been developed before the Meiji era, people were prone to consult religions to overcome any hardship in managing their businesses or to pray for more business opportunities. The owner of the Nakai merchant house managed his businesses by consulting traditional values including Confucianism, Buddhism and Shintoism. He and other senior managers regularly attended prayers at local shrines and the Ise Shrine, which was the head shrine of Shintoism (Egashira, 1992). The Nakai family believed that being pious would lead them to a better life and ensure flourishing trade and, therefore, they kept faith in Jodo-Shinshu Buddhism (Egashira, 1992; Ogura, 1962).

When the Nakai merchant house expanded its branches in different regions, it was necessary for its owner and the management to oversee the health of the entire business. To help achieve this they used the Japanese double-entry bookkeeping methods the importance of which was emphasised when the Nakai merchant house borrowed a significant amount of their capital from external investors from the early stages of their business (Ogura, 1989). Therefore, they had to maintain accurate and robust records to view their overall financial position (Ogura, 1989). They needed to know how much interest they were paying and how much they were in debt to sustain their business (Ogura, 1962). The accounting manager and branch managers were required to ensure that the income figure matched the sales figure every night, which is called *Choawase*, the accounts balanced (Ogura, 2003: 98, 99).

During the *Choawase* inspection time, managers certified all numbers and checked cash and records in their business.

It is still unknown how the basic double-entry bookkeeping methods were introduced in the Nakai and other merchant houses in the Edo era. When the Edo government adopted the *Sakoku* (closed-country) policy (1639-1854), the Netherlands was the only Western country permitted to continue its trading relationship with Japan (Hirschmeier and Yui, 1981), therefore providing the opportunity for the Japanese to access double-entry bookkeeping methods. However, although when the Dutch East India Company (VOC) came to the Dejima island in Nagasaki in 1641 and it was already using a refined double-entry bookkeeping method (Camfferman and Cooke, 2001; Robertson and Funnell, 2012), clear evidence of the use the Dutch double-entry bookkeeping methods in Japanese merchant houses has not been found (Camfferman and Cooke, 2001). In the Edo era, Western knowledge was not explicitly introduced and merchant houses did not express the need to implement Western double-entry bookkeeping methods (Kawahara, 1977). Indeed, double-entry bookkeeping methods in the Edo era were not exactly the same as their Western counterpart.

The Japanese double-entry bookkeeping approach lacked a systematic presentation method (Tsumura, 2014). Unlike Western double-entry bookkeeping methods, credit and debit were not written on the same page and, thus, it was hard to compare and verify numbers (Takatera, 1978). Examples from the Nakai accounts indicate that the balance sheet did not always match the figures of the ledgers (Ogura, 1962). This was unlikely to have occurred if they had used the contemporary Western

double-entry bookkeeping methods which would have shown positive and negative figures on the same page to contrast them (Ogura, 1989). Like many other accounting records in the Edo era, the Nakai merchant house's method did not present the double-entry categories on the same page (Ogura, 1989). One of the reasons for this was due to the size of paper and writing with a thick brush. Unlike Western paper which uses pulp, Japanese paper called *washi* could not produce a wide page due to a particular type of fibre used for manufacturing. The Japanese wrote from the top to the bottom in accounting records in the Edo era, using a long, vertical rectangular shape rather than a wide rectangular shape for the horizontal recording of both credit and debit (Ogura, 1962: 55).

Although the format and the presentation of Nakai's financial reports look different, the content of the information shared a number of elements with Western double-entry bookkeeping methods, including information on assets, liabilities, profits and losses (Ogura, 1962). This information was extracted by Ogura (1962) from a number of separate accounting records such as a cash book, ledger, stock book, purchase book and trial balance. Table 4-4 is a snapshot of income and expenditure records of the Nakai merchant house in 1802, which was calculated from ledgers and stock records. Their surviving records also indicate that they carried out a strict stock control within all the Nakai businesses (Ogura, 1962: 149-157).

Table 4-4: Tables of Income and Expenditure of the Nakai Merchant House in 1802
Income: [7]

Description	Gold coins	Silver coins
Sales	3,179 Ryo 1 bu	1 monme 9 bu 5 rin
Borrowed from the HQ	678 Ryo	0
Reserve from the previous year	2 Ryo 2 bu	12 monme 5 bu
Income from member retailers (no profits)	350 Ryo	
Total income	4,209 Ryo 3bu	14 monme 4bu 5rin

(Source: Records of Accounts in the Nakai Merchant House compiled by Ogura, 1962:149-157)

Expenditure:

Description	Gold	Silver
Pay back to the Head Office	2,142 Ryo	0
Procured cloth for resale	491 Ryo	5 monme 7bu
Procured second-hand kimono	798 Ryo 2 bu	2 monme 5bu
Procured from Edo Morisho	18 Ryo	10 monme 1bu
Procured from Edo Morifuji	308 Ryo 2bu	12 monme
Procured from Aburaya Heijiro	25 Ryo 3bu	10 monme 1bu
Procured from Kaneyama no Manbei	2 Ryo 1bu	6 monme 5bu
Other procurement	296 Ryo 2 bu	10 monme 1 bu 4 rin
Fee of dyeing cloth	78 Ryo	1 monme 6 bu 7 rin
Other fees	11 Ryo 1bu	13 monme 4 bu 8 rin
Stationery and other expenses in the shop	3 Ryo 3 bu	3 monme 4 bu 4 rin
Cash at the end of the financial period	17 Ryo 2 bu	10 monme 3 bu 6 rin
Total of Expenditure	4194 Ryo 1 bu	10 monme 9 bu 9 rin
Shortfall	15 Ryo 2 bu	3 monme 4 bu 6 rin

(Source: Records of Accounts in the Nakai Merchant House compiled by Ogura, 1962:149-157)

Their records show that when a branch of the Nakai merchant house borrowed capital from the headquarters they recorded how it was spent (Ogura, 1962). Any

[7] Unit of Currency in the early 19th century: Gold = 1 ryo =4 bu, Silver = 1 monme = 10 bu = 100 rin. Gold 1 ryo = Silver 50-60 monme depending on the market (source: Currency Museum Bank of Japan, 2019)

borrowed capital from the headquarters had to be paid back with agreed interest which was also regularly recorded in the Nakai's accounting records (Ogura, 1962; 2003). Surviving accounting records demonstrate that more than 10 Nakai branches across Japan were successfully managed under consistent management and accounting rules (Ogura, 1959). Every branch had to submit financial reports which the headquarters amalgamated to compose a consolidated financial report of the Nakai business (Ogura, 2003). Surviving accounting records indicate that the auditing of branches was regularly conducted and accountability was considered to be significantly important among the senior management of the Nakai merchant house (Ogura, 1959; 2003).

Accounting methods at the Nakai merchant house were modified throughout their business history. To avoid missing information from their records, they realised that they needed a better accounting method in order to keep comprehensive records. Accordingly, they devised the double-entry bookkeeping rules to ensure all transactions were correctly recorded (Ogura, 2003). The financial information of the Nakai merchant house indicates that they were using a type of double-entry bookkeeping method to calculate profits during the mid-18th century (Ogura, 1989; 2003). When the business expanded and new branches were opened, the method of recording financial transactions had to be altered in order to record the full financial position of each business. Without the double-entry bookkeeping method it was extremely difficult for the Nakai merchant to supervise the financial situation of all their branches (Ogura, 1962). The Nakai merchant house consolidated accounting information from all branches in *Tanaoroshi Mokuroku* documents (See Tables 4-5, 4-6, 4-7 and 4-8), which were similar to modern balance sheets (Ogura,

1962). They verified the total amount of their assets every January by adding equity and borrowing (Ogura, 1962) (See Table 4-5). Accounting records were checked and audited among senior members.

Table 4-5 The Capital section of the *Tanaoroshi Mokuroku* Financial Report of Sendai Division Office of Nakai merchant house in 1802

Debit	Ryo Gold coins	*Monme Silver coins	Note
Capital	3850.0		
Interest from the previous year	252.0		
Profits gained from the previous year	24,650.0		
Interest gained from the previous year	1,774.3	3.99	
Other profits, investment and borrowing	10,353.0	16.40	
Total equity and liabilities	40,880.0	5.39	Total liabilities and equity section in the balance sheet

(Source: Records of Accounts in the Nakai Merchant House compiled by Ogura, 1962: 164)

Table 4-6 The asset section of the *Tanaoroshi Mokuroku* Financial Report of Sendai Division Office of Nakai merchant house in 1802

Asset	Ryo Gold coins	Monme Silver coins	Note
Cash in the Sendai division	673.2	13.30	
Lending in branches in the Sendai division	2,665.3	7.30	
Profits	17.3	13.43	
Remaining lending in pawn shops	5,493.2	7.12	
Profits in pawn shops	141.1	11.84	
Others (buildings of branches, lending, consumables)	14,769.0	3.90	
Sub-total	23,761.2	11.62	
Stock of second-hand goods for resale	1,805.3	6.36	
Stock of raw cotton	4,159.3	0.91	
Account receivable in second-hand sale business (135 accounts)	8,860.3	13.79	
Account receivable in raw cotton (108 accounts)	2,235.0	5.02	
Total assets	40,823.1	7.70	Total assets area of the balance sheet
(equity + borrowing) – assets	56.2 (missing assets which were bad debt: 22.2, and missing cash:34.0)	2.31(additional assets which were originally not calculated correctly)	

(Source: Records of Accounts in the Nakai Merchant House compiled by Ogura, 1962: 164)

Table 4-7: Calculation of Profits in the *Tanaoroshi Mokuroku* Financial Report of Sendai Division Office of Nakai merchant house in 1802

Profits	Ryo Gold coins	Monme Silver coins
From sales of used goods	1,863.0	14.35
From sales of raw cotton	519.0	4.16
From pawn shops	141.1	11.84
From retail shops	17.3	13.43
Other profits	320.1	40.58
Total profits	2,862.2	9.36

(Source: Records of Accounts in the Nakai Merchant House compiled by Ogura, 1962: 165)

Table 4-8: Calculation of Losses in the *Tanaoroshi Mokuroku* Financial Report of Sendai Division Office of Nakai merchant house in 1802

Losses	Ryo Gold coins	Monme Silver coins
Paid interest	2,052.2	5.02
Expenses for employees	561.1	2.27
Others (including donation to shrines)	271.1	13.67
Total expenses	2,885.1	5.96

(Source: Records of Accounts in the Nakai Merchant House compiled by Ogura, 1962: 165)

Although the management of accounts was regularly conducted, a separate profit and loss statement was not found from the Nakai merchant house. The equation below is how they calculated profits of a financial year (See Table 4-9).

Table 4-9: The Calculation of Profits at the Nakai Merchant House:

Profits of this financial year = Assets at the end of the financial year – {Liabilities at the end of the financial year + (Carried over capital at the end of financial year + Interest)}

(Source: Records of Accounts in the Nakai Merchant House compiled by Ogura, 1962: 65)

This was a similar method used by other merchant families, such as Mitsui merchant house, when issuing their annual financial reports (Takatera, 1978).

Acquisition of property was usually regarded as an expense rather than considering it as an acquired long-term asset. The acquired property was only recorded in the asset category for the first year and then the whole value of the property was depreciated in the same year. Thus, the asset category in the following year did not

record the property purchased in the previous year (Ogura, 1962: 168). In the Edo era, it was common for apprentices and employees to live on the business premises and their living costs to be recorded as a part of business expenses (Hayashi, 1983; Ogura, 1989). The Nakai accounting records on expenses for employees indicate that they treated their employees as pseudo-family members who worked for the collective wealth within the Nakai family. Reciprocity functioned effectively in many successful merchant houses such as Nakai in the Edo era (Ogura, 2003). Retirement allowances were also paid to long-serving employees.

4.4.2 The Mitsui Merchant House

There were other prominent merchant houses from the Edo era that left accounting records, one of which, the Mitsui merchant house, preserved a substantial quantity of accounting records which have been studied by a number of accounting scholars (Nishikawa, 1993 Nakano, 2003; Nishikawa, Iino, 2013). The Mitsui merchant house was appointed as an official money exchange bureau in 1691 by the government, later establishing their headquarters, called *Oomotokata Kanjyo* (*Oomotokata*), in Kyoto in 1710. When the Mitsui merchant house expanded, the senior members of Mitsui had little knowledge of the accounts of each branch, which would have made their business vulnerable. Therefore, the *Oomotokata* office reinforced accounting methods to oversee the growth of capital and profits of all Mitsui branches and their accounting records indicate their meticulous attitude towards accounting (Nishikawa, 1993; Hayashi, 1983).

The Mitsui merchant house managed more than twenty branches and ran a variety of businesses, including kimono sales and a money exchange business (Iino, 2006).

This was the time when they introduced basic double-entry bookkeeping methods with a balance sheet and profit and loss statement (Shinpo, 1970). The headquarters provided capital to branches and ensured that any returns from investment would be reinvested in their business (Hayashi, 1983). An agreed percentage of the branch's profit along with a percentage of capital was paid back to the headquarters (Takatera, 1978). To understand the financial position of the entire Mitsui branch network, the *Oomotokata* office monitored and controlled the capital and assets using a consolidated financial statement which was called *Oomotokata Kanjyo Mokuroku* (Hayashi, 1983).

Mitsui took accountability seriously, introducing a quality assurance system where they checked the quality of gold and silver coins before lending them to their clients (Hayashi, 1983: 65). The content of pure gold and silver varied depending on the period in the Edo era and the Mitsui merchant house did not handle poor quality coins. Cash income and payment were always conducted by two members of staff to avoid inaccurate transactions and their individual stamps were recorded for accountability purposes on the paper wrappers and in their documents (Hayashi, 1983: 65). This indicates Mitsui's careful and shrewd attitude towards their daily business transactions and that disciplinary power worked effectively in this business. They religiously followed the *kakun* to ensure that sound accounting and accountability practices were maintained (Hayashi, 1983).

By the beginning of the 18th Century, Mitsui had become very influential, with the government depending on their financial and economic contributions (Kiseki, 1986). As they expanded their exchange bureau business in major cities, Mitsui had strict rules for their financing and investment, which were documented in their *kakun*

(Nakahara, 1992a; 1992b). For example, Mitsui set strict rules on collateral (Hayashi, 1983). If a customer wanted to pawn a commodity, the maximum amount he could borrow was 20-40% less than the market price of the collateral, based upon the volatility in the market (Hayashi, 1983: 63). The accounting records reassured the merchant house that their businesses were able to survive by validating the financial position of the organisation (Ogura, 2003). They were able to see their achievement or the areas they needed to enhance by reviewing their accounting records (Iino, 2013). The Mitsui merchant house saved their profits for reinvestment and never risked their business by not following the *kakun* (Matsumoto, 1983).

Mitsui were exceptionally cautious about lending money to samurai warriors who might have struggled financially. Lending to the samurai class was sometimes detrimental to a merchant house because it was extremely difficult for business people to take legal action against samurai warriors if they could not pay their debts. The Mitsui accounting records show that both the government and the samurai class frequently asked them to write off their debts (Nishikawa, 1993). As a superior class in the feudal society, it was difficult to repossess samurai collateral and collecting debt from these regional lords became an impossible task (Hayashi, 1983). The social hierarchy was still very important and merchant houses had to be diplomatic and generous towards the samurai class (Bellah, 1985). However, the Mitsui established a strict family law to ban risky lending, which demonstrates their strong will to maintain a sustainable business (Nishikawa, 1993). Accounting was also used as a tool by the Mitsui merchant house to secure the profitability of their business by highlighting any bad debt within the business.

Owing to the strict social hierarchy, lending to higher ranked members of society or associations could be extremely risky for merchant houses. Thus, the Mitsui spread their risk by investing in several businesses and branches (Nishikawa, 1993; Iino, 2006). The Edo government also became increasingly more dependent on Mitsui and other financial institutions, obtaining funding from the Mitsui and official exchange bureaus when they experienced financial difficulties (Sugiyama, 1983:320). For example, one set of ledgers from the Mitsui family business in the Edo era indicated that the government occasionally asked them to donate money when the government was in financial turmoil (Kinsei Keizai Database, 2015).

The manager of each branch and the head of each Mitsui family had regular meetings at the *Oomotokata* office to discuss future plans and any immediate business issues (Nishikawa, 1993). This was how Mitsui continued to run their operations for over two hundred years. An extremely important focus for the executive members was the management of financial affairs (Iino, 2006). Every branch had to follow the same accounting rules to allow the *Oomotokata* office to monitor the financial status of the businesses (Hayashi, 1983). The *Oomotokata* office issued financial statements every six months to review the financial and business status of all branches, a practice that continued until they established a new Tokyo Headquarters in 1874 (Iino, 2008).

The *Oomotokata* office was responsible for providing business premises and acting like a father in the Mitsui merchant house. They were responsible for making strategic decisions and controlled all the branches, so full accounting records were considered to be vital. The *Oomotokata* office had overall control of the entire Mitsui merchant house until the Mitsui merchant house modernised its business

configuration at the beginning of the Meiji era (Nakahara, 1992a; Iino, 2006; Iino, 2008; Iino, 2013). The *Oomotokata* office accumulated assets for the entire Mitsui merchant house where founding families maintained their vested stakes (Nakahara, 1992a; Iino, 2006). The original Mitsui family, who were considered to be the top of the hierarchy in the Mitsui business, had to have their influential power preserved (Nakahara, 1992b). The *Oomotokata* headquarters received interest and fees from branches and accumulated its total assets. An extract of their accounting records (See Table 4-10) shows that they changed internal accounting rules in 1714, after which the headquarters were to receive retained profits from branches which significantly increased the total assets, thereby strengthening the financial position of the Mitsui merchant house.

Table 4-10: Extracted accounting information of Mitsui *Oomotokata Kanjo Mokuroku* (*Oomotokata* Financial Snapshot Summary in January to June, 1710, 1714 and 1718)

Fiscal year and months	Total assets	Liability	Income	Expenditure	Net profit
1710 (January-June)	8,864, 173 Kan Monme	6,457, 796 Kan Monme	669, 340 Kan Monme	844, 452 Kan Monme	-175, 112 Kan Monme
1714 (January-June)	19,310, 481 Kan Monme	15,625 020 Kan Monme	763 180 Kan Monme	600 387 Kan Monme	162 793 Kan Monme
1718 (January-June)	34,568 794 Kan Monme	29,717 197 Kan Monme	10,196, 066 Kan Monme	1,668 686 Kan Monme	8,527 380 Kan Monme

Unit of currency: Kan and Monme[8]
(Source: Mitsui Oomotogata Kanjo Accounts in Nakahara, 1992c:75)

Business branches of the Mitsui were managed under the *Douzoku* partnership, or family partnership system, in which all business entities were managed by the off-spring or a member of the inner circle (Iino, 2006). Each branch was established by headquarters and they had to generate their own accounting records in order to

[8] In the city of Edo, Silver was mainly circulated: Silver 1 Kan = 1000 Monme (source: Currency Museum Bank of Japan, 2019)

illustrate how the business operated. The founder and his successors at the Mitsui merchant house composed the *kakun* on accountability and they ensured that everyone adhered to them (Hayashi, 1983). Branches had to return borrowed money to the headquarters periodically and also had to send one third of their profits as an investment return. They produced financial reports for the headquarters and ensured that money was reinvested according to the internal accounting rules (Hayashi, 1983:61). Accounting rules of the Mitsui helped employees to self-discipline and to achieve economic goals.

Most of Mitsui's employees lived in the merchant houses and were trained to follow rigidly the house law. The original *kakun* in the Mitsui merchant house was effective for many years within the whole Mitsui merchant house. The Mitsui merchant house was conservative and ensured that they followed the *kakun* to become prosperous and successful in society. Like many other *kakun* documents from merchant houses in the Edo era, Mitsui's *kakun* was significantly influenced by Confucian teachings. Confucian teachings were the firm moral reference point for business people and formed the basis of the social order in the Edo society (Watsuji, 1977). The *kakun* emphasised the importance of harmony and hierarchical relationships within the organisation. Their *kakun* encouraged collectivist thinking and self-discipline, which also ensured that business people met social norms. The first paragraph of Mitsui's original *kakun* was written in 1694 by the founder, Takatoshi Mitsui.

> Senior members of the family must look after juniors. Junior members of the family must respect their seniors. You must collaborate and work hard for the collective wealth of the family. Be frugal and modest. Be humble and don't overspend (Mitsui, 2018).

The records of the Mitsui merchant house show that the distribution of profits was carried out according to their *kakun*. The Mitsui's rules indicate that one third of profits was retained for bonus payments and dividends for all stakeholders, including investors from the other branches of the Mitsui merchant house (Nishikawa, 1993). The Mitsui's financial report from the late Edo era and early Meiji era contained information on all assets, a profit and loss statement and a balance sheet (Iino, 2006; 2013). The financial information of each branch, the kimono clothing business and the banking business, as well as the financial information of the *Oomotokata* office itself, were included in the consolidated financial statements (Nakahara, 1992a). The information in these consolidated accounts was shared among the senior members of the Mitsui merchant house every six months. Two senior managers from the two main businesses, the kimono clothing business and the banking business, compiled the Mitsui accounts (See Table 4-8). Their records indicate that they faithfully followed instructions from their *kakun*, prepared by the founder of the Mitsui merchant house, and other internal rules on accounting practice because accounting was given prime importance to sustain their business entity (Nakahara, 1992b). Retain a certain percentage of profit as a reserve fund for the Mitsui merchant house. The rest of the profit can be distributed among individual Mitsui families as agreed.

> You (Mitsui family members) must not think about retiring but think about how you can contribute to the family business all your life (Source: Mitsui History in Mitsui, 2018).

Power within the hierarchy in the Mitsui merchant house was prescribed in detail, thereby further confirming how Confucian-led values strongly supported the social order in the Edo era.

Donations to local shrines and temples were recorded in Mitsui's accounts. The amount of the donation was never reduced at the Mitsui merchant house even when the economy deteriorated during the first half of the 18th century (Hayashi, 1983). Although the record of Mitsui's donations to shrines was also evident in their accounts in the early Meiji period, their *kakun* also instructed their managers to keep a certain distance from religious institutions and not to get too involved with religions (Nakahara, 1992b; Iino, 2013). In the Edo era, Mitsui family members were expected to work hard to bring collective wealth and their time should be spent on business activities (Hayashi, 1983). The power of the belief system and social norms made business people discipline themselves but, at the same time, shrewd business people knew they should not be too enthusiastic about religions because their calling was business (Nakahara, 1992b).

Unsuccessful economic policies adopted by the Edo government on a number of occasions between the late 18th century and early 19th century resulted in adverse effects on the lives of samurai warriors and ordinary people, especially farmers (Jensen, 2000). Confucian-led society in the Edo era did not always provide a positive outcome especially in the 19th century. Feudalistic society restricted people in the lower class to have access to higher-ranking vocations and nepotism in society often prevented talented people from getting prestigious positions in society because Confucian teachings that advocated social hierarchy and filial piety (Tu, 2000). Talented and ambitious but lower ranking[9] samurai warriors felt frustrated due to the way the Edo government was structured. For many years they were given only a slim chance of being promoted (Jansen, 2000: Abe, 2007). The economy

[9] The samurai class in the Edo era was finely classified into layers of different rankings from the highest Shogun, fiefdom lords to the bottom foot soldiers (Satow, 1968; Jansen, 2000)

had deteriorated and then the pressure of US to open the nation for trade resulted in confusion among the nation and the Edo government (Jansen, 2000; Abe, 2007). These became the underlying causes for the Meiji Restoration in the mid-19th century (Kawahara, 1977; Nishikawa, 1979). Some of the prominent merchant houses could no longer sustain their businesses and had to close down due to the adverse economy and bad debts (Abe, 2007). An influential Nakai merchant house lost their Sendai branch towards the end of the Edo era by overlending to the Sendai local government and the samurai class (Ogura, 1962). As the authority of the Edo government began to diminish with each failure in their economic policies, their subjects, especially the new low ranked samurai class, no longer retained a high level of loyalty towards their lords and the government (Hirschmeier and Yui, 1981; Abe, 2007). Even with Confucian teachings, it was becoming extremely difficult for the government to overcome mounting discontent.

Towards the end of the Edo era in the mid-19th century, an increasing number of the samurai class were now unable to pay back their debts and no longer able to maintain their financial well-being (Hayashi, 1983). This was mainly due to a stagnant economy and frequent natural disasters (Hirschmeier and Yui, 1981). Coinciding with this economic deterioration, a convoy of ships from the USA came to a port near Yokohama in 1853, demanding that the country be opened for trade. When the Edo government after two hundred years finally opened its borders for trade in 1858, the US demanded an unequal trading treaty and other Western countries such as Holland, England, Russia and France followed suit (Hirschmeier and Yui, 1981). With this treaty, Japan was not allowed to set the rate for tariffs on imported goods and could not prosecute foreign criminals in a Japanese court (Hirschmeier and Yui,

1981). It was a time when the long-lasting Edo government and established traditional business customs were questioned in society (Sugiyama, 1983: 319).

By the end of the Edo era, the government and the samurai class had almost lost their ruling power over the rest of the population. They were no longer able to fulfil the promise of reciprocity taught by Confucius. The Edo government could not look after their subjects and frustration with the government mounted among the lower ranking samurai leading to the Meiji Restoration in 1868 (Jansen, 2000). Yoshinobu Tokugawa, the last Shogun from the Tokugawa family, relinquished his position and sovereign power was returned to the Meiji Emperor of the traditional Imperial family (Jansen, 2000). A new Meiji government formed by a group of ex-samurai (Hirschmeier and Yui, 1981) who re-established national beliefs and authority by promoting the Meiji Emperor as a living God (Yasumaru, 1988). At first they wanted to dismiss old values imposed by the Edo government and tried to establish new values (Watsuji, 1973; Yasumaru, 1988).

The new Meiji government (1868-1912) was determined to transform Japan into a strong and modernised nation, learning from Western culture. The nation was beginning to be reformed and modernised after more than two hundred years of national isolation. Japan needed to earn the respect of Western powers and to become a more equal partner to renegotiate trading terms and conditions (Jansen, 2000). They were also afraid of being invaded and colonised like Indonesia and Macau (Beasley, 1989). For the Meiji government, it was crucial to gain Western knowledge which represented international power (Kudo, 2015; Nishizutsumi, 2012). Established business entities from the Edo era had to modernise their management

and accounting methods in order to survive after 1858 when the Edo government concluded the Treaty of Amity and Commerce between Japan and the United States which resulted in unequal treatment for Japan (Jensen, 2000). The powerful countries in the West were able to trade on favourable terms under a tariff structure that the Japanese government did not have the ability to amend (Beasley, 1989).

4.5 Accounting in the Early Meiji era: Traditional norms vs. Modernised norms

4.5.1 Threats from the West and Accounting as Raison d`État

At the beginning of the Meiji era Japan, as a new entrant in international commerce, had to confront the potential threats of Western military and economic power which had undermined the sovereignty of many Asian and African countries. It was extremely important for Japan to gain equivalent power in order to maintain its sovereignty and to demand the revision of the unequal treaty with the Americans. The Meiji government wanted to become like the US and Western European countries with significant economic and military power. Consequently, the Meiji government implemented a series of Westernisation policies for the survival of its sovereignty (Yasumaru, 1988; 2004; Maruyama, 2006). These included even basic features of everyday Japanese life. For example, the traditional Japanese *kimono* clothing and hair style were replaced with Western dresses and hairstyles (Hirschmeier and Yui, 1981; Jensen, 2000). Modernisation of society and business practices, including Western double-entry bookkeeping, was to become the norm for any corporation that wished to operate globally (Abe, 2007; Tsumura, 2014). In order for Japan to be acknowledged internationally, the nation had to act like a Western developed country with sophisticated business structures and accounting methods (Kudo, 2015). Western business techniques, including double-entry

bookkeeping methods, were considered as a representation of power in international society by the Japanese at the beginning of the Meiji era (Tsumura, 2014; Chiba, 2009b). This meant that acquiring and implementing Western knowledge was '*raison d`État'*, *what makes it possible to preserve the state* and *what assures the integrity of the state*, for the Meiji government (Foucault, 2009: 288; Kudo, 2015).

The nation was desperate to learn sophisticated Western management techniques, including accounting. However, there was a severe shortage of accounting specialists during this period in Japan (Tsuchiya, 1969). The Ministry of Finance was enthusiastic about introducing Western double-entry bookkeeping methods and invited a group of specialists from the UK and US to teach it to Japanese officials (Kudo, 2015). Western double-entry bookkeeping methods were gradually spreading in the Meiji era throughout large corporations, especially in the banking sector, but a number of small companies still continued using the traditional bookkeeping methods in a traditional format (Tsumura, 2014) Table 4-10 summarises the significant legal reforms and events in this period.

Table 4-11 Significant Laws and Events between the Late Edo era and the Meiji Era:

	The Commercial Code (Japan)	Accounting methods introduced (Japan)	Historic events
1858			Opened the country for free trade
1868			Edo era ended; Meiji era started
1871			The Mint Bureau was established.
1872			Mr. Shand was invited to teach banking and accounting;
1873		Publication of double entry bookkeeping textbooks: *Shand bookkeeping methods for banking;* *Common school book-keeping translated by Fukuzawa;* *Book-Keeping by Single and Double-Entry translated by Kato*	The First National bank was established
1874			Mitsui moved its headquarters to Tokyo. The Banking Academy was opened.
1875		Publication of double entry bookkeeping textbook: *The science of double-entry book-keeping translated by Kobayashi*	
1876			Mitsui Bussan started using Western double-entry bookkeeping methods
1878		Publication of bookkeeping textbooks: *A textbook on Western single and double entry bookkeeping methods: Kiboh Shoho translated by Yoshida*	
1890	The first Commercial Code enacted		
1899	The Commercial Code revised		
1911	The Commercial Code revised		

(Marsh, 1836; Inglis, 1861; Bryant and Stratton, 1864; Hutton, 1878; Someya, 1996; Kawakita, 2008; Kubota, 2001)

The Japanese government was eager to adopt Western business practice. They planned to establish a Western banking system in order to finance large factories and infrastructure and to promote the appropriate circulation of money (Hirschmeier, 1964; Tsumura, 2013). The First National bank was established in 1873 after the Ministry of Finance invited Alexander Allan Shand, the ex-manager of Chartered Mercantile Bank of India, London & China, to learn about the Western banking and

accounting methods (Tsuchiya, 1969; Someya, 1996; Tsumura, 2014). Shand was invited to give training to civil servants and employees of the bank on Western double-entry bookkeeping and banking administration (Tsumura, 2014; Someya, 1996). He taught the Japanese bankers at the First National Bank on accounting and taxation. This was later called the Shand system and became prominent among Western accounting methods for Japanese banks and other institutions in the Meiji era (Abe, 1995).

As a part of modernisation programme, the Meiji government encouraged prominent business people to establish commercial banks to promote investment in industry (Hirschmeier, 1964; Tsuchiya, 1969). More than one hundred banks had been founded by 1882 in Japan, which helped the country to become a more economically developed nation (Hirschmeier and Yui, 1981). Although significant Western influence reflected *raison d`État* in Japan in the early phase of the Meiji era, it is crucial to note that the transformation of Japanese business was embedded in Confucianism-led teachings. The Meiji government initially dismissed the old values imposed by the Edo government, but they soon realised that Confucian teachings would help the Japanese to work collectively and to achieve the government's economic goals (Zenke, 2004; Morishima, 2004). Confucian teachings were adopted by the Meiji government to educate the Japanese to work hard for the collective wealth of the nation (Watsuji, 1973; Maruyama, 2006). Confucianism helped the Meiji government to manipulate disciplinary power, which allowed the nation to become modernised and industrialised.

A few years after the new Meiji government came into power and they moved the capital city from Kyoto to Tokyo, previously called Edo, the Mitsui merchant house moved its Headquarters to Tokyo in 1871 to assist the new government and to seek new business opportunities (Asajima, 2005). Successful merchant houses from the Edo era were transformed into modern conglomerates called *zaibatsu*, which launched a variety of key industries including shipbuilding and steel (Abe, 2007; Tsuboya, 1893). One of the most successful *zaibatsu* was Mitsui who had a number of companies in a range of industries including banking, textiles, and coal mining (Asajima, 2005; Abe, 2007). Mitsui had a very close relationship with both the Edo and Meiji governments. The Mitsui exchange bureau became the most trusted modern bank, Mitsui Bank, and was commissioned by the new government to carry out banking operations for them (Iino, 2013).

Companies which worked closely with the government had to adopt Western double-entry bookkeeping methods, taught by invited Western specialists (Tsuboya, 1893; Abe, 2007). Writing with a pen rather than with a brush on Western paper and using numbers without *fucho*, the secret language, became the norm among business people in the Meiji era (Someya, 1996; Tsumura, 2014). During this time the Mitsui *zaibatsu* developed their new accounting rules. Mitsui Bussan, the trading company of the Mitsui *zaibatsu* group, was one of the first Japanese corporations to adopt Western accounting methods in 1876 (Nishikawa, 2012). This was because the CEO of the Mitsui Bussan had worked for the newly established Osaka Mint Bureau where he had been trained in Western double-entry bookkeeping methods.

The Mint Bureau using Western technology was established in 1871 by the Meiji government with a strong connection with a British bank in Hong Kong

(Nishizutsumi, 2012). The Meiji government had to standardise different notes and coins from the regional provinces from the dissolved Edo government. To achieve this they borrowed the technology of minting and administration methods from Britain and the British colony of Hong Kong who backed the establishment of the Meiji government (Nishizutsumi, 2012). Thomas W. Kinder, a British official, was hired as an executive member in the bureau and accounting records of the first year of the bureau were written in both English and Japanese. The chief accountant was Vicente E. Braga who taught Japanese officers Western double-entry bookkeeping methods (Tako, 1921; Nishizutsumi, 2012). Introducing both standard accounting methods and inviting accounting specialists from the US and Europe were a part of the strategy of the Japanese to become a more sophisticated country. Technology and knowledge from Western countries were highly regarded by the Meiji government (Jansen, 2000).

Rapid industrialisation led to an increase in company investments from the public. Stock exchanges were opened in Tokyo and Osaka in 1878 to enable companies to gain access to capital from the public (Someya, 1996). After a number of public companies were established during the Meiji era accounting attracted the attention of shareholders. Shareholders naturally wanted to know the returns they are able to obtain from their investments. Published accounting records would be the main source to gain information for investors. However, investors of listed corporations during the Meiji era tended to be individuals or companies that had a business relationship with these listed corporations (Sawai, 2007). Accordingly, the assumption was that shareholders were also inner circle members and auditing was

not necessary in Japan. The power relationship among stakeholders hindered accountability and transparency in accounting.

4.5.2 Educating for Accounting and Accountability in the Early Meiji Era

The concept of accountability was introduced to a wider interest group when bookkeeping methods for banking were issued at the beginning of the Meiji era based upon lectures by Shand (Tsumura, 2014). Western practioners and scholars invited by the Meiji government advised them to legalise auditing. Although auditing never became compulsory, business people were beginning to realise that accountability was important in Western management (Fujikawa, 2008). The Confucian-based *kakun* and related business ethos continued to be effective in many corporations. Many of these corporations were eager to adopt Westernised business practices in order to survive in an international market. Gaining new knowledge and the adoption of Western business practices were a part of self-cultivation and, thus, Confucianism encouraged them to acquire new ideas (Bellah, 1985; Maruyama, 2006).

The Japanese Commercial Code, the antecedent of the modern Commercial Code, was enacted in 1890 and accountability was mentioned for the first time in Japanese law (Tsuchiya and Nakagawa, 1972). However, the implementation of auditing was still optional and enforcement never happened in the Meiji era (Fujikawa, 2008). A number of listed corporations which were founded by ex-merchant houses such as Mitsui or ex-samurai class members such as Mitsubishi insisted that their accounts were well managed and that there was no necessity for any extra checking, such as

external auditing. They were also the major shareholders of banks and their names were used to indicate the high credibility of their financial reports (Takahashi, 2012).

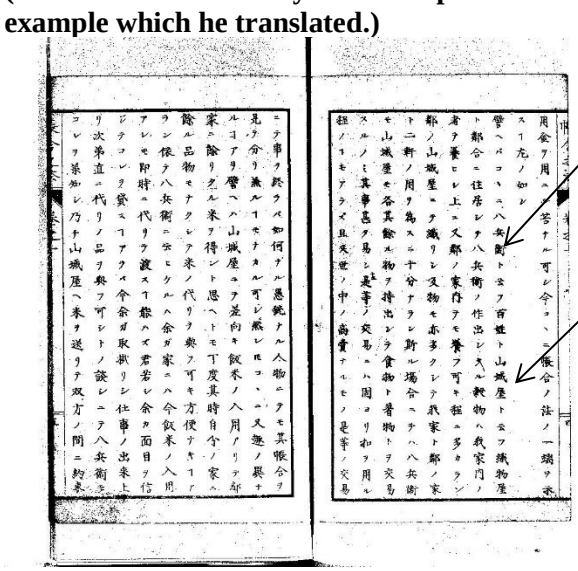
Business education which included accounting became very popular among people in the Meiji era who aspired to gain wealth in the modernised and less feudalistic society. The government also encouraged entrepreneurs to donate money and to open modern academic institutions in major cities in Japan (Hirschmeier and Yui, 1981; Abe, 2007). Consequently, an increasing number of people were given opportunities to study subjects imported from Western countries (Abe, 2007). Yukichi Fukuzawa and Eiichi Shibusawa, prominent economists and consultants for the new government, vigorously promoted the Western double-entry bookkeeping methods for a better understanding of business and finance (Tsumura, 2014). They were convinced that it was crucial to comply with the accounting methods of economically strong countries such as the US and the UK where accounting standards were significantly more influential, which the Japanese were keen to learn from. The Japanese government, politicians and prominent business people were desperate to enhance the level of business sophistication and skills in Japan (Tsumura, 2014; Nishikawa, 1977).

An increasing number of bookkeeping textbooks were translated and published, encouraging pupils and business people to adopt Western bookkeeping methods. In 1873 and 1874 Fukuzawa translated and published American accounting textbooks into Japanese (See Figure 4-7). These textbooks, called *Choainoho*, were widely adopted and taught at universities and schools of commerce in Japan during the Meiji era (Tsumura, 2014). Fukuzawa did not produce a word-for-word translation, but instead he added more commentary and Japanese examples in the book. He

believed that Japanese readers would benefit from recording full accounts, using examples which helped the reader to understand the concepts (Bryant and Stratton, 1864, Translated by Fukuzawa, 1873). His books demonstrate his passion for enlightening the Japanese with newly introduced Western knowledge at the beginning of the new era. He and his colleagues persuaded readers to understand the idea of Western capitalism and how bookkeeping would assist business people to become more prosperous (Bryant and Stratton, 1864, Translated by Fukuzawa, 1873). Fukuzawa strongly felt that the Japanese had to acquire modern business skills to deal with Western nations on an equal footing (Maruyama, 2006). Accordingly, the imbalance of power between Japan and Western countries made Fukuzawa and the Japanese government encourage business people to adopt Western accounting methods.

Figure 4-7
Choainoho Textbook

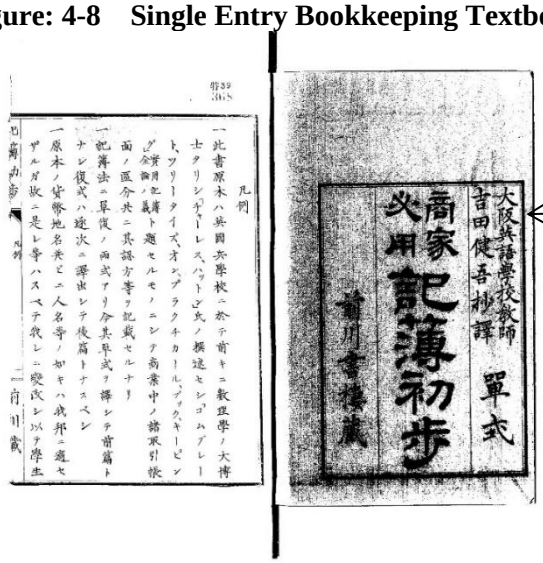
(Fukuzawa deliberately wrote Japanese names (i.e.Hachibei, Yamashiroya) in the example which he translated.)



(Source: Bryant and Stratton, 1864, Translated by Fukuzawa, 1873: 26,27)

Books on accounting written by other authors such as Charles Hutton were also translated and read by students at schools of commerce and by practioners at this time (See Figure 4-8). Hutton explained both single-entry bookkeeping and double-entry bookkeeping methods for business people (Yamashita, 2012; Hutton, 1878). Examples from translated books were converted into Japanese names and, thus, readers were able to relate the examples to their business circumstances (Hutton, 1878:9).

Figure: 4-8 Single Entry Bookkeeping Textbook for Business People



"Introduction to Single-entry bookkeeping for merchant houses; Translated by Kengo Yoshida, Osaka English School, Maekawa Publishing House."

(Source: Hutton, 1788, Translated by Yoshida, 1878: 1)

4.6 Conclusion

Examining historical business and accounting records in Japan provides a means to understand the values of society in a particular period. The Edo era was a significant period when the Japanese established a business ethos and philosophy based on a set of beliefs and values that had been embedded in the nation for centuries. The Edo government was using Confucianism as a controlling mechanism which had led to normalisation judgement within society (Maruyama, 1974; Foucault, 1975).

By encouraging the samurai class and ordinary people to follow Confucian teachings, the Edo government developed the social hierarchy and disciplinary system within which business people were able to generate wealth. This powerful social hierarchy ensured that all significant business decisions and the *kakun* rules were composed by merchant houses in line with the intentions of the Edo government. For a large number of merchant families, Confucian-led teachings as in the *kakun* played an important role to govern and discipline their members. Accounting was a vital disciplinary tool, as presented in *kakun* documents, to sustain business that was closely linked to power (Kawahara, 1977; Radcliffe, 1998).

When a business became more complex, the accounting methods were improved to meet business demands (Miyamoto, 2007). Although Western double-entry bookkeeping methods were not officially imported into Japan until the Meiji era, a number of successful merchant houses in the Edo era left accounting records that applied the basic form of double-entry bookkeeping. There were some similarities with Western double-entry bookkeeping but Western methods were more systematic and easier to compare profit and loss on the same sheet which the Japanese format was unable to provide (Ogura, 1989; Chiba, 2009a). Accounting records and the *kakun* documents from the Edo era indicate that prominent merchant houses conducted their businesses in a conservative manner to ensure that their business would survive and be passed on to their descendants.

Without nationally agreed accounting methods, each merchant house devised their own accounting rules to record business transactions in order to demonstrate their accountability to their headquarters or business owners, but never to lower level employees or outsiders (Tsumura, 2014; Nishikawa, 1993). The Nakai and Mitsui

merchant houses left large amounts of accounting records which indicate that they were significantly influenced by Confucian teachings. They also show that the hierarchical relationships among the headquarters and branches were strictly defined. Notably, their *kakun* contained detailed internal rules on accounting and accountability and managers would be severely punished by the merchant house if they did not follow the *kakun* rules (Ogura, 2003). Their stakeholders did not explicitly include the public, but the Edo government would have intervened if there had been illegal or unethical dealings (Nakai, 1988). A certain level of accountability existed in merchant houses in which Confucianism played a significant role. Business people in the Edo era related their businesses and lives to Confucian teachings and openly showed their interest in religious rituals and customs.

When the Edo era ended, the new Meiji government strongly promoted the modernisation of society and business practices. After the nation was opened to free trade, the Meiji government became committed to competing against Western countries, for which accounting was considered to be very important (Tsumura, 2014). Japan was desperate to become a developed country and they were eager to learn any Western technology. Confucianism continued influencing business people to achieve these national goals and modernisation of accounting was considered to be raison d`État in Japan. Successful merchant houses from the Edo era transformed themselves into modern business entities. To gain recognition in Western dominated international society, accounting methods from the West were considered by the Meiji government to be the means to increase sophistication and modernisation. However, accounting was still considered as an internal affair and

transparency of accounting information was not prioritised. The following chapter investigates how Japan at the height of imperialism in the latter Meiji era perceived and implemented Western double-entry bookkeeping methods and the implications for society.

Chapter 5

Japanese Accounting and Accountability at the Height and Demise of Japanese Imperialism

5.1 Introduction

Westernised accounting standards and practice helped to advance the Japanese economy and Japan to become a major imperial power in the early 20th century. This chapter examines how accounting and accountability developed during the latter part of the Meiji era and at the height of imperialism in the first half of the 20th century when there was a dramatic transformation in Japanese accounting and a movement away from the use of traditional Japanese accounting methods (Kudo, 2015). This was especially evident with large corporation groups called *zaibatsu*. In the Westernised Japanese society and with accounting practices, Confucian beliefs continued to exert a major influence. Significant social and political events, most especially the Great Depression and Japan's involvement in a series of wars during the first half of the 20th century, triggered the government to modernise the country's economic system and military forces. The Japanese government assisted industries to gain a competitive edge using the slogan of '*Shokusan Kougyou*' (Industrialise the Nation) (Abe, 2007). All Japanese workers were encouraged to work harder under this slogan. As a result, Japan became a serious threat to the West when its economic and military power became internationally evident by the 1940s (Jansen, 2000).

Although Westernised double-entry bookkeeping became widespread among large corporations in Japan, there were still no unified national accounting standards during the first-half of the 20th century. After the end of the Pacific War, the General

Headquarters, the Supreme Commander for the Allied Powers (GHQ) forced Japanese corporations to adopt American accounting methods (Sawai, 2007; Udagawa, 2007; Jensen, 2000). Thereafter, the US became the major political influence on accounting and accountability in Japan. When the GHQ occupied Japan between 1945 and 1952 they removed financial and social power from the old Japanese ruling class and many of the Japanese elite (Jansen, 2001). As a result accounting methods became more Americanised from 1945.

5.2 Accounting and Accountability in the Mid to Late Meiji era

In the mid-Meiji era, when a corporation became large and was engaged in more complicated business transactions, the management of accounts was taken more seriously in many organisations. This was crucial for any company that wished to expand during this period (Nakano, 2013). During the Meiji era the modern concept of a limited company was introduced but some companies still managed to base their accounting records on traditional practices which had been common. Despite difficulties, prominent companies from the Meiji era were committed to establishing a modern accounting system and surviving accounting documents from Mitsui, Kanematsu and others indicate that they had improved their accounting over a number of years.

When Senshu Kaisha, formally Mitsui Merchant House, was established in 1874, they recorded journals, cashbooks and ledgers in English using the Western double-entry bookkeeping methods and with pen rather than the traditional brush (Nishikawa, 2012). Mitsui, which had used Japanese double-entry bookkeeping methods during the Edo era, now generated financial reports biannually, including a balance sheet

and a profit and loss sheet (Nishikawa, 2010). The accounts of Senshu Kaisha focused mainly on net profits and they did not officially publish assets, possibly because their accounting books included secret capital given to them by the government and other official entities and they did not wish to disclose it explicitly (Iino, 2013). However, it took about ten years for Mitsui Bussan, the new company name of Senshu Kaisha in 1876, to publish annual reports to abolish the use of Japanese brush and numbers in Chinese characters, despite their accounting records being all written using Western double-entry bookkeeping methods (Nishikawa, 2012).

Mitsui Goumei Kaisha, a more modern form of Mitsui holding company, was established in 1893. They considerably increased their business volume to become one of the most influential *zaibatsu* groups (Iino, 2008). When Mitsui Goumei Kaisha further modernised their organisation in 1909, their accounting methods became sophisticated by fully adopting the Western double-entry bookkeeping methods (Chiba, 2009b; Asajima, 2005). Their accounting records from the early Showa era (1926-1989) indicate that Mitsui standardised their accounting rules and that staff members had gradually gained expertise (Asajima, 2005). Surviving documents indicate that Mitsui's accounting rules were not well documented until 1914. The number of staff who worked for the accounting department was small, partly due to employees being called up for military service (Asajima, 2005). Mitsui's records show that there were only a few dedicated employees working in the accounting and finance department during the Meiji era when the company was re-establishing itself in a modern form. One article from the rule book forbade employees in the accounting department to move between departments. This meant

that only selected employees were allowed to work in the accounting department throughout their careers (Asajima, 2005).

Another example from this period is Kanematsu Shoten Trading Co. Ltd. (Kanematsu), which was established in 1889 and later became a prominent trading corporation in Japan. It was founded by Bojiro Kanematsu, who at one stage worked in the early form of the Mitsui Bank. Very early Kanematsu acknowledged the importance of Western accounting practices (Yamaji and Fujimura, 2007). When Kanematsu worked for the bank he became familiar with the Shand bookkeeping system which was originally designed for the banking industry and recommended by the Treasury at the beginning of the Meiji era (See Chapter 4, Table 4-5) (Yamaji and Fujimura, 2009). Although Kanematsu was not a large business entity, their business involved international trading which meant that they had to prove they had a well-developed accounting system (Yamaji and Fujimura, 2007). Kanematsu eventually realised, however, that the Shand system did not appropriately capture all of their trading business transactions, in particular their business dealings with the import and export of commercial goods. Thus, they added their own accounting rules to ensure that all of their business transactions were properly recorded (Yamaji and Fujimura, 2007).

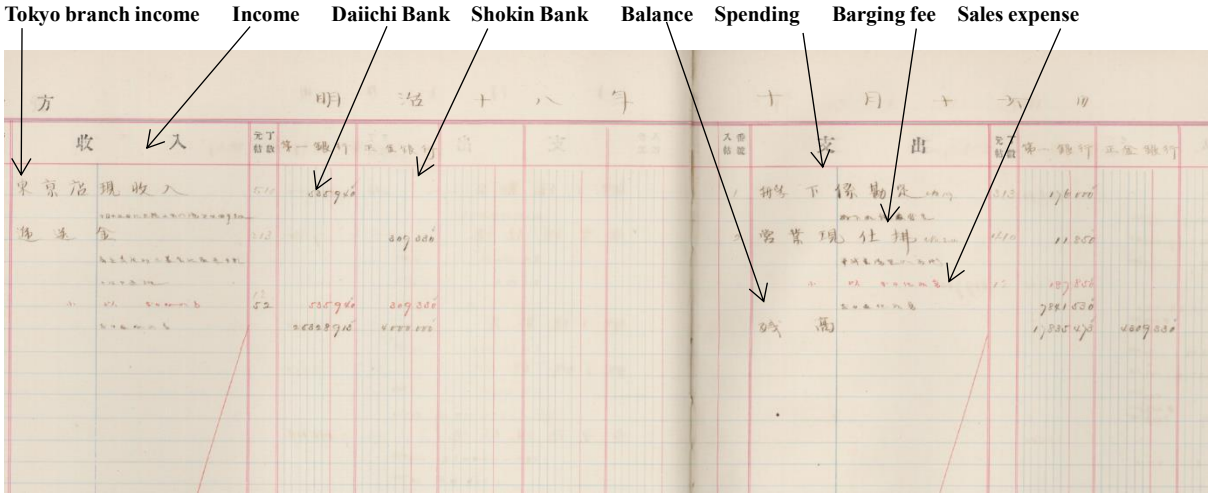
In 1893, Kanematsu introduced a new system which included a list of provisional prices of imported goods from their subsidiary in Australia. Previously, they had to wait until the actual price was determined. The new rule helped them to calculate and predict profits from imports more accurately. In 1914, they introduced the rule of 'added charge', which meant that their excess stock would incur charges which

would reduce their total profit (Yamaji and Fujimura, 2009). This rule encouraged the management and operational departments to increase the speed of business transactions and reduce the amount of excess stock. Therefore, they were able to improve profitability. Although Kanematsu appeared to take accounting very seriously and always sought a way to make improvements, they found it difficult to introduce a consistent uniform accounting method across their branches (Tsumura, 2014). Surviving documents show that it took twenty years for Kanematsu to establish the appropriate accounting methods for their operations. This process included the modification of transaction categories to represent their business and to ensure that accounting records became more comprehensible (Yamaji and Fujimura, 2009). Transforming the bookkeeping methods into a modern double-entry bookkeeping form in any company required persistent effort and training (Chiba, 2009b). It requires both strong motive and determination to change accounting methods and it takes time for the new business practice to be fully adopted.

The importance of more advanced accounting records was gradually recognised by a number of large companies by the early 1920s (Yamaji and Fujimura, 2009). Indeed, sophisticated and well managed accounting systems were considered to be a priority for a number of large companies before the Pacific War (1941-1945). Accounting records from the Meiji era confirm that new accounting methods could not be fully implemented immediately; they needed firstly to undergo an extensive trial period as in the examples below from Nihon Yusen Co. Ltd. (Nihon Yusen). The figures below are snapshots of cash books by Nihon Yusen, one of the largest shipping companies in Japan and a member of Mitsubishi *zaibatsu*, from different periods between 1885 and 1940 (See Figures 5-1, 5-2, 5-3, 5-4). These examples

demonstrate the gradual development of accounting practices in Nihon Yusen. When Nihon Yusen started their business operations in 1885 they adopted Western accounting methods using a pen instead of the traditional brush. In the cash book, shown in Figure 5-1, the left hand side pages show revenue and the right hand side pages show expenses. The example also shows that in the early stages of their business the relatively small number of business transactions resulted in simple accounting records.

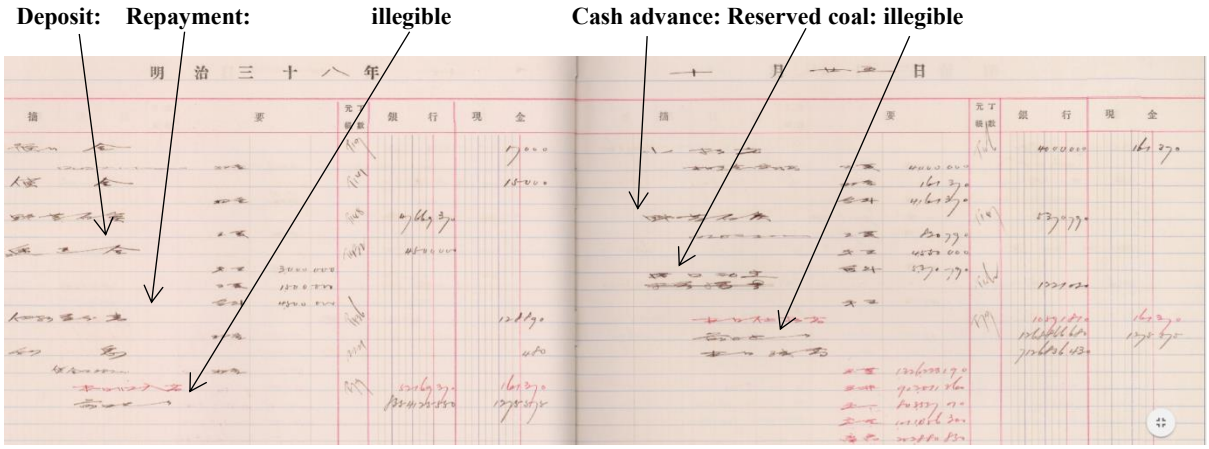
Figure:5-1 Cash book from Nihon Yusen Co. Ltd. on 16 October, in 1885



(Source: Hitotsubashi Univ. Yusen, 2017a)

Towards the end of the Meiji era, the volume of business increased significantly, as seen in Figure 5-2 which shows more accounting categories than the one at the early stage of their business as in Figure 5-1. Examples from Nihon Yusen demonstrate changes in accounting records over 50 years, which show Nihon Yusen worked closely with the government who considered Westernisation of business practices, including accounting methods, as the raison d'État and significantly important to the nation.

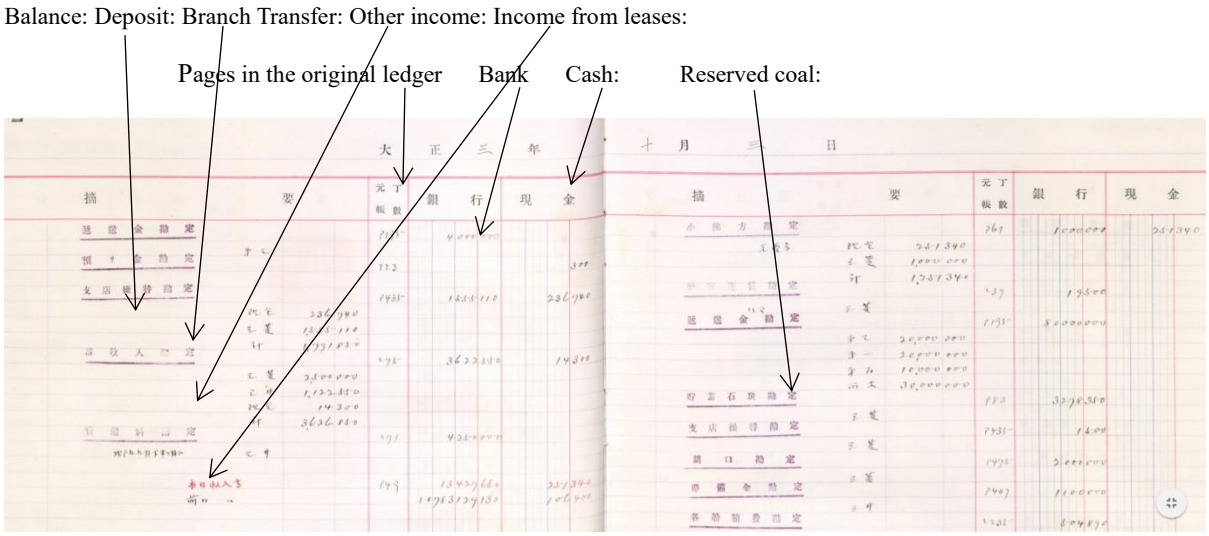
Figure:5-2 Cash book from Nihon Yusen Co. Ltd. on 25 October, in 1905



(Source: Hitotsubashi Univ. Yusen, 2017b)

At the end of the Meiji era the Japanese characters for each item in Nihon Yusen's cashbook were illegible and similar to the '*fucho*', a secret language used in the Edo era (See Figure 5-2). Also, their ledger of 1885 was illegible to most staff at the time, thereby ensuring that it was accessible only to a limited number of staff (Kudo, 2015; Nishikawa, 1979b). Nihon Yusen's notation of accounting records significantly improved after a few decades by using rubber stamps and simplified descriptions to make accounts more legible, as in Figure 5-3. Nihon Yusen expected that only some of these accounting records would be disclosed to their investors. The company had its own accounting rules, one of which was to write the balance in US dollars in red (Nishikawa, 1979b).

Figure: 5-3 Cash book from Nihon Yusen Co. Ltd. on 3 October, in 1914

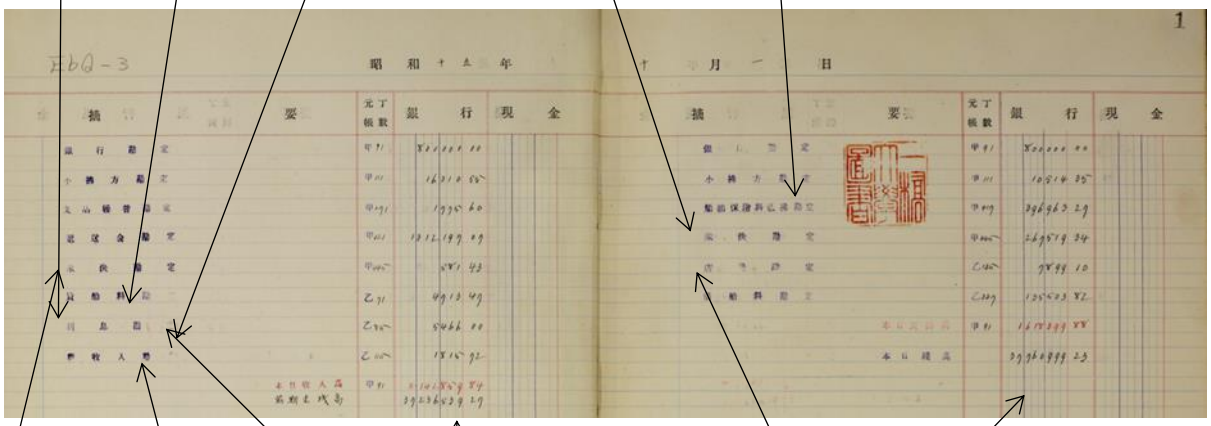


(Source: Hitotsubashi Univ. Yusen, 2017c)

Nihon Yusen's method of recording cash transactions in a cash book was further improved in 1940, as shown in Figure 5-4 which looks much neater and consistent. Nihon Yusen adopted double-entry bookkeeping in the 1940s and regularly generated a ledger based on cashbooks and journals. This coincided with the instruction issued by Japan's military forces to improve accounting and accountability. Using this accounting information, the company periodically compiled financial reports for investors (Nishikawa, 1979a). Their accounting methods had to be improved to ensure that all transactions were accurately captured.

Figure: 5-4 Cash book from Nihon Yusen Co. Ltd. on 1 October, in 1940

Balance: Bank account: Cash income: Branch Transfer: Insurance for ships



other income: Interest: Bank balance: Shop expense: Bank balance:

Miscellaneous income:

(Source: Hitotsubashi Univ. Yusen, 2017d)

The company's accounting records indicate continuous business growth throughout the first half of the 20th century and by 1941 the presentation of their records had been significantly improved. Indeed, employing Western double-entry bookkeeping methods and producing a financial report for investors using accounting records became the norm for large listed corporations by the early Showa era (Nishikawa, 1979b; Asajima, 2005).

Nihon Yusen's records also demonstrate a changed relationship with religious organisations in the Meiji era. Unlike the existing accounting records from the Edo era, Nihon Yusen's records did not indicate any evidence of donations to religious organisations. Business organisations became more detached from, and less obviously influenced by, religious rituals, although traditional values were still maintained after the Meiji era (Watsuji, 1973). Instead there were many advance

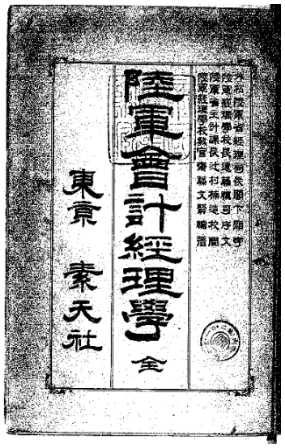
cash payments in their records which lack specific detail. However, there was no explicit evidence of their relationship to local shrines or temples. A religious donation was included in the category of 'others' in order for a company to be regarded as more sophisticated and Westernised. This was especially the case when companies planned to deal with Western countries (Watsuji, 1973). Westernisation of business customs and accounting practices was crucial for the government to obtain better trade terms and conditions with developed countries in the West (Watsuji, 1973; Tsumura, 2014).

5.3 Accounting Standards and Accountability before the Pacific War

5.3.1 Military Forces and Accounting

Military forces played a major role in Japanese imperialism between the Meiji era and the end of the Pacific War. Their influential power in politics and the economy was immense, which was also evident in accounting practices (Chiba, 2010b). Indeed, accounting was considered to be a significant concern within the military forces. For example, procurement of military supply at appropriate cost was crucial (Watanabe, 2011). Figure 5-5 shows a copy of the front page of the Army Accounting and Bookkeeping instructions in which the preface states the significance of keeping appropriate accounting records, thereby confirming that the management of accounts was regarded as an important part of serving the nation (Saito and Tsujimura, 1902: 6).

Figure 5-5: The Army Accounting and Bookkeeping Instructions published in 1902



(Source: Saito and Tsujimura, 1902)

The Army Accounting and Bookkeeping Instructions published in 1902 explained the importance and necessity of mandatory auditing (Saito and Tsujimura, 1902). According to the document, accounting records and financial statements had to be inspected by a special auditing department within the military, as well as by the government auditing office (Saito and Tsujimura, 1902). Accounting administration was managed within the military forces based upon internal rules but their control became stricter in the early Showa era when the severe global recession in 1929 struck the Japanese economy.

The Japanese government adopted a number of new policies and passed laws in order to bring about the recovery of the national economy after the recession. Companies in the same industries, such as coal, steel and sugar, negotiated with each other in the 1930s to form cartels to protect their vested interests and their markets. Eighty three cartels were created by 1932 and the *zaibatsu* and other newly formed business groups significantly expanded in size and profit (Sawai, 2007). Heavy industries were especially promoted and protected by the government to reinforce their capacity

to catch up with the West and to get ready for imminent wars (Abe, 2007; Suzuki, 2010). Accounting and management controlled by military forces urged the government to make the *zaibatsu* groups, which supplied goods to military forces, improve their own accounting practices. Especially, cost accounting was imposed upon domestic suppliers before and during the Pacific War because it became more difficult for the military forces to procure supplies from outside of Japan (Moroi, 2007; Chiba, 2010b).

The authoritarian pre-war government passed laws in 1931 which granted significant power to military forces over industries that supplied the military (SCAP, 1946a; Sawai, 2007). Military forces at the time were a major political power in Japan and thus accounting practices were heavily influenced by military needs and priorities (Kubota, 2000; 2001). Both the army and navy were keen on improving accounting methods and business customs in order to procure supplies at a more reasonable cost. Military forces had consistently stressed the importance of accounting and later tried to control accounting and management of their suppliers, especially after 1940 when Japan was about to enter the Pacific War. With cost accounting, military forces instructed their suppliers to improve their manufacturing efficiency (Moroi, 2007). The importance given by Confucianism to hierarchical relationships meant that *zaibatsu* corporations providing military supplies would give priority to the needs of the military forces. The government and military forces were at the top of the social hierarchy and every Japanese citizen was reminded that they should contribute to their country, which reflected Confucian teachings of respecting seniors and authority (Maruyama, 2006). This encouraged the Japanese to internalise the norm of being an obedient and dedicated citizen in society (Foucault, 1976; Maruyama,

2006).

> Confucius said that young people must follow and show respect to their parents when they are at home, and then they must listen to senior members in society. Be prudent and modest (Analects of Confucius, Chapter 1, Gakuji I-6).

When the international relationship between Japan and the US worsened after the Sino-Japanese conflict in 1931, the Japanese government tried to develop national industries to prevent military forces from becoming dependent on foreign imports (Maeda, 2008). For example, a law called the Automobile Manufacturing Enterprise Act in 1936 was passed to protect domestic automobile manufacturers, one of many new laws passed in this period as shown in Table 5-1 (SCAP, 1946a; Fujimoto and Tidd, 1994). The Act greatly assisted newly established Japanese manufacturers, such as Toyota, Nissan and Isuzu by making them exempt from paying corporate taxes and allowing them to issue debentures above the legal limit (SCAP, 1946a: 64).

Table 5-1 Significant laws and standards relating to accounting after the early 1900s:

	The Commercial Code (Japan)	Accounting standards (Japan)	Historic events
1927		The Registered Public Accountant Act was passed	
1931	The Commercial Code amended: to uniform format (not strongly enforced); Major Industries Control Law		Manchurian Incident
1932	Capital Flight Prevention Law		
1933	Japan Iron Manufacturing Company Law		
1934		Financial Statement Rules published	
1936	Automobile Manufacturing Enterprise Act	Rules for evaluating assets published	
1937	Temporary Fund Adjustment Law; Law for the Temporary Control of Imports and Exports; Foreign Trade Adjustment Law; The Gold Production Law; Iron Manufacturing Industries Laws Enforcement Ordinance	Manufacturing costing Rules published	Second Sino-Japanese War
1938	Act to Promote the Production of Important Minerals; National General Mobilisation Act	Restriction on Dividends	
1939	Shipbuilding Industry Law; Cast Iron Manufacturing Facilities Restricting Regulation		WWII started

(SCAP, 1946a; Kawai, 1983; Someya, 1996; Kawakita, 2008; Kubota, 2001)

The intention of nurturing and protecting domestic industries also influenced accounting rules in Japan, which enabled corporations to access capital and retain profits for reinvestment (Aochi, 2006; 2009). It became customary to record unpaid equity by shareholders in the assets section. This meant that there were a number of major shareholders who did not pay the full cost of the shares but companies considered them as shareholders (Aochi, 2006). Before 1938 companies were able to distribute disproportionately large remuneration to their directors and large dividends to their shareholders. However, this would eventually be banned by the National General Mobilisation Act in 1938 and the Kaisha Keiri Touseirei Ordinance in 1940 (Shibata, 1992). By 1939, domestic manufacturers drove out

foreign car manufacturers, thereby, achieving the government's and the military forces' goal of developing national industries (Fujimoto and Tidd, 1994).

After the outbreak of conflict with China in 1931, military spending greatly increased and military forces were determined to improve productivity and cost accounting among their suppliers (Shibata, 1992). The autonomy within a corporation was gradually removed by the government who subsequently strengthened its control over companies' accounting and management by creating a number of regulations (Shibata, 1992; Sawai, 2007) (See Table 5-1 and 5-2). The new laws which promoted Japanese industry were also to bring about changes in accounting practices and requirements. At the same time, the budget for military spending was increased every year during the 1930s, reaching 66% of total government expenditure by 1940 (Cohen, 1949:5). This confirmed that both the army and the navy had an immense impact upon the economy and that they had the authority to make decisions on where resources were allocated (Cohen, 1949). Thus, decisions made by the government and military forces had the power to influence accounting standards (Funnell, 2005). This power held by the military forces was evidenced by the way in which the military forces influenced and imposed accounting standards on their suppliers according to military practices and priorities (Saito and Tsujimura, 1902; The Navy Accounting Dept., 1899). The archival records of the army reveal how it stipulated meticulous rules on how accounting records had to be managed within the military and by its suppliers. Influence of Western accounting was outweighed by the Japanese government's will to protect industry.

5.3.2 The *Kaisha Keiri Touseirei* law and Accounting Practice

At the height of Japanese imperialism, maintaining a strong military force was considered essential to the national interest. Stockpiling supplies for an imminent war had always been a priority during the first half of the 20th century when Japanese imperial ambitions were at their peak. This meant that military spending was considered to be the nation's top priority at the beginning of the 20th century (Jensen, 2000; Morishima, 1982; Maruyama, 1969). The management of production costs by suppliers was considered to be also vital. Accounting was regarded as a tool to help the country to become more efficient and influential (Foucault, 2009: 288). In 1940 the Japanese government and military forces stipulated a new set of laws on accounting called the *Kaisha Keiri Touseirei* (Imperial Ordinance Concerning Regulation for Company Accounting), which enabled the nation to enhance the production of supplies for the military (Moroi, 2007; 2009) (See Table 5-2).

Table 5-2 Significant laws and standards relating to accounting between 1940 and 1942:

	The Commercial Code (Japan)	Accounting standards (Japan)	Historic events
1940		Kaisha Keiri Touseirei (Imperial Ordinance Concerning Regulation for Company Accounting); Ordinance for Control of Corporate Accounts; Ordinance Concerning Operation of Funds of Banks and Other Financial Institutions; Synthetic Chemical Industry Law	
1941	Law Concerning Extraordinary Exceptions from Application of Convertible Bank Note Law; National Savings Association Law; Law concerning the Sangyo Setsubi Eidan	Financial Administration Rules published	Pacific War (1941-1945): Japan vs Allied Forces
1942		Cost Accounting Principles for Manufacturing Industry	

(SCAP, 1946a; Kawai, 1983; Someya, 1996; Kawakita, 2008; Kubota, 2001)

In order to strengthen the national economy, 647 companies that had capital of more than 10 million Japanese Yen had to reinvest their earnings or retain their profits within the organisations rather than giving them dividends (Kubota, 2001:4-5). Corporations were encouraged to obtain any finance from banks rather than from the share market. A number of influential *zaibatsu* groups who supplied military forces followed this policy and Mitsui's archives indicate that 50-60% of their entire capital now came from banks, mainly the Mitsui Bank and Yokohama Specie Bank (Asajima, 2005: 275). The government and military forces persistently instructed business organisations to increase their efficiency and productivity. Accordingly, economic activities were heavily regulated to comply with the economic objectives of the government. Article 2 in the accounting law of 1940 stated that companies must work hard to help the nation win the imminent war (Izumi, 1940: 2). Companies were to maximise their resources and ensure that they kept detailed and accurate accounting records. Accounting played an integral role in managing the financial positions of corporations and the military forces in order to win the Pacific War

(Chiba, 2010b).

Confucian teachings of respecting senior figures helped the government to legitimise the subjugation of corporations and their employees (Maruyama, 2006; Boardman and Kato, 2003). The government and military forces were able to control the Japanese by using values and teachings from Confucianism which made the Japanese work collaboratively for the country. The new law strictly regulated various aspects of accounts in a listed company. For example, the amount of dividends, remunerations for board members, wages and other expenses were strictly controlled, leaving reserve funds for companies (Kubota, 2001). The expenses of a company had to be approved by the State Treasury in advance. Any expenses in excess of spending approved by the government were not allowed (Izumi, 1940:12-13). The *Kaisha Keiri Touseirei* law instructed that accounting categories and their definition must be standardised and clearly separated in accounting books. For example, materials, (*Zairyo-hi*), labour (*Roumu-hi*) and other expenses (*Keihi*) had to be itemised separately. Suppliers to the military forces especially had to comply with these categories.

The *Kaisha Keiri Touseirei* law required that corporations should depreciate their assets so they could retain more reserves for reinvestment and, thereby, support government plans to strengthen the national economy (Shibata, 1992). The government strongly recommended that companies should purchase government bonds whenever surplus profits were made (Shibata, 1992; Kubota, 2000). The government instructed corporations to provide these bonds to their board members as a part of their remuneration (Cohen, 1949). The government, therefore, was able

to extend a controlling power over business entities as to how they should distribute their surpluses before the end of the Pacific War (Sawai, 2007).

Accounting records were still considered to be for internal information only. Shifting the perception of accounting and accountability in Japan required more time (Kubota, 2001; Endo, 2015). Although the standardisation of accounting rules and the necessity of auditing were recommended in the *Kaisha Keiri Touseirei* law, they never became officially compulsory. Military suppliers were told to send their financial reports to military forces for approval, which was the most realistic way to check their accounts instead of having external auditing at that time (Chiba, 2010b). The enforcement of external auditing would also have been very difficult due to the lack of resources (Kubota, 2001; Sawai, 2007). Most especially, there were insufficient accounting specialists who were able to carry out financial auditing either in industries or military forces (Kubota, 2001).

External auditing was not commonly conducted in companies nor did the concept of mandatory audit exist in Japanese business practice before the Pacific War. The surviving lecture notes from a school of commerce on accounting and auditing from the early 20th century imply that a number of companies did not understand the significance of being accountable and did not follow recommended accounting rules (Baba et al, 1921). The lecturer criticised the attitude towards accounting and accountability of business owners in Japan and highlighted that very few practitioners understood the importance of accountability practices. The following comment from a practitioner in the book containing the lecture notes indicated that auditing was only deemed necessary if an organisation was not trusted.

As long as we do our business honestly, the accounting records

> should be fine. Why do we need to bother? Please trust us and there is no need for you to check accounting records …
> (Translation of Baba et al, 1921:120)

The lecture notes suggest that accounting records were considered to be private information by the majority of practioners and not for public scrutiny in the early 20th century in Japan (Baba et al, 1921). The absence of any importance being given to rigorous accountability practices was driven by a lack of accuracy and consistency in general. High standards of accounting management and accountability were still lacking among business people before the Pacific War (Baba et al, 1921). Although accounting had been considered to be very important at the height of imperialism, a high standard of accounting knowledge and accounting practice came into practice only decades after the end of the Pacific War (Abe, 2007; Someya, 1996; Tsumura, 2014). The trust derived from Confucian teachings potentially could not coexist with the concept of external auditing. For example, the fact that accounts were checked by independent professionals from outside of the company implies that internal audit could not be trusted.

New accounting rules stipulated by military forces helped the nation to retain the surplus profits of corporations in order to purchase national bonds to prepare for the Pacific War (Chiba 2010b). The new accounting rules instructed companies to produce financial statements including balance sheets, tables of assets and profit and loss statements (Izumi, 1940: 15). The *Kaisha Keiri Touseirei* law granted free access to the military forces to examine the books of any corporation, although this was rarely undertaken (Kubota, 2001). Auditing was not prioritised despite the importance given to this by the military (SCAP, 1946a). Not all companies produced financial reports using the recommended format. They knew they would

not be specifically penalised because they were rarely checked due to the lack of resources and the chaos of war (Izumi, 1940; Kawai, 1983; Someya, 1996; Sawai, 2007).

The imperialist government wanted to control cost accounting of military suppliers in order for the military forces to gain better access to supplies at competitive prices. The Ministry of Finance highlighted the significance of accounting by suppliers and efficient management when the Pacific War was imminent (Chiba, 2010c). Soon after, new accounting principles called the Cost Accounting Principles for Manufacturing Industry were introduced in 1942, which expected companies to maximise cost effectiveness now that the country was at war (Moroi, 2007). Although the Ministry of Finance and the military forces did not have sufficient manpower to ensure the full implementation of these new accounting rules, their instructions helped a number of companies to improve their cost accounting (Kubota, 2001:109-110; Shibata, 1992). However, a number of companies did not pay much attention to the recommendation for financial auditing, choosing only to adopt the new cost accounting principles to enhance their productivity. The government and military forces did not pursue the compulsory auditing but instead were more eager to improve productivity.

Before and during the Pacific War, law enforcement relevant to accounting and accountability was carried out sporadically. The priority for the government and military forces was to supply for the front line and not necessarily accounting and auditing in the back office (Sawai, 2007). This meant that selected aspects of accounting practices became overlooked, despite the military's original insistence on

the importance of cost auditing and accountability (Moroi, 2009; Saito and Tsujimura, 1902). Depending on the objectives of the military, some accounting rules were not enforced. This demonstrates that the intentions of the authority in society reflect national attitudes towards accounting. At this time accounting standards were not yet nationalised. Only large corporations who produced military supplies were the centre of attention from the perspective of military forces.

5.4 Accountability in Large Corporations in the Pre-War Period

Despite the original intentions of strong accounting control, inappropriate accounting and accountability practices and profiteering often took place. Military suppliers did not invest in auditing in the absence of government pressure to do so (Kawai, 1983; Someya, 1996 Sawai, 2007). For some business entities which were established after the Meiji era accountability and business ethics were not always a priority, unlike prominent merchant houses from the Edo era (Uehara, 2000). A number of military suppliers offered bribes to military forces in order to obtain contracts from the beginning of the 20th century to the end of the Pacific War (Uehara, 2000). Also, the absence of strict laws for controlling unfair business dealings resulted in some companies colluding with cartels in order to maximise their profits during this period. Inappropriate relationships between bank managers and their clients triggered unethical dealings. It was not uncommon for a senior manager at a bank to be a board member of a company that borrowed money from the same bank (Uehara, 2000). This made it easy for board members to falsify accounts and to conceal financial mismanagement.

Confucian teachings such as respecting social hierarchy and harmony had

occasionally an adverse effect on accountability and hindered challenges from suppliers or accountants who had little power over their clients or senior members of their companies. When there were discussions about introducing new laws on external auditing in 1970, a majority of influential companies persistently persuaded the government to withdraw the idea of having their books examined by external accounting specialists (Tsuchiya and Nakagawa, 1972). These companies argued that it would be too difficult for external auditors to understand the complicated nature of their business and insisted that only internal members of staff should be allowed to conduct the audit (Uehara, 2000:68). Furthermore, the old Commercial Code of 1911 did not specifically impose a requirement for external auditing (Someya, 1996; Uehara, 2000:68). Although the idea of external auditors was not accepted before the war, internal auditing regularly took place in a number of large companies (Uehara, 2000).

Without a unified law on the maintenance of accounts, it appears that only companies with a strong sense of accountability produced consistent accounting statements. The *zaibatsu* organisations and their former merchant houses had historically recognised the importance of accountability and internal auditing (Miyamoto, 2007). Traditional ex-merchant houses from the Edo era, notably the Mitsui and Sumitomo companies, regularly audited their accounting books (Uehara, 2000). Internal auditing had been a part of their accounting practices since the Edo era, following their *kakun* which emphasised the significance of regular audits (Sakudo, 1979; Hayashi, 1983). In the Edo era they checked accounts every evening when they closed the business for the day, which was meant to create a sound organisational culture (Ogura, 1969; Sakudo, 1979; Egashira, 1992). The surviving documents of

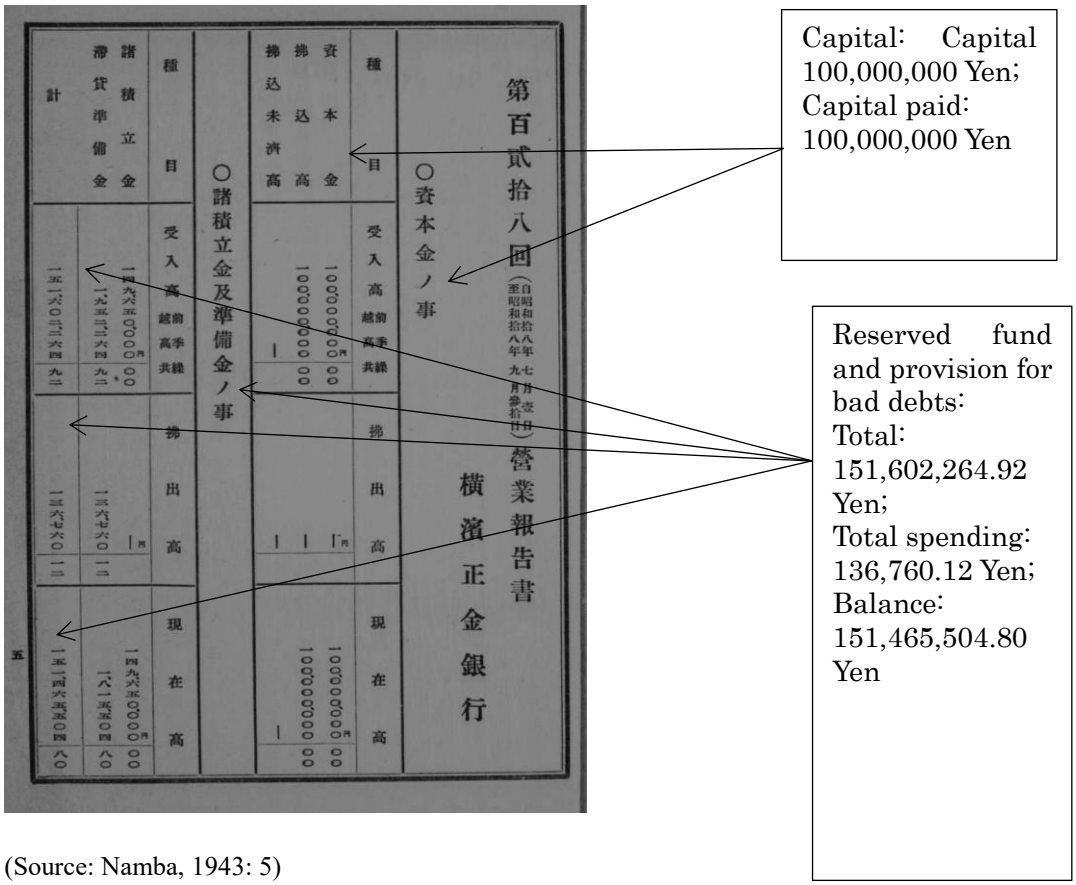
Mitsui indicate that their notion of accountability was stronger than most of the other Japanese organisations during this period and that they regularly issued financial reports for their investors (Asajima, 2005). At Mitsui, accounting statements and company-wide accounting rules had been officially issued for investors since 1914. Article 7 of their rulebook stressed the importance of complying with both relevant commercial and accounting laws and internal rules (Asajima, 2005:49). Mitsui established strict accounting rules to ensure that their financial transactions were always controlled (Asajima, 2005).

One positive example of internal auditing from a newly established organisation in the pre-war period is found in the financial reports of Yokohama Specie Bank (See Figure 5-6). This was a special foreign exchange bank established for trading which funded corporations that wished to extend their markets abroad, following the economic policies of the government (Namba, 1943; Uehara, 2000). They had strong political and economic relationships with the government and military forces in Japan. Thus, this bank complied with laws and requests from the government, including auditing requirements when handling their accounts (Uehara, 2000). Their financial reports show that they periodically underwent strict audits before the end of the Pacific War (Uehara, 2000). Yokohama Specie Bank issued financial statements every three months with sales reports, balance sheet, profit and loss sheet, list of assets, dividends and the remuneration of board members (Namba, 1943). According to the financial report from 1943 (Namba, 1943), the bank appears to have had four internal auditors who certified these financial statements. However, the auditing was not yet widely implemented in Japan, partially due to the fact that accounting information had been always for selected members of merchant houses

in the Edo era and of corporations before the end of the Pacific War (Kawahara, 1977; Kubota, 2001).

Figure 5-6: The first page of the financial report No. 128 (1 July – 30 September, 1943)

at Yokohama Specie Bank



(Source: Namba, 1943: 5)

The preface to the report of Yokohama Specie Bank in 1943 indicated that the government encouraged the Japanese to save money with banks and to purchase as many bonds as possible in order to fund the Pacific War (Namba, 1943: 1). The financial statements of the bank explicitly reflected the intentions of the Japanese government and obvious power relationships between the government and its subjects were evident. The social hierarchy was given significance and the influence of Confucian-led values were prominent in their report (Namba, 1943; Chiba, 2009b). The final sentence of the preface written by the head of the bank states, 'Our business has been managed successfully and we are happy that we fulfil our mission thanks to you (shareholders)' (Namba, 1943:4). His comments suggest that the bank was functioning in order to deliver wealth and success to the nation, even in a time of war. The comments confirm the hierarchical and paternalistic

relationship between the government and banks that were influenced by traditional Confucian values. The chairperson of Yokohama Specie Bank addressed the financial report to investors, fully aware that the government would view it as it had control over the bank (Nishikawa, 2012; Chiba, 2009b). In addition to the approval of their shareholders, without the approval of the government, who was the authority with power, their financial report would not have been accepted as legitimate financial information because power always closely relates to knowledge (Foucault, 1976).

There was an implicit power relationship between large corporations and influential stakeholders such as the government and the military. To prevent any accounting problems, suppliers of military forces or the government would usually regulate themselves and introduce strict internal auditing rules (Nishikawa, 2012). Mitsubishi, another leading *zaibatsu* group which was established in the mid-Meiji era, also tightened their internal regulations on business management and accounting (Aochi, 2009). This included controlling accounting in order to promote efficient production throughout their operations (Aochi, 2009). Furthermore, the examples of Mitsui and Yokohama Specie Bank demonstrate strong leadership in accountability, even though their financial reports were exposed only to a select group of stakeholders (Nakano, 2013; Nishikawa, 2012). Many companies were reluctant to disclose their accounts and accounting was still considered to be only for the inner circle of stakeholders (Nishikawa, 1991).

Accountability in Japan before the end of the Pacific War was focused more on improving productivity in order to supply and support the war effort rather than on

improving communications and increasing dividends to stakeholders (Aochi, 2009). Depending on what the government and military forces demanded at the time, corporations had to change their focus in their accounting practice (Izumi, 1940; Kubota, 2001). This confirms that accounting practices can be strongly influenced by the economic and political environment of a nation, as has been clearly evidenced in Japan since the Meiji era (Nishikawa, 1991). Without the strict enforcement of laws and strong leadership, it was extremely difficult to maintain sound accountability in financial statements before the war. Power was required to reinforce accountability in financial statements. Owing to the fact that supervision from the government did not exist, small companies were only able to achieve a limited degree of accountability. Unless the government prioritised accountability there was little chance it would be promoted in Japan during this period (Okazaki, 1994; 2005).

5.5 The GHQ and Accounting Standards after the Pacific War

5.5.1 Democratic Management and New Regulations Imposed by the GHQ

The defeat of Japan in in 1945 brought historic changes to Japanese society and accounting practices (Endo, 2015). The day that Japan surrendered the nation became controlled by the occupying GHQ, later located in Tokyo, which was predominantly made up of American officers (Sawai, 2007). The GHQ's main goal was to transform Japan into a more democratic country that would no longer constitute a military threat to the Allied Powers (Jansen, 2000). The GHQ intended to bring about the complete reform of Japanese society and its political system with a democratic constitution and an economic system with new accounting standards (SCAPINs, 1945). To achieve these dramatic reforms, the GHQ began to dismantle

the authoritarian regime and transform Japanese values. The Emperor's status and significance were greatly reduced. He was no longer a 'living God' and the aristocratic system was abolished (Jansen, 2000). The GHQ and its sub-division called the Economic and Scientific Section (ESS) were unable to predict the amount of corporate tax being paid and, therefore, they warned the Japanese officials that the nation would never become economically independent without standardized accounting methods (SCAPINs, 1945; ESS, 1947; Suzuki, 2010a).

The controlling American officials had great power and influence over economic policy and accounting rules in Japan, enabling them to compel the Japanese government to follow their directions (ESS, 1947; Suzuki, 2010a). The GHQ insisted that Japanese companies should comply with American style management, accounting standards and accountability practices (Someya, 1997). To implement the changes expected by the GHQ they selected a group of major trading and manufacturing companies, categorising them as '*Seigengaisha'*, which literally means controlled companies, placing them under the supervision of the GHQ (Kubota, 2004). To assess the financial position of Japanese companies, financial statements from *Seigengaisha* corporations covering the previous 10 years were demanded by the GHQ (Kubota, 2004). The pre-war commercial and company laws were severely criticised by the GHQ and, thus, they were to be revised (Kubota, 2005).

The ESS kept pressurising the *Seigengaisha* and the Japanese authorities to adopt standardised accounting rules. Lengthy comments and examples from the GHQ indicate that great discrepancies existed between the US version of the balance sheet

and its Japanese counterpart. It was therefore not surprising that the US officers were keen to change the Japanese accounting standards. Without uniform accounting standards, the assessment of the financial position of *Seigengaisha* and other companies was impossible. The old Japanese accounting records did not categorise assets and liabilities clearly in balance sheets and it was common for accumulated losses and unpaid capital to be shown in the assets category of the balance sheet (ESS, 1947). This raised a serious concern among American officials as old Japanese balance sheets contained items which should not have been categorised as assets (ESS, 1947: 312.1; Kubota, 2005). Thus, the ESS commented that before the end of the war financial statements of Japanese corporations did not accurately reflect their financial position. The GHQ also identified that there were a number of ambiguous accounting categories in Japanese companies' accounting books and to tackle this it suggested a new recording format.

The first half of the suggested format of a balance sheet illustrated sample items which were supposed to be posted in assets or liabilities. The bottom part of the format provided examples of expenditures and revenues. One example which confused inspectors was the category of 'provisional payment' or 'temporary payment' which then included payment by goods instead of cash payments (Kubota, 2005). There were no detailed explanations for these accounts which exemplified how some Japanese corporations before the war did not record accounting transactions comprehensively. Financial reports had not been previously published for external members of the public and members of the inner circle accepted incomplete financial reports compiled by the same inner circle. When the ESS found out about these Japanese accounting practices, they instructed that a balance

sheet must contain explanatory foot-notes and supplementary tables in order to present a full picture of a company's financial position (ESS, 1947: 3-402-3). The GHQ and ESS whilst they occupied Japan issued numerous documents to instruct Japanese corporations to adopt Americanised accounting methods. To address discrepancies between accounting standards between the US and Japan, a number of new laws relating to accounting and business practice were passed after the end of the Pacific War (See Table 5-3).

Table 5-3 Significant changes in laws and standards related to accounting after 1945:

	The Commercial Code / The Securities Act	**Events relevant to Accounting and Financial reporting**	**Tax Law**	**Historic Events**
1945				The Pacific War ended; GHQ occupied Japan
1946				GHQ and ESS demanded new accounting standards; Instructions for the Preparation of Industrial Financial Statements of Manufacturing and Trading Companies (- 1951)
1948	Securities and Exchange Act	Certified Public Accountant Law		
1949		Kigyou Kaikei Gensoku (Japanese GAAP)	The Shoup Mission was published.	
1950	Major revision: to allow expense for issuing new shares, to distinguish between profit provision and capital provision		The Shoup Taxation system was established.	Korean War (-1953)
1951	Auditing: officially introduced by law	Instruction for Reporting Companies was issued by ESS		Treaty of Peace (Allied Forces - Japan)
1952				Japan became independent of the Allied Powers

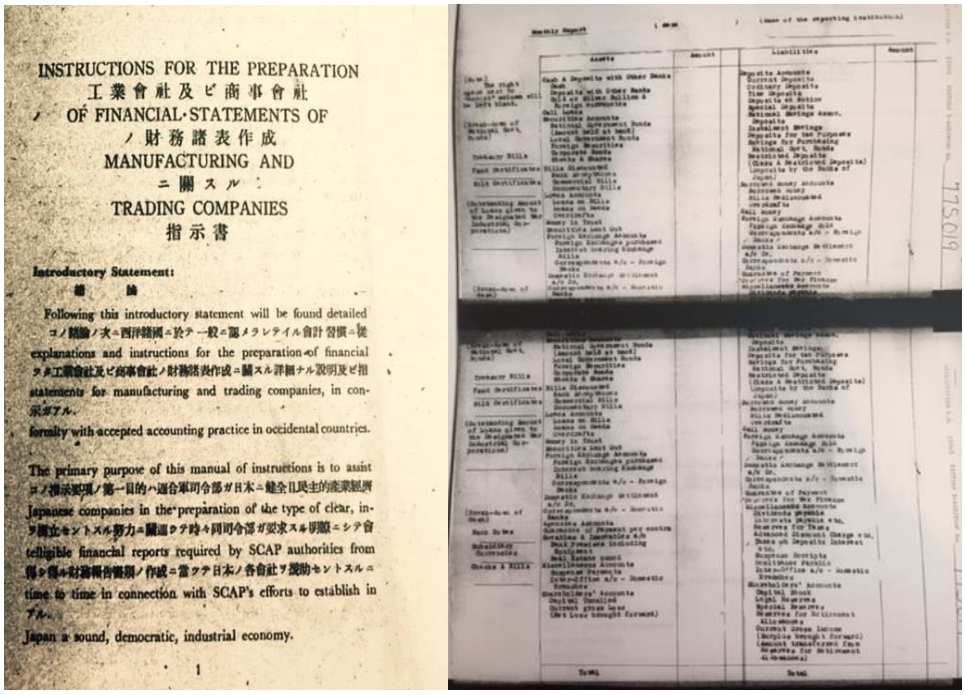
(Sources: SCAP, 1946a; Someya, 1996; Kawakita, 2008; Shibata, 2007:32; Oguri, 2003; 13; Oguri, 2014: 266)

5.5.2 Composing Kigyo Kaikei Gensoku: Japanese Generally Accepted Accounting Principles (Japanese GAAP)

Establishing nationally agreed accounting standards was considered to be one of the most urgent provisions for Japanese industries by the GHQ and ESS. In 1947, *the Instructions for the Preparation of Financial Statements of Manufacturing and Trading Companies* were published by the ESS and they demanded that the Japanese

government and companies should adopt American-style accounting standards (ESS, 1947: 3-402-3). However, it was difficult for many businesses to implement them immediately and, accordingly, ESS issued more detailed instructions in 1951, which further explained how to prepare financial reports (SCAPINs, 1951) (See Figure 5-7).

Figure 5-7: Pages from the Instruction for the Preparation of Financial Statements of Manufacturing and Trading Companies by the GHQ



INSTRUCTIONS FOR THE PREPARATION
工業會社及ビ商事會社
OF FINANCIAL·STATEMENTS OF
ノ財務諸表作成
MANUFACTURING AND
ニ關スル
TRADING COMPANIES
指示書

Introductory Statement:
緒論

Following this introductory statement will be found detailed explanations and instructions for the preparation of financial statements for manufacturing and trading companies, in conformity with accepted accounting practice in occidental countries.

コノ緒論ノ次ニ西洋諸國ニ於テ一般ニ認メラレテイル會計慣習ニ從ヲ工業會社及ビ商事會社ノ財務諸表作成ニ關スル詳細ナル説明及ビ指示ガアル。

The primary purpose of this manual of instructions is to assist Japanese companies in the preparation of the type of clear, intelligible financial reports required by SCAP authorities from time to time in connection with SCAP's efforts to establish in Japan a sound, democratic, industrial economy.

コノ指示要項ノ第一目的ハ連合軍司令部ガ日本ニ健全且民主的産業經濟ノ樹立セントスル努力ニ關連クテ時々同司令部ガ要求スル明瞭ニシテ會計報告書類ノ作成ニ當クテ日本ノ各會社ヲ援助セントスルニアル。

1

(Source: SCAPINs, 1951)

The instructing documents specified that a company must annually prepare a balance sheet, profit and loss statement, surplus statement, and the plan for distribution of accumulated uncategorised profits (ESS, 1951). They showed examples of financial statements to educate Japanese companies how to prepare financial reports based upon nationally agreed rules. Furthermore, they created a model balance sheet

in order to educate companies on the new accounting rules (SCAPINs, 1951). Accounting records which were traditionally perceived as private documents in Japan now had to be published for the public. This required a major shift in Japanese business practice. The great political and economic power of the US was about to change some aspects of Japanese culture and business practice (Morishima, 2004).

The accounting instructions of 1947 became the basis in 1949 of Japanese Generally Accepted Accounting Principles, called *Kigyou Kaikei Gensoku* (Japanese GAAP) (See Table 5-2) (Someya, 1997; Kubota, 2000). It was the first publication of Japanese nationally agreed accounting principles. They were compiled by prominent Japanese economists and scholars (Someya, 1996: 30; Kubota, 2000; Suzuki, 2007) who consulted the American GAAP. However, they also incorporated Japanese business customs and practice rather than adopting everything from the American standards (Someya, 1996). For example, the concept of external auditing and the employment of external Certified Public Accountants (CPAs) was not yet explicitly required (Suzuki, 2007). The introduction of the Japanese GAAP, which provided the basic accounting framework for Japanese companies until the end of the 20th century, was a significant landmark in Japanese accounting (Someya, 1996; Kubota, 2000; Suzuki, 2007). The basic principles included the truthful, accurate, explicit, consistent, conservative and systematic recording of accounts (Arai and Kawamura, 2010). The Japanese GAAP became the key reference point for Japanese accountants when preparing accounts in Japan (Arai and Kawamura, 2010).

The Japanese GAAP, although based upon the US GAAP, they were not exactly the same: accounting principles will reflect national goals and be consistent with *raison d'État* (Kubota, 2000; Foucault 2009; Chiba, 2010). It was believed to be important for the Japanese GAAP to take Japanese business customs into consideration and, therefore, the Japanese GAAP were influenced by Japanese industries. The aim of introducing the Japanese GAAP was to enhance the standardisation of accounting practices across Japan and to promote reconstruction of the country, allowing the government to have access to company financial information for taxation purposes (Someya, 1997, Kubota, 2000a). The unified accounting rules and format assisted the government to predict tax revenue, which was crucial for the government as it sought to rebuild the nation (Kubota, 2000a; 2000b).

The GHQ and ESS convinced the Japanese government that unified accounting standards would have the ability to benefit the national economy (Endo, 2015). The formalisation of new accounting standards was supported by new laws, which indicates the Japanese government's strong intention to maintain authority over accounting (Someya, 1996). Accounting standards reflect the desire and intentions of the ruling government (Funnell, 2005). Particularly notable was the way in which the Japanese accounting standards allowed corporations to reserve excess profits within their organisations rather than by distributing them to investors (Someya, 1996; Chiba, 2010). It was a norm for the government to encourage Japanese corporations to reinvest excess profits and funds so that the national economy would prosper.

According to the Japanese GAAP, which emphasised the importance of a profit and loss statement and a balance sheet, companies were required to accurately calculate their balances in an agreed period (Arai and Kawamura, 2010). In Japan, a surplus was not traditionally openly stated in accounting records, whereas American accounting principles required companies to state any surplus equity and surplus profit (Someya, 1996). As shown earlier in Chapter 4, although the calculation of assets and profits had been recorded in the accounts of business entities, assets and liabilities were not traditionally recorded in a manner which would have allowed the user to compare them with each other (Sakai, 1983). This was partially because balance sheets were written with a brush and on conventional Japanese paper, which was significantly narrower than paper used in the West. This meant that it was physically impossible to write assets and liabilities on the same page due to the size of conventional paper (Kawahara, 1977).

The new accounting standards changed how the information of profits from business activities was perceived and released (Sakai, 1983; Wakasugi, 2014; Arai and Kawamura, 2010). Examples of additional rules included the introduction of more comprehensive financial reports which were now required to include a Profit and Loss Statement, the depreciation of fixed assets, the valuation of stock, the definition of deferred assets, and the calculation of foreign exchange transactions (Arai and Kawamura, 2010: 37-39). Shareholders were now also granted significantly improved access to the company's annual financial reports, which was strongly suggested by the ESS (Someya, 1996; Kubota, 2000a). Nevertheless, there were still opportunities for corporations to conceal financial losses or to inflate profits while external auditing was not yet consistently conducted in the 1950s and 1960s

(Matsumura, 1983). Changing the mind-set among business people was not straightforward. Indeed it would take more than a few decades.

In line with accounting standards, laws on securities were established. In 1948, the Security and Exchange Law was enacted in Japan which was based upon the US Securities Act of 1933 and US Securities Exchange Act of 1934 (Someya, 1996:54). The new law required companies to recognise only capital they physically had in their accounts. Hence, partially paid shares were no longer valid. Companies were banned from declaring the capital they physically did not have in their bank and the pre-war business custom of allowing partial payment for shares was banned (Kawai, 1983; Someya, 1996). In the past, the pre-war accounting practice and the Commercial Codes allowed companies to overstate capital even when it had not been paid fully (Aochi, 2006). This was a common business practice which allowed investors, who were often group companies or individuals from the *zaibatsu* families, to make instalment payments when purchasing the significant amount of shares from companies (Aochi, 2006). As a result, *zaibatsu* groups in Japan were able to inflate the value of their companies (SCAPINs, 1948; Kawai, 1983).

As part of post-war recovery and the requirements by the American officers, Japanese corporations had to restructure their management practices including cost accounting and financial accounting (Someya, 1997; Kawai, 1983; Kawakita, 2008). Cost accounting was considered to be a vital tool to ensure better productivity because during the post-war period there was a chronic shortage of products and materials, with insufficient manufacturing capacity, which caused severe inflation and a failing economy (BoJ, 1945). Prices of materials soared considerably and

most companies found it difficult to finance their businesses without assistance from the government (Someya, 1997). The average price index for corporate goods was 70.5 times higher in 1950 compared to the index in 1945 (Ito, 2012; BOJ Statistics, 2016). Controlling the high inflation rate and stabilising the economy were given priority by the state, but it was extremely hard for the Japanese government to achieve these objectives within a short period of time (Sawai, 2007). The government announced Emergency Economic Countermeasures, urging companies to improve their productivity and efficiency (Ito, 2012). Consequently, the importance of cost accounting was increasingly recognised by practitioners as well as government officials in Japan (Someya, 1996). American cost accounting methods were consulted but it took more than eight years to establish cost accounting standards in Japan in 1962 (Someya, 1996).

5.5.3 New Business Practices in Japan

There were many economic projects and policies undertaken by the GHQ to improve the Japanese economy. The US became the paternal figure who advised and guided the Japanese. The US heavily subsidised Japan during its occupation, which would eventually cease after the Dodge Line report with recommendations was published by an American banker commissioned by the US in 1949 (Yonekura, 1991; Sawai, 2007). The Dodge Line report strongly advised that Japan should no longer receive financial support from the US, but instead that the nation should improve its economy and become more financially independent by its own efforts (Yonekura, 1991). The Dodge Line report also recommended that the Japanese Yen should be officially exchanged for US dollars. This would allow Japan to export products and gain foreign currencies to enhance its national economy (Yonekura, 1991).

Along with the revival of the manufacturing industry, banks in Japan were also re-established after the war. In order to promote national investment and to improve international competitiveness, the Japanese government strictly regulated competition among domestic banks which were now heavily protected by the new Japanese government (Kikkawa, 2007; Ikeo, 2009). A strong economy was a common goal for the Japanese. Strong influence and requests from the US made the Japanese determined to collectively work hard (Morishima, 2004). Banks played a key role in financing industries, which would enable Japanese industries to gain better access to finance (Kikkawa, 2007). The interest rates of banks were fixed by the Japanese government and all banks were supervised very closely by the Ministry of Finance (Tanaka, 2004).

Unlike Japanese companies, significantly more US companies sought funds from the stock market and, thus, shareholders in the US demanded transparency in financial information (Oguri, 2016). Japanese companies, in contrast, had a strong tendency to borrow capital from banks especially after the introduction of the *Kaisha Keiri Touseirei* law in 1940 rather than depend on the stock market. Each *zaibatsu* group had allied banks and they could also be shareholders of their client companies (Okazaki, 2005; Okazaki et al, 2005). Hence, major shareholders were not necessarily third-parties but, instead, the majority of them were often their own group companies or the banks from which they had borrowed funds (Oguri, 2016). Inner circle members did not usually criticise other group members, based upon Confucian teachings and, thus, it was rare for them to challenge critically when financial reports were issued (Someya, 1996; Wakasugi, 2014; Arai and Kawamura, 2010). The GHQ insisted that Japanese companies should give greater emphasis to equity

financing, which required improved financial transparency and enhanced accountability. This would prevent large corporations from borrowing capital from their *keiretsu* banks who had close business relationships with them (Oguri, 2016; Wakasugi, 2014). A company's financial information would therefore have to be made available to both potential and existing investors. Although the stock market in Japan required time to re-establish itself during the post-war chaos, the GHQ encouraged the Japanese government to resume stock market trading after the war (BOJ, 1946).

Under the supervision of the GHQ, the democratisation of management continued and large companies were instructed to promote their own employees to board members rather than recruiting prominent financiers or former aristocrats (Kawai, 1983; Sawai, 2007). Following direction by the GHQ, approximately 230 large companies in Japan dismissed nearly 2000 board members and replaced them with selected employees within these companies (Sugayama, 1996:23). These new board members did not have a strong familial connection to the *zaibatsu* families and they were not part of the old ruling class (Sawai, 2007; Sugayama, 1996). The complete renewal of board members in large companies also gave hope to employees for their future progression within organisations (Sugayama, 1996; Morishima, 1982; Oguri, 2014). This assisted Japanese corporations to have more equitable and fairer management and remuneration systems after the war. Hitachi, a major manufacturer and engineering corporation, allowed the workers' union to influence the management and personnel plans of the company, which was very democratic and unthinkable before the war (Sugayama, 1996).

Labour unions in Japan were established independently in each company and they often included lower managerial as well as operational employees (Sugayama, 1996). The relationship between a labour union and its company was often amicable and they collaborated to achieve their company's objectives (Sawai, 2007; Chiba, 2010b). The new, more democratic relationship between employers and employees also helped to motivate employees who might become president or senior managers one day (Sawai, 2007). The new employment system which included life-long employment and a seniority system also drove younger generations to work harder. However, life-long employment and the seniority system had existed since the Edo era, which was often evidenced in documents of merchant houses (Ogura, 2003). The traditional employment system was influenced by Confucian teachings of filial piety and seniority (Morishima, 1982). This resulted in cohesive industrial relations with newly promoted senior executives, who once worked in the operational department, now able to relate to other workers (Sawai, 2007). With the new system of promoting existing employees and job security derived from traditional Confucian values, Japanese organisations developed their own unique management style such as life-long employement during the post-war period (Oguri, 2014).

The GHQ was perceived as a 'senior figure' by the Japanese during the post-war period and their instructions were accepted without critical questioning at that time. The Japanese government and industries worked together towards the national goal of ensuring economic recovery for the nation (Kikkawa, 2007). With clear economic objectives stated by the government, Japanese corporations and their employees were implicitly expected to internalise those national objectives and work

towards targets. Confucian-led values helped the Japanese work together and achieve economic objectives year after year (Morishima, 1982). The shared values promoted by Confucianism was a major factor in ensuring that the Japanese people worked hard to improve their lives during the post-war period (Maruyama, 2006). Before the end of the war *zaibatsu* companies were extremely influential in the Japanese economy and in politics, which made the GHQ determined to reduce their influence (SCAPINs, 1945b). The GHQ always criticised the concentration of wealth among a limited members of *zaibatsu* groups which GHQ believed had assisted the Japanese government in its preparations for war. Traditional business practices of the *zaibatsu* groups and the extent of their economic control were considered to hinder the democratisation of Japan (Oguri, 2014). Thus, the GHQ felt strongly that the Japanese economic and social system needed to be reformed (Kubota, 2000a; Yamashita, 2014; Jensen, 2000). Hence, the GHQ introduced a drastic measure, the expulsion of board members of the *zaibatsu* companies and dividing the *zaibatsu* groups into independent companies (Jensen, 2000). The symbol of power in pre-war Japan, the *zaibatsu,* was dissolved and appeared to relinquish its power to the GHQ who thought that they were able to Americanise business systems in Japan (Udagawa, 2007).

The GHQ established and implemented new disciplinary power in Japan after the Pacific War. The dissolution of *zaibatsu* groups, such as the Mitsui and Mitsubishi *zaibatsu*, was initiated by the GHQ and the system of holding companies was banned in 1947 (Oguri, 2016). This was a tremendous shock for the Japanese as before the end of the war the *zaibatsu* symbolised wealth and power in Japan. The Mitsui family once owned 64% of the entire Mitsui group's shares and their main source of

external funding had been from group banks before 1945 (Sawai, 2007:233; Asajima, 2005). The Sumitomo families held 83% of the entire Sumitomo shares and the Yasuda families owned 100% of the Yasuda shares (Sawai, 2007:233). The GHQ criticised the concentration of wealth in a limited number of *zaibatsu* families. Thus, the GHQ forced ex-*zaibatsu* companies to sell off *zaibatsu* shares on the stock market between 1949 and 1955, in order to diminish their monopolistic power in the Japanese economy (SCAPINs, 1945b; SCAPINs, 1948; Yamashita, 2014). This provided the opportunity for the general public to own shares in ex-*zaibatsu* companies until 1952. However, these shares were immediately bought back by ex-*zaibatsu* group companies when the GHQ left the country in 1952 and Japan regained full sovereignty (Sawai, 2007).

Consistent with Foucault's conception of power which is related to the interests of elite groups and networks of influential people, the dissolved *zaibatsu* was re-convened by its ex-zaibatsu members and new alliances were formed called *keiretsu* (Foucault, 1976; Kikkawa, 2007). However, they no longer referred to themselves as the *zaibatsu* group. This decision was in line with Foucault's argument that power works efficiently when it does not show its appearance overtly (Foucault, 1976; Sawai, 2007). The new form of alliances, *keiretsu,* replaced those of the *zaibatsu* and soon accumulated economic and political power after the GHQ left Japan. The Japanese government believed that some embedded traditional values and business practices from the pre-war period should pervasively maintain their places in society in order to sustain Japanese sovereignty and to rebuild economic strength (Kikkawa, 2007). Gaining economic power was the shared national goal during the post war period in Japan (Jensen, 2000).

5.5.4 The Introduction of Financial Audit

The GHQ also highlighted the significance of professionally conducted audits and stated that the previous quality of financial statements in Japan did not meet with the approved standard (SCAP, 1946b). Surviving statements on auditing in the GHQ's official documents called Supreme Commander for the Allied Powers (SCAP) stressed the objective and importance of sound financial reporting (SCAP, 1946b).

> The audit of the financial statements of an enterprise to be conducted by a professional auditor when the management of the enterprise intends to have such financial statements made public to outsiders. The purpose of audit is to increase the general public's reliance upon the financial statements by having them audited by an auditor. Auditors should endeavour to detect dishonesty and errors and not to overlook any serious fraud, errors or omissions … (SCAP, 1946b: 12065).

The new Commercial Code of 1950 was enacted to make external auditing compulsory for listed companies (Chiyoda, 1983). The introduction of compulsory external auditing was finally put into effect in 1951 by law. In addition to recording accounts under the new nationally agreed principles, accounting records now had to be certified by external auditors (Kawakita, 2008). There was a grace period while the auditing of accounts was gradually promoted in Japanese corporations in the 1950s (Someya, 1996). However, the new law did not clearly define the role of Certified Public Accountants (CPAs)' accountability within a public company (Chiyoda, 1983). Although the Japanese government introduced the qualification of CPA, they did not specifically force corporations to hire qualified CPAs at first, resulting in less rigorous audits. The law only stipulated that financial reports must be audited 'by a statutory auditor' instead of 'by a qualified CPA' when it was first passed (Chiyoda, 1983). Some companies deliberately failed to hire CPAs which left room for many industries to interpret the law advantageously and allowed

unqualified people to audit financial reports (Chiyoda, 1983). During this period when new accounting practices were established in Japan, the significance of 'a qualified CPA' was not widely recognised (Kawakita, 2008).

The formal and systematic implementation of auditing required the transformation of the mindsets of Japanese business people and it necessitated dramatic changes in corporations. This new change took time for society and corporations to fully accept (Kawakita, 2008). In 1951 there were fewer than 400 CPAs in Japan, which slowly increased to 1185 in 1956. Yet this was still too few for the 952 companies that required annual auditing (Chiyoda, 1983: 138). The laws relating to CPA's were reformed several times during the early years after their introduction in the 1950s, which indicated that the introduction of the CPA needed constant discussion and practice (Kawakita, 2008). Despite the many accounting and accountability reforms introduced, the responsibility of disclosing financial statements to shareholders was only slowly taken by the majority of listed companies. It had not existed previously in Japanese business customs and, traditionally, accounting information was considered to be secretive (Egashira, 1992; Someya, 1996). Individual shareholders were regarded as less important than corporate shareholders who were often the inner circle members or '*keiretsu'* members of the corporation (Matsumura, 1983). Confucian respect for the social hierarchy and collective harmonisation ensured that the right of the individual shareholder was less significant than collective prosperity in society (Ishida, 1975; Bellah, 1985).

There were occasions when Confucian values adversely interpreted and affected fair auditing. Some statutory auditors had a close business relationship with companies,

which allowed window-dressing and later cases of accounting fraud (Someya, 1996: 27). This was a negative consequence of Confucian teachings or the manipulation of Confucian teachings, which stated one should not criticise one's superiors or clients (Durlabhji, 1993; Ishida, 1975). Superiors or clients had more hierarchical power, which meant that people with less power such as auditors would have tended to become more obedient to them (Maruyama, 2006). Japanese business people continued to maintain Confucian-led values and did not become 'Western' business people as the GHQ and ESS had originally hoped (Morishima, 2004; Maruyama, 2006).

Once Japan retrieved its sovereignty in 1952, the power structure in Japan shifted. This enabled the government and large corporations to interpret the accounting standards in order to meet their needs, such as allowing them to retain excess profits within organisations (Someya, 1996). Japanese industries regained their power in society with the support of the Japanese government (Kikkawa, 2007). In later years of the 1980s, this caused disagreement and debate about unfair trade terms and protectionism set by the government when Japanese corporations competed internationally against American and European corporations (Nakano, 2013). Although democratisation by the GHQ appeared to be successful, it did not mean that the Japanese completely sacrificed their traditional beliefs and customs.

The democratisation reforms in legal and economic policies in Japan were compellingly carried out by the GHQ. To rebuild the nation and their lives, the Japanese had to unwillingly accept changes forced upon them. Accordingly, the Japanese and their government did not overtly resist the new regime and the social

changes forced upon them. They realised that GHQ's financial support for the nation would help it to recover from the devastation it suffered during the war (Sawai, 2007). Nevertheless the majority of Japanese continued to show great respect for tradition, including the Emperor and the Imperial Family who remained an important symbol of Japanese society (Jensen, 2000). Temples and shrines in Japan still had a revered position and business customs continued to be influenced by traditional values based upon Confucianism, which continued to play a significant role in Japanese society (Durlabhji, 1993; Tu, 2000; Imanaka, 1965). The nation was traditionally a collectivist society, which was advocated by Confucianism as 'harmony'. Thus, developing and maintaining harmonious human relationships was prioritised in business practice.

5.6 Conclusion

Before the Pacific War, accounting standards and auditing had not been systematically established in Japan because accounting was still considered a private matter by businesses. However, military forces identified the significance of coordinated accounting practices and with their *Kaisha Keiri Touseirei* law, military suppliers had to improve their accounting and business practices. Military forces had influential political power and, thus, it was possible for them to impact on accounting practice where they had an interest. After the end of the Pacific War power in Japanese society shifted and the GHQ was now able to state how accounting had to be conducted. The GHQ imposed American accounting standards in order to modernise the Japanese economy and accounting standards. The post-war Japanese accounting standards that were to be universally adopted had significant implications for the Japanese economy. Having companies preparing accounts

using a standard accounting system was considered to be extremely important for economic recovery during the post war period (Suzuki, 2010a).

New accounting methods and external auditing were introduced in listed companies in Japan after the new Commercial Code was enacted in 1951. Before the war external auditing had not been demanded by investors who were often from the same inner circle and financial statements were not publicly scrutinised. This resulted in companies maintaining the secrecy of accounting information. Japanese companies now had to understand that accounting records were no longer their private information and that they were to be exposed to public scrutiny. However, Japanese accounting and business practice were still influenced by Confucian beliefs and traditional values. Before the war a third party rarely audited company accounts and, therefore, the Japanese had to transform their mindset considerably.

Although dramatic democratisation of the social system was initiated in Japanese society after hundreds of years of feudalistic and authoritarian regimes, the Japanese still maintained their traditional values in some business practices, especially when the GHQ left Japan in 1952. Dissolved *zaibatsu* groups soon re-established corporate groups called *keiretsu*. Traditional values influenced by Confucianism such as maintaining a collectivist society and encouraging harmony in business while partially lost never disappeared completely (Maruyama, 2004; Tanaka, 2010; Hamada, 2008). These values influenced accounting practices in Japan, which was crucial for Japan's recovery from the ravages of war and its restoration as an industrial power. The Japanese selectively continued their traditions and business customs such as prioritizing filial piety and reciprocity, which in turn influenced their

accounting standards and practice throughout the postwar period (Dore, 1987; Dollinger, 1988; Tu, 2000). This is further expounded in the following chapter.

Traditional values based upon Confucianism have always been profoundly embedded among Japanese business people and, therefore, had an impact on accounting and accountability practices (Wakasugi, 2012; Chiba, 2010; Maruyama, 2006). After the war Confucian values of harmonising society helped the Japanese to unite the government, industries, banks and people, to work cohesively in order to achieve national goals and to be consistent with raison d'État (Dollinger, 1988; Tu, 2000). Social hierarchical relationships that have endured for centuries played critical roles in Japan (Bellah, 1985). The Japanese employment relationship between employers and employees profoundly reflected traditional values derived from Confucianism, despite the strong influence of the GHQ. The following chapters examine how these values and beliefs influenced accounting and accountability practice in contemporary Japan, using recent examples of accounting scandals.

Chaper 6

‘Japan Inc.’ and Accounting and Accountability

6.1 Introduction

The Japanese government, industries and their workers were all determined to rebuild the nation after the defeat in the Pacific War (Kazusa, 2016). This chapter examines how Japanese accounting standards and practices were developed and their relevance to Confucianism and disciplinary power from the 1960s to the early 1990s. Japan experienced a series of economic boom years after the 1960s and its Gross Domestic Product (GDP) significantly increased annually to overtake other developed countries (Kikkawa, 2007). This was the time when the country was becoming internationally recognised as ‘Japan Inc.’(Morishima, 1982). The Japanese government and industries worked collaboratively to achieve high economic targets. When Japan became an economically successful country in the 1970s and 1980s, the US and European countries believed that Japan was no longer a developing country and, therefore, they demanded that the Japanese should establish more internationally accepted business practices including accounting standards (Someya, 1996; Oguri, 2014). This chapter examines the shift of power from the GHQ to the Japanese government and how this change affected the development of accounting and accountability in Japan in the second half of the 20th century. Accounting played a significant role in the economic development of Japan.

Confucian-led values implicitly continued to encourage Japanese employees to work hard which resulted in improved international competitiveness in the 20th century

(Boardman and Kato, 2003). Confucianism helped the Japanese to rebuild the nation's confidence and to enhance self-cultivation (Morishima, 1982). The government policies of liberating trade and capital between the 1950s and 1960s dramatically increased the volume of exports and encouraged Japan's economic advancement (Kikkawa, 2007). Collective thinking and a strong sense of shared goals among Japanese people helped the nation and businesses to create an environment of prosperity in the country in the 1960s. Essential to this process, Japanese accounting standards were established (Someya, 1996). The 'Izanagi Boom' between 1965 and 1970 brought significant prosperity to the Japanese as a result of the competitive success of products such as machinery and automobiles. The average annual GDP growth rate during the Izanagi Boom was 10.6%, compared with the later growth rate of 1.4 % in 2015 (World Bank GDP data, 2016; Kikkawa, 2007). In addition, a favourable exchange rate and the protective import regulations at that time enforced by the Japanese government further enhanced its economic competitiveness (Kikkawa, 2007: 298).

The Japanese regained their confidence and pride whilst Confucian values were implicitly embedded in society, which motivated the Japanese people to work exceptionally hard (Morishima, 1982). Confucian values bound together the government, corporations, their employees and employees' families and helped them work towards the shared goal to become an economically strong country like other developed countries (Tu, 2000). The government also educated Japanese pupils to promote the values influenced by Confucianism (MEXT, 2015b). School teachers nurtured Confucian ideals in the consciousness of pupils which was to have an enduring effect upon the Japanese (MEXT, 2015b; Maruyama, 2006). To this day,

Japanese education respects non-academic subjects such as cleaning rooms and looking after flower gardens at school, which are a part of cultivating one's benevolence and ethical behaviour (MEXT, 2018).

> Confucius taught that it is heavenly if one respects benevolence. If one ignores benevolence, one never becomes a wise person (Analects of Confucius, Chapter 4, Rigin IV-1).

This is considered to lead to a positive work ethos and amicable employee relationships for better productivity of industries for future employers and employees (MEXT, 2015a; 2015b; Saguchi, 2015).

Japanese employees internalised social norms which respected industriousness and dedication. Their employers not only rewarded employees with salary and job security, but also provided a second 'home' to which their employees would feel loyal and a sense of belonging. Employees would work diligently in the hope that their employment would be protected, even when the economic climate deteriorated, which is a form of reciprocity reflecting Confucian teachings. (Shinoda, 1997; Okabe, 2002; 2012; Kamuro, 2015). The Japanese interviewees in this research all agreed that Confucian teachings are subtly entwined in Japanese business practice. According to them, Confucianism is ingrained in society and in themselves without explicitly being taught.

> Yes, we are heavily influenced by Confucianism but we do not realise our customs come from Confucianism as they are embedded everywhere in our society and in our minds when doing business (Interview with H, 2016).
>
> I thought I received a training from the company, but my knowledge comes from university. But, I guess from deep inside, it is Confucianism which affects my ethical standards (Interview with M, 2016).
>
> Well, I think we ought to be thankful. When we have a feeling of gratitude, we naturally want to contribute to society. We need to show our gratitude for our good fortune (Interview with X, 2017).

They claimed that although they never thought they believed in Confucianism, it had been planted in their minds subliminally. Most Japanese interviewees claimed that their daily behaviour and moral standards reflect Confucian-led values which are embedded in society.

6.2 Preparation for 'Japan Inc.' and its Implications for Accounting Practice

6.2.1 Changes in Laws and Accounting Standards in the 1950s in Japan

The Korean War (1951-1953) prompted the Japanese economy to improve dramatically (Sawai, 2007; Yonekura, 1991). Due to the high volume of demand for supplies during the Korean War, manufacturing companies soon recovered their production capacity and, as a result, met demand from the US (Fujimoto and Tidd, 1994). Companies such as Toyota obtained approval to restart production of automobiles, prompting improved productivity and inventory management in the early 1950s (Fujimoto and Tidd, 1994). By the time the Korean War had ended in 1953, Japanese manufacturers had re-established their production infrastructure and

become more competitive in international markets (Okano and Suzuki, 2006; Jansen, 2000).

Ex-*zaibatsu* groups such as Mitsui and Mitsubishi, who were forced by the GHQ to break up their economic ties, started forming group companies called *keiretsu* in order to enhance business efficiency and synergy as soon as the GHQ left Japan in 1952. Non-*zaibatsu* companies such as Toyota and Nissan also created their own *keiretsu* groups (Kikkawa, 2007). The *keiretsu* group was created based upon hierarchical relationships among group companies and, therefore, it retained traditional values based upon Confucian teaching (Maruyama, 2006). Confucian teachings assisted the Japanese to reinforce the importance of traditional values to compete against foreign competitors.

> We do not exist in isolation; we are a part of a larger and more complex family where harmony can be achieved by acting appropriately with one another by Confucius (Boardman and Kato, 2003:320).

Confucian teachings helped the Japanese to feel content about the unwritten social hierarchy by preaching that their destiny had been pre-decided by Heaven at birth[10] (Maruyama, 1969; Tu, 2000). Power relationship dynamics between parent companies and their subsidiaries always influenced employees of these companies. As Confucian teachings advocated social hierarchy and seniority, employees were always conscious of their positions within their organisation. Thus, Confucian teachings prevented employees from becoming rebellious against the power of hierarchy (Morishima, 1982; Maruyama, 2006). They would normalise

[10] Buddhist teachings also imply reincarnation which suggests that wealth in this life was the result of virtuous behavior in the previous life (Bellah, 1985; Kitagawa, 1987). Thus, the Japanese had a tendency to believe that their social positions were as a result of their past deeds.

hierarchical relationships and become obedient to their employers, as well as to employees in higher positions or higher ranking *keiretsu* companies. The creation of such *keiretsu* groups reinforced the economic strength and synergy of Japanese industry. The economic power was concentrated within the *keiretsu* groups in order for them to become extremely competitive in the market (Morishima, 2004; Kikkawa, 2007).

The Commercial Code and the Japanese GAAP substantially reflected the intentions of the government which wanted to help corporations to retain their profits for reinvestment rather than distributing them as dividends (Tanaka, 2010). Although the rights of shareholders were slightly enhanced with voting the rights, rights of shareholders were not explicitly actioned during the mid-20th century (Matsumura, 1983). This was mainly because the major shareholders in large Japanese corporations were generally members of group companies or their *main banks* that would generally help finance allied companies (Kikkawa, 2007: 312). They usually monitored and gave advice to allied companies outside of general meetings of shareholders (Prows, 1992).

Main banks would normally hold a certain percentage of shares in a company which is often chosen from the same *keiretsu* group (Kikkawa, 2007: 312). For example, 45.6% of shareholders of listed companies in 1990 were group companies and main banks, of which 10.4% were main banks. This ratio had gradually increased since the 1960s but now it has been reduced dramatically to 38.3% and 4.1% respectively in 2008 (Miyajima et al, 2003: 210; Miyajima and Nitta, 2011:6). It was common for the board members to decide how to distribute profits without publishing a

detailed explanations and short-term profits were not necessarily expected by shareholders (Kikkawa, 2007; Yoshida, 2002). It should be noted that the ratio of foreign shareholders has risen dramatically since the early 2000s due to various changes in raising financial capital, including taxation on intercompany dividends (Prows, 1992; Choi, 1995).

Although Japanese corporations adhered to the Japanese GAAP, discrepancies in accounting policies between the Japanese GAAP and the Commercial Code occasionally caused confusion among accounting practitioners. Accounting methods were not consistent in some cases because the valuation method varied between the Japanese GAAP and the Japanese Commercial Code (Matsumura, 1983). Also, the Security and Tax Act of 1948 was not necessarily established in line with the Japanese GAAP. The Japanese GAAP, the Commercial Code and the Security and Tax Act were slightly different from each other. They were often referred to as a '*Triangle system'* of accounting principles in Japan (Kubota, 2000a; Oguri, 2014; Nishido, 2004). Traditionally, the Commercial Code in Japan was enacted in the Meiji era to protect lenders' rights and the law did not allow any item without a commercial value to be included in the asset category of the balance sheet (Endo, 1962). However, the Japanese GAAP were based the American GAAP which was concerned more about shareholders who needed to understand profits and losses of a company within a set period (Someya, 1996). Although the government intended to remove discrepancies between the GAAP and Commercial Code, some areas of the revised Commercial Code still contained traditional accounting practices such as using a book value when evaluating assets (Endo, 1962). This means that a

company's asset value is not publicly represented by a market value, which leads to lack of transparency.

The Japanese government wanted to create an environment where industries could reinvest their retained funds more easily. The revised Company Law of 1962 encouraged companies to save their profits by using depreciation and provisions (Kazusa, 2016). For example, depreciation of assets had to be consistently deducted and a reserve fund for unpredictable events was allowed to be established within a company's accounts (Someya, 1996; 1997). Also, to protect lenders rather than shareholders' rights to claim higher dividends, it was traditionally considered more important to secure funds (Kazusa, 2016). The revised law allowed companies to hold reserve funds for special expenditure, which was often used as a place to conceal profits (Matsumura, 1983). The importance of the profit and loss statement was further reinforced in the reformed Commercial Code, and the terminology of accounting was standardised in 1963 (Chiyoda, 1983). Depreciation for tangible assets such as property and machinery was officially incorporated according to a revision in the Commercial Code in 1962, but the method of calculating depreciation was still flexible, which enabled companies to retain and reinvest their profits (Matsumura, 1983: 46-47) (Please see Table 6-1). The government also aided Japanese companies by imposing high taxes and quantity restrictions on imported goods, which created major disadvantages for foreign companies (Kikkawa, 2007). This economic structure led to the creation of 'Japan Inc.'.

The government eventually initiated the reform of laws to adjust differences between the Japanese GAAP and the Commercial Code. The government felt corporations must produce more comprehensive financial information such as profit and loss statements and balance sheets, based upon an agreed format (Endo, 1962; 2004). The Commercial Code was revised in 1962 to allow more items in expenses, such as business commencement expenses, expenses for research and development (R&D) and the cost of issuing bonds as deferred assets (Sakai, 1983) (See Table 6-1). The newly revised Commercial Code had fewer discrepancies, which restricted the scope for interpretation. Provision for a reserve fund had now to be clearly categorised in the balance sheet and depreciation had to be correctly calculated and recorded.

Table 6-1 Significant Changes in Laws and Standards related to Accounting between 1950-1963:

	The Commercial Code (Japan) / The Securities Act	**Accounting standards (Japan)**	**International Accounting standards**	**Historic Events**
1950	Major revision: to allow expense for issuing new shares, to distinguish between profit provision and capital provision			Korean War (-1953)
1951	Auditing: officially introduced by law	Instruction for Reporting Companies was issued by ESS		Treaty of Peace (Allied Forces - Japan)
1952				Japan became independent of the Allied Powers
1962	Major revision: to introduce compulsory Profit and Loss statement, valuation standards for different types of assets, to redefine deferred assets, to introduce a reserve fund, to revise calculation method	To conform more with the commercial Code		
1963	Revised Kigyou Kaikei Gensoku (accounting formats)			

(Shibata, 2007:32; Oguri, 2003; 13; Oguri, 2014: 266; Murai, 2009; Yamada, 2013)

6.2.2 Keiretsu and Japanese Business Practice

Keiretsu groups of allied companies gained financial synergy and expanded their influence in industries in the 1960s and 1970s to reinforce 'Japan Inc.' (Kikkawa, 2007). Large Japanese corporations and their *keiretsu* groups were protected from external competition by regulations established by the government. The hierarchical relationship within the *keiretsu* group also helped member companies to retain profits within the same group (Kikkawa, 2007: 310). The structure of a Japanese *keiretsu* group signified the traditional hierarchical society in Japan. Lower ranked subsidiaries were expected to pay respect and assist their parent companies to achieve business excellence. In return, parent companies would provide protection and rewards to their subsidiaries, such as employment security and fringe benefits, such as holiday villas for group employees (Morishima, 2004). Employees of *keiretsu* group companies understood their positions in the hierarchy within the group and internalised norms to obtain collective benefits (Morishima, 2004).

Economic growth in Japan in the second half of the 20th century was achieved by collaboration between the government, industries and their employees. The Japanese government heavily regulated the financial and distribution system which made it extremely difficult for foreign companies and new start-ups to obtain a share of the market and allowed the *keiretsu* groups to protect the interests of their member companies (Kikkawa, 2007: 310). Accounting practices were generally made favourable to the corporations, and detailed accounting information was not readily available to the public (Shibata, 2007). Japanese companies did not have to be accountable as the main stakeholders were often from the same *keiretsu* group who would not criticise their inner circle members (Udagawa, 2007; Kikkawa, 2007).

This reflected Confucian teachings in which one should not criticise one's superior or seniors in the same group or family (Morishima, 2004).

Before 1965 companies did not have to produce their subsidiaries' financial statements and, thus, it was not uncommon to disguise potentially negative financial information in one's subsidiary accounts. One interviewee for this study stated that it was not a rare occurrence to see the manipulation of accounts in the textile industry in Japan. For them, it was common to move accounting information from their books to their subsidiaries' accounts.

> I saw many cases of moving inventories from one place to another in the 1970s and 80s. We had a secret nickname for this action. My boss also said that it was really common to move excess stock to subsidiaries. Another tactic was that we asked our clients to take ownership of stock and then we bought them back later on. Also, employees with the responsibility of falsifying accounts were never severely reprimanded. They were sent to other departments temporarily, but they would return after a while. They did it for the company, not for personal gain. Therefore, I rarely saw anyone demoted. Especially in large Japanese companies, they would protect their subordinates (Interview with R, 2016).

The sense of belonging in the same inner circle was especially pronounced among Interviewee R's bosses and their subordinates and, consequently, no one pointed out the absence of the Western concept of accountability (Interview with R, 2016). The approval by their inner circle members was significantly more important (Morishima, 2004).

Accounting standards were not always clear and, therefore, left room for individual corporations to interpret them to their advantage. Companies within the same *keiretsu* group often exchanged stocks of goods and shares to make their financial

records look healthy and, sometimes, they deliberately did not record their transactions in detail (Endo, 2015). A continuing problem was that not all subsidiaries' accounts were required for a parent company's financial reports. The accounting standards had allowed corporations with subsidiary companies to be selective about their consolidated accounts. A *keiretsu* group often consisted of a large number of subsidiary companies, but the less significant of subsidiaries' accounts could be excluded from consolidated financial statements (Tanaka, 2010). For example, Mitsui Fudosan, one of the largest property development companies, had 160 subsidiaries in 1995. Yet, Mitsui Fudosan only incorporated 52 subsidiaries in their consolidated financial statements for the financial year of 1995, claiming that the rest of their subsidiaries did not have a significant impact on their financial statements (Tada, 1997: 155).

There were several other schemes which some companies adopted in order to artificially make financial statements appear sound. Some companies had resorted to selling their *mochiai kabu*, cross-sharing shares, of other group companies. This is now impossible under IFRS, but it was permitted before 2000 in Japan (Tanaka, 2010; Kurata, 2014). According to one interviewee, the cross-sharing shares were recorded using the historical book price and, therefore, companies often created artificial profits by selling these shares to their allied company at a high market price before the end of a financial year (Interview R, 2016). This transaction was called *ekidashi*, which literally means 'to generate profits'. This artificial profit making to help one's allied companies was not an unusual action in Japan before the 2000s when accounting standards and the Commercial Code were further reformed. Helping member companies within the *keiretsu* group had been an acceptable and

‘benevolent’ business custom in Japanese society for decades (Kikkawa, 2007). However, these business customs sometimes resulted in delaying action by a company to rectify the root cause of any financial problems. In the worst case, they led to bankruptcy. In the 2000s the government introduced a new law to prevent companies from concealing financial information in their subsidiaries after a number of companies, including Yamaichi Securities, collapsed due to the mismanagement and fraudulent accounts during the late 1990s (Oguri, 2003; Hamada, 2008).

Transparency in financial statements for investors was gradually introduced during the 1960s and 1970s (Chiyoda, 1983; Kawakita, 2008). However, the timing of official deadlines for financial statements was not strict before the Revised Commercial Codes in 1973 and companies were allowed to amend their financial statements even after the approval by shareholders had been granted (Someya, 1996). Financial statements contained artificial business transactions by using subsidiaries or *keiretsu* companies to process fabricated orders and to hold excess stock, which was a convenient way of making financial statements look healthy (Hamada, 2008). This act was often overseen by the companies’ internal and external auditors. During the period of economic boom some companies were able to recover their shortfalls in the following financial years (Hamada, 2008).

A major shareholders tended to agree with business decisions made by the board members as their main goal was long-term returns and collective wealth, which coincided with Confucian teachings (Tagaya, 2014; Boardman and Kato, 2003). This, however, was a short-term solution and it was contrary to original Confucian teachings of sustainability and the need to adopt a long-term perspective: ‘Confucius said that we should not try to achieve the objective in haste, or look for small profit’

(The Analects of Confucius, Shiro 13:17). This element of Confucianism was misused and wrongly gave legitimate justification for employers to exploit their employees, allowing Confucianism to be manipulated by employers who wanted their employees to become more efficient and docile.

A number of Japanese manufacturers increased their global market share, especially in the US during the 1960s and 1970s (Tagaya, 2014). Japan consistently expanded its export volume and eventually became one of the leading industrial countries (Saguchi, 2015). Textiles, steel, consumer electronics and automobiles were sold worldwide, mainly to Japan's biggest market, the US which accumulated a trade deficit from the mid-1960s (Kikkawa, 2007). Car manufacture and machinery sectors experienced an extremely high rate of growth, thereby providing the opportunity to strengthen positive relationships with their employees in the 1960s and 1970s by giving them various benefits (Statistics Japan, 2016; Saguchi, 2015). Japanese employees were able to enjoy job security and to improve their standard of living (Chiba, 1998). The collaborative way in which the government, industries and their employees worked together improved productivity and greatly expanded the volume of exports in the 1970s, allowing the country to achieve a significant trade surplus (Ito, 2002).

The enforcement of accounting standards was not straightforward in Japan. Although consolidated financial statements became compulsory in 1977, the enforcement of consolidated financial statements was not rigorously implemented for many years (Someya, 1996). This law still allowed subsidiaries with a small turnover or capital of 3 % or less of the holding company to avoid issuing a consolidated financial statement (Tada, 1997:158). Parent companies were given a degree of autonomy to

decide whether or not they included their subsidiaries in their consolidated accounts (Chiyoda, 1983). Parent companies were able to change the proportion of their subsidiaries' shares in order to avoid publishing the consolidated accounts (Chiyoda, 1983). This meant that some companies were able to avoid producing consolidated accounts and could conceal excess stock in their subsidiaries accounts but they were rarely admonished by the government (Interview with H, 2015; Interview with R, 2016). Japanese industries pressured the government to allow them room to manipulate their accounts involving subsidiaries, until the US government strongly suggested the modification of accounting standards in the 1980s (Kikkawa, 2007). Still, it took more than 20 years for Japanese companies to issue consolidated financial statements (Nishido, 2004). Without pressure from the US, the Japanese government were cautious about imposing new practices because many Japanese industries were opposed to changes (Tada, 1997; Hamada, 2008).

Strong enforcement of consolidated financial statements only became fully effective after 2000, again due to pressure from the US (Tanaka, 2010; Oguri, 2014). At this time the US had significant political and economic influence over Japan. The US was still able to dictate accounting standards to be used by Japanese industries at a time when the Japanese economy was far more buoyant than the US and most other developed countries (Tanaka, 2010). However, Japanese industries managed to resist improvements in financial transparency for years (Oguri, 2014). Accounting information was still considered to be available only to a number of Japanese senior executives and companies within the same inner circle tended to help each other before issuing annual financial statements (Chiyoda, 1983; Hamada, 2008; Oguri, 2014). Transparency in accounting and financial information was rarely given

prominence to those people who did not belong to the company. The information was only for a select internal group.

6.3 Economic Success and Accounting Scandals

6.3.1 Economic Success and Confucianism

Companies, which were similar to the business structure of merchant houses in the Edo era in Japan despite their modern organisational outlook, were considered to be pseudo-families for the majority of employees (Maruyama, 2006). This reflected Confucian teachings that said a father and senior figure was the most respected person and in return, he had to look after all his family members or subordinates. Takenaka (1998), a prominent researcher on Sekimon Shingaku emphasised what Confucius expected.

> A person who is in charge must look after his subordinates and subordinates must respect and be loyal to him. In particular, Confucius said that young people must follow and show respect to their parents when they are at home, and then they must listen to senior members in society. Be prudent and modest (Takenaka, 1998: 272).

The government and industry leaders used Confucian values to keep employees docile without explicitly referring to the term 'Confucianism' (Tu, 2000). Harmonisation and discipline within the workplace was reinforced by providing 'enclosed institutions' for employees, a practice consistent with Foucault's views (Foucault, 1977). The way in which Confucian values were subtly applied to encourage people to become devoted employees was emphasised by Interviewee F.

> Colleagues from the accounting group at Company A were all close and had a good relationship. For me it was like a second family as I spent long hours with them, day and night. The company had a number of social and sports clubs, so all my colleagues and I could all socialise. Most of single male employees lived in the halls of residence before they got married. They fed us and provided all sorts of welfare facilities. The closeness among colleagues and bosses had both positive and negative implications. You would be happy if you are conservative and want to avoid uncertainty (Interview with F, 2016).

The above is not an exceptional comment. People who worked in traditional, large corporations such as Mitsui and Sumitomo often shared similar beliefs. Consistent with traditional Confucian values, Japanese workers were encouraged to be dedicated to their companies and employers (Tu, 2000; Boardman, and Kato, 2003). Self-sacrifice was strongly praised in Japan (Interview with M, 2016; Interview with N, 2016).

> When you are at home, be a devoted child to your parents; when you are out, be loyal to your senior figures. Be loyal and obedient to them. You must be closer to a virtuous person and to become like one (Yoshida, 2002:11).

This is a teaching that is ingrained in the Japanese from childhood onwards, and so was a natural attitude for companies to expect from their employees (Morishima, 1982; Maruyama, 2006). Interviews with Japanese business people indicate that it is still the case that Confucian ideas influence the relationship between employees and their employers in contemporary Japan. Many full-time employees spend most of their time in their companies, due to long working hours, and so they tended to feel attached to their companies (Interview with N, 2016; Interview with R, 2016).

> Well, belongingness to the company… The company is part of you and your family. The British may have long-term employment,

> but they don't have a life-long employment as such. That's a big difference and of course their loyalty, but you know, that's the Japanese. British obviously don't have that (Interview with C, 2015).
>
> I am a Japanese 'salaryman', so it is the norm for us to work until 10 or 11 pm on weekdays. My colleagues and I feel loyal and emotionally more attached to the company (Interview with N, 2016).

Teachings from Confucianism, which encourage the Japanese to work exceptionally hard, were applied to strengthen employees' devotion to their companies. Management accounting was also used to quantify employees' devotion as reflected in output and profit. The dedication of employees and the strength of Confucian teachings were soon to be severely tested when in the early 1970's the Japanese economy suffered major setbacks.

Japan's economic success led to the US, which was the major importer of Japanese products, demanding that the Japanese government adopt a new exchange rate for Japanese yen (Yonekura, 1996). In 1971 the US and developed countries in Europe agreed with Japan that the value of the Japanese Yen should be increased. As a result, its value went up by 16.88% (i.e. 1US$=from 360 Yen to 308 Yen), which would further increased in 1985 (i.e. 1US$=238 Yen) (Yonekura, 1996: 236). The appreciation in the value of the Japanese yen in 1971 had adverse effects on some industries. Textile manufacturers such as Kanebo started accumulating financial losses from this period because of cheap imported textiles (Hamada, 2008). Nevertheless, other exporting industries, such as automobiles, and household appliances, continued to expand globally with attractive products. The oil crisis in 1973 brought another set of challenges and the need for innovative responses. Accounting for internal management, management accounting, became more

significant in order to remain internationally competitive after the oil crisis in the 1970s (Oguri, 2014). Management accounting needed to be rigorously introduced in all divisions in an organisation in order to reduce costs and to enhance their financial position (Someya, 1996; Oguri, 2014). Managers and workers were encouraged to find a way to reduce administration and production costs.

Thus, to improve productivity and to reduce production costs, strict cost accounting and the voluntary Quality Control Circle (QC) activity were implemented in many manufacturing companies such as Toyota and Panasonic, especially when the Japanese economy slowed down due to the oil crisis in the 1970s (Kikkawa, 2007: 315-316). QC activities were led voluntarily by groups of employees who proactively sought ways of eliminating costs and enhancing productivity (Morishima, 1982; Kikkawa, 2007). These Japanese companies depended upon employees' self-disciplined improvement activities such as QC activity to enhance company profitability. Employees felt proud when they improved their productivity, reflecting Confucian teachings which encouraged employees to work hard without receiving high compensation (Morishima, 1982; Tu, 2000; Interview with F, 2015; Interview with X, 2017).

Employees were compelled to believe that it would be selfish to make demands on their company if it was experiencing financial difficulties. If they regarded their company as their second home, they would work hard to find a way to save their company. Thus, employees would try their best to reduce costs and increase productivity. In return, redundancy would be the last resort as life-long employment was the norm. This represented the positive side of the paternalistic concept of Confucianism (Takenaka, 1998; Kikkawa, 2007: 297). The president,

or one's immediate boss, was expected to look after the welfare of his pseudo family members (Yasumaru, 1974; 1988; Morishima, 1982; Kikkawa, 2007). The manner in which employees adhere to their superiors' intentions and discipline themselves for the benefit of their employers was confirmed by Interviewee R.

> To me, the company was my second family during my time for more than two decades. In fact, I felt like I was married to the company. When I quit the company, I felt guilty and also my boss was devastated as if I betrayed him. He tried to stop me too. It was just like I was divorcing the company… Many employees of my generation have this sentiment (Interview with R, 2016).

Interviewee R's emotional attachment to his company was shared with other interviewees from large Japanese organisations. The comment below illustrates how employees of a large Japanese corporation treat their fellow colleagues depending on their employment conditions.

> There was a strong unseen bond between employees who were sent from the headquarters and their wives were also part of it. There was no privacy as such among them because they were like all one pseudo family. However, they never included me because I was locally hired and there was a clear line between them and myself. I was not part of their inner circle (Interview with AA, 2017).

According to Interviewee AA, the notion of an inner circle was given prime importance when working for a large corporation. Although she worked for the same organisation as a qualified CPA, she was treated differently because she was not hired by the company's headquarters in Tokyo.

6.3.2 Benefits for Both Employers and Employees

The traditional Japanese employment system also assisted Japanese companies to increase their financial assets, especially when the national economy was growing before and during the Bubble Economy (Ito, 2002). By looking after its employees' welfare, the company also benefited. One example is how the majority of Japanese companies retain a part of their employees' wages in a number of legitimate arrangements. Large corporations would offer to their employees a long-term savings scheme called *zaikei chochiku*, which literally means saving asset, providing better interest rates than retail banks (Oguri, 2014). Employers were able to convince their employees that they could look after them financially in the long term. This paternalistic act was appreciated by society and individual employees (Tai, 1983; Okazaki, 1996). Employees' lump sum retirement allowances were put aside every year as a planned expense in the accounts and employers were able to claim tax relief (Yamaji, 2012). Both accounting and taxation systems enabled Japanese corporations to retain the savings of their employees for reinvestment, which was considered to be collective wealth. Employees were not explicitly informed that a part of their salary was kept legitimately by their employers in order to finance their companies.

Companies were still allowed to retain reserve funds for employees' pensions. These funds did not need to be shown in the balance sheet before 2001 (Tanie, 2003). It was a business custom for many companies to save their employees' retirement money or deposits for their mortgage on their behalf. This partly reflected the traditional assumption where employers knew the best use of employees' wages (Morishima, 2004). The majority of board members of Japanese companies

consisted of long-serving employees who had known their subordinates for many years in the same organisation and they felt a sense of obligation to look after them (Kikkawa, 2007: 298). This was further perpetuated by the government granting a significant tax advantage to both employers and their employees, which assisted companies in keeping these savings as their capital (Tanie, 2003). However, the greater power of the employers allowed them to release only partial financial information to employees. The Confucian values would make employees believe that their companies would look after their future financial wellbeing. At the same time companies also gained significant financial benefit by retaining these employees' savings as low-cost finance, about which employees were not necessarily well informed (Morishima, 1982).

> There are many employees with college degrees who do not bother to understand how to read their pay slip. They don't know how much had been deducted from their salary. In Japan, we have this culture; the subject of money should not be spoken about much. I think we all should be more aware (Interview with Z, 2017).

Employees were told that their money would be looked after on their behalf to a gain a better return, which was considered to be a benevolent act. The *zaikei* saving plan, the retirement lump sum allowance system, and long-term employment system, were all considered to be benevolent welfare systems of Japanese companies (Okano and Suzuki, 2006; Yoshikawa, 1991).

Throughout the second half of the 20th century companies such as Panasonic had been able to retain funds within their corporations rather than distributing some of them as dividends (Tai, 1983). Japanese companies were saving cash by encouraging individual business units to generate more reserves. It was common

for Japanese companies to retain profits in a reserve fund by claiming that they were for the future payments, such as retirement allowances, and this was accepted by their shareholders. For example, in 1973 Panasonic was able to hold 400 billion yen as reserve funds, which was 5.7 times more than their issued shares (Tai, 1983: 245). These funds continued to increase and by 1981 they had 831 billion yen as reserve funds, which was 8.2 times more than their issued shares as shown in Table 6-2 (Tai, 1983: 245).

Table 6-2: Comparison table: Capital and Reserve Fund in Panasonic

	1973	**1981**
Capital	45.7 billion Yen	71.3 billion Yen
Reserve fund	400 billion Yen	831 billion Yen

(Tai, 1983:245)

Like many other shareholders at large *keiretsu* groups, Panasonic's major shareholders did not query this action (Tagaya, 2014). For example, Japanese corporations historically have had the high ratio of cash savings. This was not unusual compared with other large corporations (Suzuki, 2014). Toyota started publishing details of their retained earnings in 1991, which indicated that their reserve fund was 8 trillion Yen whereas their official capital was 5.9 trillion Yen (Oohashi, 1993: 104). Toyota has retained an exceptionally high ratio of reserve funds, resulting in their equity ratio being 70.1% in 1991 (Oohashi, 1993: 104). Toyota legally retained a part of their profit as 'provisional expense'. The Japanese government encouraged companies to hold on to funds in order to become more competitive in international markets (Endo, 1962; Tanaka, 2004). Accounting rules which allowed a high ratio of provisional allowances for various expenses and depreciation helped them to retain profits within their organisations (Ohashi, 1993;

Tanaka, 2004). Accounting rules in this period strongly reflected the intentions of the Japanese government to improve the nation's economy.

6.3.3 External Auditing in Japan

There were a series of accounting scandals during the 1960s which highlighted shortcomings in the accounting standards and the Commercial Code (Endo, 2015). Sanyo Special Steel Co. Ltd. (Sanyo), with employees of more than 3,500, went bankrupt in 1965 after 10 years of concealing more than 9 billion Yen (about 86 million US dollars) of losses but produced financial information purporting to show that the company was financially healthy (Suematsu, 2006: 39). The management allegedly inflated profit figures in their financial statements after their external CPA had officially certified the financial statements (Chiyoda, 1983). This fraudulent case was possible due to a lack of control by the external auditing company. They fabricated sales figures and recorded reduced amounts of depreciation in order to increase their profits. The Sanyo management also concealed liabilities and some fixed assets in off-balance sheets and unofficial secret statements (Suematsu, 2006: 40). This was widely condemned by the Japanese public who were infuriated and Members of the Parliament blamed the government for not preventing these accounting frauds and demanded tougher accounting regulations (Yoshimi, 1995:271). Particular prominence was given to the need to strengthen the role of external auditors to ensure that there was a more thorough and comprehensive check on all possible cases of fraud (See Table 6-3) (Chiyoda, 1983). The wider remit of external auditors has been gradually recognised since then. However, all the time that external auditors are paid by companies, the balance of power is still skewed in favour of companies (Hamada, 2008).

Table 6-3: Significant Changes in Laws and Standards related to Accounting between 1964-1981:

	The Commercial Code (Japan) / The Securities Act	**Accounting standards (Japan)**	**International Accounting standards**	**Serious Accounting scandals**
1964				San Wave Co. Ltd. scandal
1965				Sanyo Special Steel Co. Ltd. scandal
1971	Revised the Security and Exchange Law			
1973			International Accounting Standards Committee (IASC) established	
1974	Revised (Large businesses with capital of over 500 million yen are now required to be audited by CPAs or an auditing corporation.)		US Security Supervision Association	
1977		Consolidated accounting became compulsory		
1978				Fuji Sasshi scandal – inflated profits
1979				Daiko Sougo Bank scandal, Tokuyo Sougo Bank – concealed debt, Tekken Kodan – illegal accounting,
1980				Heiwa Sougo Bank – concealed debt
1981	Revised (Businesses with capital of over 500 million yen or with total liabilities of more than 20 billion yen are now categorised as large businesses)			

(Shibata, 2007:32; Oguri, 2003; 13; Oguri, 2014: 266; Murai, 2009; Yamada, 2013)

Other accounting scandals at the time included Fuji Sasshi Co. Ltd. (Fuji Sasshi) which forged its accounts with losses of about 30 billion Yen (about 264 million US dollars) (Yoshimi, 1995: 119). The president of Fuji Sasshi told one of the board of directors to fabricate accounts and the entire accounting department worked on inflating the valuation of assets and profits by using its subsidiaries for the previous 15 years (Yoshimi, 1995). Another notorious case was San Wave Co. Ltd. which had to cease trading in 1964 following the exposure of inflated profits. As a result of these high profile failures, the government felt strongly that tighter laws and strict accounting rules, such as the introduction of consolidated financial statements, needed to be introduced (Oguri, 2014; Endo, 2015). Although it was difficult to quantify the extent of cultural legacy that influenced accounting scandals, the government and other authorities such as the Japanese Institute of Certified Public Accountants were pressurised to act upon accounting frauds (Chiyoda, 1973; Kawakita, 2008).

The Japanese Institute of Certified Public Accountants wanted to strengthen their code of conduct in order to improve standards among Japanese CPAs (Chiyoda, 1973). Thus, the Institute sent their members to the US and to the UK to study Western accounting practices, which helped raise their profile and understanding of their role in Japan (Chiyoda, 1983). A revised Commercial Code of 1974, the Showa 49 nen Law No. 21, stipulated that external auditors had to be officially appointed by stockholders in an attempt to prevent them from becoming too close to their clients (Someya, 1996:27-28; Arai and Kawamura, 2010). In 1974 a company with a capital of 500 million yen or more had to have its financial statements certified

by qualified CPAs (See Table 6-3). Companies who fell into this category were defined as large companies in Japan.

Although the government tightened the regulatory structure for accounting and kept reminding CPAs to be independent and to distance themselves from their clients when auditing, it was traditionally difficult for the Japanese to criticise their seniors and clients (Boardman and Kato, 2003; Todeschini, 2011). This is not a unique problem but the extent of difficulty is even greater in Japan due to traditional business practice. This contradiction confronting CPAs when acting as external auditors was noted by several of the interviewees.

> Auditors just sign it off. And auditors themselves are saying that. They would just put the stamp without studying financial information. So, it's just a waste of time and money. External auditors are just for formality (Interview with D, 2015).
>
> It is still very hard to challenge one's boss in the company. If my boss insists something, I would follow it. I am not just talking about myself, but it is the culture in my organisation (Interview with M, 2016).

Contrary to the experience of CPA auditors, Confucian teachings are meant to encourage dignified and honest dealings. Covering for one's company or bosses did not represent obedience by the workforce but instead a manipulated interpretation of Confucianism. Although the US and UK influenced Japanese CPAs, changing business customs did not happen immediately and the Japanese GAAP continued to dominate accounting practices in Japan.

6.4 'Japan Inc.' and Moving Towards the Bubble Economy in the 1980s

6.4.1 Booming Economy and Accounting Standards

In the 1970s as Japanese business practices began to conform with new rules, further accounting scandals took place resulting in 1981 in the revision of the Commercial Code, the Showa 56 nen Law No. 14, to provide more authority to external auditors (Someya, 1996; Sato, 2010) (See Table 6-4). The revised law sought to ensure that companies enhanced their transparency by disclosing more detailed financial information and there was greater emphasis on the role of auditors providing independent, authoritative inspections of the accounts (Someya, 1996; Sato, 2010). Both internal and external auditors were instructed to conduct thorough and strict examinations of financial statements. Companies had to ensure that accounts were no longer only for internal use. The revised Commercial Code of 1981 also stipulated the accountability of board members and made large companies hire full-time internal auditors. The revised Commercial Code now required that auditors of a corporation were to be appointed at the shareholders' meeting instead of by the board members, which was to ensure more transparency and independence (Chiyoda, 1983).

Table 6-4 Significant Changes in Laws and Standards related to Accounting between 1981-1989:

	The Commercial Code (Japan) / The Securities Act	Accounting standards (Japan)	International Accounting standards	Historic Events
1981	Revised and tougher accountability to be required by corporations (Businesses with capital of over 500 million yen or with total liabilities of more than 20 billion yen are now categorised as large businesses)			
1982		Revised: rules for provisional depreciation were introduced		
1983			IASC*, IAFC** agreement; IOSCO*** established	
1984				Riccar went bankrupt due to serious accounting scandal
1985				Plaza Accord; high appreciation of Yen started
1986-1991				Bubble Economy
1989-1990				US demanded deregulation of foreign investment in Japan :Structural Impediments Initiative (SII)

(Yoshimi, 1995;Someya, 1996; Kawakita, 2008; Shibata, 2007:32; Oguri, 2003; 13; Oguri, 2014: 266; Murai, 2009; Yamada, 2013) *IASC: International Accounting Standards Committee; ** IAFC: International Federation of Accountants; *** IOSCO: International Organization of Securities Commissions

The revised Commercial Code of 1981 also specified the format of financial reporting and enforced the certification of accounts by CPAs (Kawakita, 2008) (See

Table 6-4). Before this new law was enacted the format of financial statements had been freely decided by each company, thereby confusing potential investors by making it difficult to compare information. If a company wanted to revise their method of reporting the balance sheet or profit and loss statement they now had to justify their changes in writing and have them approved by external CPAs (Kawakita, 2008). The new law only allowed a reserve fund for designated purposes and it had to be used for losses and expenses during one financial year (Kawakita, 2008). The reserve fund has to be categorised as an asset instead of a liability (Kawakita, 2008). The original intention was to prevent companies from retaining excess profits without distributing them to shareholders.

The Japanese GAAP were modified in line with the Commercial Code and other relevant laws such as the Security Law and Company Tax Law to prevent any confusion or manipulation (Kubota, 2000a; Nishido, 2004; Oguri, 2003). The Japanese GAAP principles and Commercial Code became more compatible in 1981 in order to avoid confusion among practitioners (Kubota, 2000a). These constant changes are influenced by the economic intentions of the government, thereby confirming that accounting plays a significant role in society (Endo, 2015).

6.4.2 Japan Inc. and Bubble Economy

Although the Japanese GAAP were originally established based upon US accounting standards, they had a number of differences compared to the American model GAAP (Nishido, 2004). From the late 1970s the US government became concerned about the high level of imports from Japan and criticised the Japanese GAAP and the business practice for discouraging competition (Tanaka, 2008; Tagaya, 2015). Increasingly, as Japanese corporations sought to be more attractive to foreign

investors, Japanese corporations were criticised by foreign investors, predominantly from the US, for their low profitability and dividends in comparison with American companies (Oguri, 2003; 2014; Kikkawa, 2007). For example, the average return on equity (ROE) for large corporations in the US in 1988 was 19.1% whereas the ROE for large corporations in Japan was 7.9% (Yamada, 1996: 7).

The US in the 1980s and 1990s during the negotiations with Japan argued that the dividend yield by Japanese corporations must be improved. The average dividend yield between 1975 and 1989 in the US and Japan was 4.6 % and 1.6% respectively (Morgan Stanley Capital International Perspectives in Choi, 1995: 348). Japanese GAAP allowed high depreciation charges called 'special depreciation' of 50% that enabled corporations to retain high levels of reserves, a practice which became the business norm (Hiki, 1996; Tagaya, 2014). However, with the increase in the number of foreign investors since 2000 after deregulation, Japanese corporations made efforts to increase key ratios such as return on assets (ROA) and ROE to satisfy investor demands (Shibata, 2009). For example, on average dividends paid by large Japanese corporations increased 3.3 times from 2001 to 2007, whereas they reduced the average wages of employees by 20% (Shibata, 2009:72). This clearly showed how the influence of foreign investors changed the management and finances of Japanese corporations (Shibata, 2009).

The US's influence over Japan led to the Japanese government gradually accepting their demand to alleviate the trade conflict by deregulating restrictions and modifying accounting standards. Further changes in the exchange rate stipulated by the historical Plaza Accord, the agreement between five developed countries (the US,

the UK, West Germany, France and Japan) on the revised exchange rate of Japanese Yen against US dollar in 1985, significantly increased the value of the Japanese Yen by between 40-50% (Ito, 2002). The higher Japanese Yen had a detrimental effect on most export industries such as steel and ship-building (Ito, 2002; Kikkawa, 2007) but also the Japanese Yen suddenly gained extreme buying power in the overseas markets (Jansen, 2000; Oguri, 2014).

The Japanese government reduced interest rates and invested in a number of public projects to enhance the economy, which initially worked but soon led to the Bubble Economy starting in 1986 (Kikkawa, 2007). During the Bubble Economy (1986-1991) Japanese industries started direct foreign investments and set up factories in the US and European countries instead of investing at home (Kikkawa, 2007: 318). A large number of Japanese corporations bought financial products, shares and property, even though their main business had little to do with financial investment or property management (Shibata, 2007). Property and overseas investments became extremely popular with the low cost of borrowing and high capital return (Kawakita, 2008). Banks had excess funds and encouraged their clients to borrow money to invest further. Interviewee G remembered that:

> It was a crazy time. I was invited to the executive reception room at the top of a skyscraper in Shinjuku by a bank manager who encouraged my company to invest in properties. They were desperate to lend billions of Yen to any potential clients. I know a few managing directors who borrowed money from banks and bought properties. Unfortunately, they went bankrupt soon after the Bubble Economy crashed in the 1990s (Interview with G, 2017).

A great number of Japanese corporations, including Olympus, bought a significant number of investment products such as shares and properties (Abe et al, 2012), which was also confirmed by the account below.

> It was the norm for many Japanese corporations to purchase financial products or properties during the Bubble Economy and there were many invitations by major banks to do so. However, our company was very cautious in investing something which we had never done. We did not purchase them and, therefore, we had no failed investment from the Bubble Economy and there was no need to conceal anything in our accounts like Olympus. However, I know many companies that went bankrupt or seriously into debt after the burst of the Bubble Economy (Interview with V, 2017).

After experiencing the economic boom in the Bubble Economy, the Japanese government felt it necessary to slow down the Bubble Economy. However, the government's actions to strictly regulate excess lending in the early 1990s caused a prolonged depression called the 'lost decades' in Japan (Kikkawa, 2007). As Japanese accounting standards at the time were not designed for protecting individual shareholders, the transparency of company accounts was not yet strongly emphasised (Okazaki, 1996) (See Table 6-5). Owing to the increased volume of international business, the need for international accounting standards had been gradually identified by scholars and accountants in Western countries, which led to Internationally Agreed Standards (IAS) and International Financial Reporting Standards (IFRS) in the 2000s (Oguri, 2003).

6.4.3 Structural Impediments Initiative and Accounting Reform

When the US suffered from an excessive trade deficit of about 122 US billion dollars in 1985, while Japan achieved a trade surplus of 56 US billion dollars, the US government was determined to reverse the situation (Kikkawa, 2007: 303). The

negotiations with the US continued to take place over 15 years in the 1980s and 1990s, during which accounting standards received considerable focus (Tanaka, 2004: 111). Most importantly, the Structural Impediments Initiative (SII) took place between 1989 and 1992 in Japan and the US (Yonekura, Gallhoferb, and Haslam, 2012). Before SII meetings were established, the US government issued a number of official request documents to the Japanese government to demand deregulation, administrative reform and the enhancement of market competition (US Government, 1996). The documents covered a wide variety of areas including agriculture, the automotive industry, distribution systems, import administration, financial services, energy production and distribution, housing construction, insurance, legal systems, medical services, telecommunications, transportation and, significantly, accounting methods (US Government, 1996). This was a comprehensive list and the Japanese government agreed to consider how to improve these areas based upon US demands (Ito, 2002). Indeed, SII initiated the transformation of Japanese business customs in a number of ways, including accounting practices in Japan (SII, 1990a) (See Table 6-5).

Table 6-5 Significant Changes in Laws and Standards related to Accounting between 1985 and 2000

	The Commercial Code (Japan) / The Securities Act	Accounting standards (Japan)	International Accounting standards	Historic Events
1985				Plaza Accord; high appreciation of Yen started
1986				Bubble Economy – 1991
1989				US demanded deregulation of foreign investment in Japan (SII) - 1990
1991				End of Bubble Economy
1993	Simplified administration for the suing of a company by shareholders; Strengthened audit function			
1997	Stock option is allowed for all corporations	Market value can be used for valuing assets.		
1999	Forming a holding company is allowed.	Cash flow statement must be issued.	Core standard established	
2000	Consolidated financial statements enforced			

(Shibata, 2007:32; Oguri, 2003; 13; Oguri, 2014: 266; Murai, 2009)

Strong pressure from the US made Japan change traditional business practices such as *keiretsu* grouping, complicated distribution systems and bureaucratic investment rules (SII, 1990a; SII, 1990b; SII, 1990c). The argument raised by the US government on accounting standards was that Japanese corporations lacked transparency in disclosing financial and other management information (SII, 1990a). The US insisted that the Japanese GAAP should be reformed dramatically in order to make the Japanese market more free, fair and global (Tagaya, 2015). This meant

that rules and practices that may have been disadvantageous for the Japanese industries would have to be accepted, especially when the Japanese government was unable to persuade the US to drop their demands. This was because Japan continued to be under the significant influence of the US (Jansen, 2000). Ongoing enormous trade deficits with the US directed the US persistently to demand that Japan should further remove trade restrictions and revise accounting standards (SII, 1990a). The improvement of consolidated financial statements and the disclosure of financial information were key issues pressed in SII meetings (SII, 1990c). During the negotiations, Japanese officials tried to incorporate their economic objectives but in the end the US had more power to revise a number of business practices.

> I was a member of SII negotiation meetings and I can tell you that it was a very interesting experience. When we (the US) demanded numerical targets, the Japanese government never said no but, instead, they always came up with a solution which met our target. However, their proposed solution in the end was tactfully modified and was slightly more favourable to them. They always managed to find some room to manipulate, and yet, the Japanese government was very polite and tried their best to please us (Interview with BB, 2017).

The above account indicates that the Japanese government treated the US as a strong authority and ensured that their proposal would not distress the US officials. When the US demanded the reform of accounting rules, Japan agreed to revise the Japanese GAAP in the near future (Tanaka, 2004: 111). The demands from SII influentially promoted the modification of accounting standards in Japan at the beginning of the 2000s (Tagaya, 2015).

New accounting standards after the 2000s forced corporations to disclose financial information which until then they were able to conceal legitimately or even illegally

(See Table 6-5). During this period serious accounting scandals were exposed one after another by the need for more accurate information required by the new accounting standards (Hamada, 2008; Endo, 2015). The result was that the SII negotiations gradually transformed the mindset of the Japanese. Returns on equity became explicitly more important for companies and shareholders after the 2000s (Koga, 2009). Before SII negotiations, dividends were set at a relatively conservative level and Japanese shareholders did not complain about it. Traditionally, reflecting Confucian teachings, it was also considered embarrassing and shameful in Japan to seek short-term financial returns (Ishida, 1739, edited by Adachi, 1935).

6.5 Accounting Scandals from the 1990s and early 2000s

6.5.1 Yamaichi and Kanebo and their Auditors

Within a few years of the collapse of the Bubble Economy a number of large financial institutions went into bankruptcy because of financial losses from past investments (Someya, 1996; Hamada, 2008). Bad debts forced Japanese banks to merge and several medium-sized banks had to close down their operations, which was previously unthinkable because the government had always protected banks (Kikkawa, 2007). A number of financial institutions were also exposed to financial crises and accounting scandals. The Yamaichi Security, a well-established security company, ceased its long-serving business due to the lack of capital resulting from the concealment of large losses following the collapse of the Bubble Economy (Tezuka, 2015:1372). The Yamaichi sales agents had been allowed to guarantee investment returns to their clients, which seemed to work well during the Bubble Economy, but their endorsements finally could not be sustained by 1997 (Tezuka,

2015). Yamaichi had subsidised financial losses from clients' investments, hoping that the financial market would recover. Compensation for clients accumulated over a number of years which led to a further manipulation of their accounts.

Yamaichi's accumulated losses of more than 2.2 billion US dollars were not publicly disclosed for more than five years by the board members or their external auditors (Tezuka, 2015: 1372). Yamaichi's traditional business and accounting practices were not sustainable after their losses and debts were exposed after their constant concealment in different subsidiaries' accounts. Furthermore, senior managers at Yamaichi sensed Japanese society as a whole did not want to accept Yamaichi's negative financial results because Yamaichi was a prestigious company (Hamada, 2008). Japanese society had implicit power to underestimate the extent of Yamaichi's deceptive accounting practices, which became a norm for Yamaichi (Skinner and Srinivasan, 2012), and government officials did not force Yamaichi to reveal serious financial problems. The then chief chairperson of the Security Department of the Ministry of Treasury continued to deny the negative impact of Yamaichi until Yamaichi voluntarily ceased the business in 1997 (Tanaka, 1999: 150). The internalised norm of protecting Yamaichi's reputation had worked fatally for the survival of the company and the president of Yamaichi publicly apologised in tears during the announcement of the closure (Ikeo, 2009: 95). Confucian-led traditional values were misused, creating the illusion that made these companies and their employees believe their conducts were acceptable by helping inner circle members.

Kanebo, once a prestigious textile and cosmetic company in Japan, had long abused the old accounting standards for consolidated financial statements. The company

had falsified their accounts for over twenty years using their subsidiaries' accounts and inflating their sales profits (Hamada, 2008). This was one of the worst accounting scandals in the 2000s, with losses of more than 1.7 billion US dollars intentionally concealed by Kanebo's senior managers (Shibata, 2007:158). Sakura Bank, Kanebo's *main bank* and their largest creditor, had assisted Kanebo to falsify their accounting records and financial statements (Hamada, 2008: 13). It was common that employees of *main banks* were transferred to their allied companies to work and help their accounting departments (Interview with B, 2015). A group of staff from Sakura Bank instructed Kanebo to fabricate their accounts because the bank would lose their credit if Kanebo went bankrupt (Kameoka, 2011). They wanted Kanebo to continue their operations as if there was no financial problem.

Kanebo and Sakura Bank were members of the same inner circle and, therefore, they were supposed to 'assist' each other. The Japanese government was also very protective towards banks and their major clients, especially before the SII agreement (Morishima, 2004; Kittaka, 2007). Kanebo started the illegal accounting operation in the 1990s by concealing their unsold stock of goods and falsifying their sales through the accounts of their subsidiaries and clients (Shibata, 2007: 159). The then president was hoping the company would recover its commercial strength one day (Hamada, 2008:9). Unfortunately, Kanebo never regained its market strength and they were declared bankrupt in 2007 (Kameoka, 2011). Concealing excess stock through various accounting 'loopholes', such as in subsidiaries' accounts, was evident in many other textile companies before the enforcement of the new accounting rule on consolidated financial statements in 2000 in Japan (Hamada, 2008). Subsidiaries and clients were also considered to be lower-ranked members

of their inner circle group and they were expected to assist in the fraudulent accounting operation.

The management of Kanebo believed that the act of accounting fraud would protect the future of the company (Hamada, 2008). It was common for the management and employees of large established Japanese corporations to have great pride in their company and to maintain an emotional attachment to their company (Morishima, 1982). This emotional attachment to one's company was often heard during interviews for this research.

> Well, in Japan, employees are proud of their work as they feel strongly about their job and company … I am one of them. Because we work long hours and we feel that the workplace is our second home…Employees have strong feelings towards their company (Interview with L, 2016).
>
> Oh, my boss from Japan was really nice to me and sometimes he acted like my father. This kind of close relationship is very unique in England. I think it only happens in a Japanese organisation (Interview with A, 2015).

The management of Kanebo prioritised their employees as pseudo-family members, rather than their investors' benefits. Employees may not have received direct instructions to manipulate accounting records or financial statements but, instead, they did this voluntarily. Their superiors considered the act of falsifying financial statements a positive effort in order to protect the reputation of the company.

> When I was working for that company, I never thought about its investors. If I had been one of their investors, a completely different perspective would have been taken. When I was working there, I would have done anything as long as it was legal. They were proud of themselves and they felt they were as good as investors (Interview with R, 2016).

Interviewee R admitted that employees in R's company, a prominent listed corporation, did not give much consideration to their shareholders. The employees saw themselves as the main driving force behind the company. Therefore, shareholders came second and board members did not appear to feel guilty about manipulating financial statements in order to protect their employees' job security and the company.

6.5.2 External Auditors and Scandals

It was evident that external auditors failed to effectively fulfil their role in the cases of Yamaichi and Kanebo. External auditors who certified Yamaichi and Kanebo's accounts were from one of the prominent Japanese auditing companies, ChuoAoyama which had partnerships with PricewaterhouseCoopers (PwC), one of *the Big Four* auditing companies and one of the most prestigious auditing companies in Japan (Shibata, 2007: 79). However, ChuoAoyama would not rectify the fraudulent accounts of Yamaichi and Kanebo (Shibata, 2007: 112; Skinner and Srinivasan, 2012). ChuoAoyama's other clients, Ashikaga Bank, Yaohan and Nikko Cordial were also accused of falsifying their accounts in the late 1990s and early 2000s (Skinner and Srinivasan, 2012). Most significantly, ChuoAoyama was alleged to have directly assisted Kanebo's fraudulent accounting operations for over 10 years, which resulted in a criminal investigation and the arrest of three CPAs in ChuoAoyama (Shibata, 2007: 81; Hamada, 2008:2). This was partially because

these auditors were part of their client's inner circle and, therefore, they did not want to criticise the members of the same inner circle. One of ChuoAoyama's auditors who was in charge of Kanebo for over thirty years was certainly a part of their inner circle, allowing him and his colleagues to help Kanebo to conceal accumulated losses (Shibata, 2007:112). The failure of auditors resulted from mutual expectations on the both sides: auditors and their clients. The expectation of reciprocity and the strength of hierarchical relationships on both sides were considered to have influenced auditing practices (Hamada, 2008).

One interviewee who was an ex-senior member of a large Japanese bank raised the question of why external directors and auditors had not functioned in Japanese corporations that had experienced accounting scandals. He expressed the view that external auditing was a mere formality. He claimed that no one in Japan thinks auditors are necessarily critical in their judgements.

> Auditors weren't questioned right? So many people criticised the company, but nobody criticised their auditors, right? Because they know they are just a rubber stamp. You know, that's strange. What were the external directors and what were the auditors doing? (Interview with D, 2015).

The relationship between auditors and their clients in Japan is partly influenced by Confucian teachings which advocate a 'master-servant' or 'senior-junior' relationship in society (Takenaka, 1998: 272; Shibata, 2007:111). A number of interviewees strongly suggested that the external auditing system needed drastic changes.

> If auditors have a long-term relationship with particular companies, they may not raise questions sometimes. It may be difficult for them to not to authorise their clients' accounts or to reject their proposals because we Japanese read minds and intend to keep the relationship longer. Even if there is something wrong in the accounting books, they may intentionally ignore it and pass the audit. So, my suggestion is to separate auditors from companies and make auditors real outsiders (Interview with M, 2016).

ChuoAoyama were in a lower position in the business hierarchy than their clients when carrying out the audit for their clients. As a result of their failure to carry out exacting audits, the Financial Services Agency (FSA) in Japan banned ChuoAoyama's operations for two months in May 2006, which was an unthinkable disgrace for an established auditing company in Japan (FSA, 2006; Hamada, 2008: 4). The problems associated with the auditing system in Japan had been pointed out by many practitioners and researchers for decades, as confirmed by Interviewee P (Shibata, 2007).

> The government must carry out a dramatic change in the auditing system. The current system has so many weaknesses and it is so easy for companies to manipulate accounting records. The auditing company is hired by a company, their client. This implies the auditing company would naturally want to please their client and they want to certify the financial report of their client without conflict (Interview with P, 2016).

Prior to suspension of their operations in 2006, ChuoAoyama had chosen to ignore the concealed losses of Kanebo rather than give advice on their clients' financial weaknesses, and on several other clients. This reflects the influence of Confucianism that forbids criticising one's senior (Imanaka, 1965; Ishida, 1975; Tu, 2000). Their clients' had more power and it was considered to be positive conduct for ChuoAoyama to be obedient (Shibata, 2007:111). Confucianism supports the

hierarchy of society and one is supposed to be subordinate to one's business clients and, therefore, not in a position to challenge their practices.

ChuoAoyama assisted their clients' illegal transactions by signing off their audit certificates over a number of years partly because they were inner circle members of their clients and respected the hierarchical relationship (Hamada, 2008). Although the ChuoAoyama's case was an extreme example, there were a number of other cases that were exposed where auditors had failed to prevent fraudulent accounting (Shibata, 2007; Hamada, 2008). External auditors involved in accounting scandals could have been more detached from their clients. External auditors could have taken a stronger role in advising their clients even when they were expected to adhere to blind obedience which was implied by Confucian teachings. Confucian teachings of filial piety and harmonious relationships in a community were adversely used. They concealed accounting information as a consequence of poor business decisions.

6.6 Conclusion

Confucian-led values have continued to be practised in post-war Japan, which was vital in rebuilding the country from the devastation of the Pacific War. Traditional social norms subtly shaped Japanese business and accounting practice by influencing social hierarchy and perspectives throughout the 20th century. Confucian teachings of self-cultivation and self-regulation indirectly helped the Japanese to achieve outstanding economic success between the late 1970s and the 1980s (Morishima, 1982). The Japanese business customs, such as the *keiretsu* group and the *main bank* systems, reflected accounting standards to assist the establishment of 'Japan Inc.'. Cooperative relationships between the government, industries and workers

helped the Japanese economy to grow much faster than the rate which was originally anticipated by the US (Kazusa, 2016). An ethos of strong team work and loyalty towards one's company helped the Japanese build a highly developed nation as Japan Inc. (Morishima, 2004). However, the negative side of Confucianism led to serious accounting scandals in the 1990s and early 2000s such as Kanebo.

Japan had to revise their accounting standards when they faced strong pressure from the US especially after SII negotiations. The Japanese GAAP faced criticism from the US during the SII negotiations because the Japanese GAAP legitimately allowed corporations to retain more profits and left their investors with lower dividends. The old accounting standards and laws allegedly allowed Japanese companies to conceal deficits in subsidiaries. When major investors were all from inner circles such as *keiretsu* group companies and their *main banks*, they were supposed to help each other and to attain 'collective benefits' (Morishima, 2004). In addition to pressure from the US, a number of accounting fraud cases forced the government to revise laws and accounting standards (Oguri, 2014). Businesses became more globalised and the need for internationally agreed accounting standards increased (Endo, 2015). The traditional Japanese ways of managing accounts and auditing became unsustainable, especially when internationalisation of accounting standards became more prevalent in Japan (Endo, 2015). However, many companies had little intention to change their attitude towards accounting and accountability practices (Shibata, 2007: 110). This became especially obvious with the Olympus scandal.

Chapter 7

Revised Accounting Standards and Recent Accounting Scandals in Japan

7.1. Introduction

The US has been Japan's major trading partner and political ally since the end of the Pacific War and, therefore, the Japanese government has always taken the concerns of the US government very seriously. The US has continued to have a strong influence on Japanese accounting, which was more evident when a trade conflict broke out in the early 1980s (Kikkawa, 2007). The greatly increased trade deficits of the US since the late 1970s saw the US continue to pressure the Japanese government to deregulate various business practices and to further emulate Americanised accounting rules (Tanaka, 2010). US officials argued that the then Japanese GAAP and the Commercial Codes allowed Japanese companies to accumulate excess wealth before compensating their shareholders (SIIa, 1990). The US was against traditional Japanese business practices such as *keiretsu* groups and life-long employment which promoted a protective business culture that allowed firms almost unlimited control over their own activities (Kikkawa, 2007).

The existing Japanese accounting standards were no longer sufficient enough to meet international expectations and, thus, they had to be changed to meet the expectations of influential states and organisations, most especially the US and the EU (Oguri, 2014). During the continued negotiations with the US, the Japanese government agreed to revise fundamental business practices and laws,

including accounting standards (SIIa, 1990). The US had a domineering economic and political power in the global community and, thus, it was imperative for the Japanese government to adopt their approved accounting standards (Tanaka, 2000). Accordingly, the Japanese government stipulated significant changes in the Japanese GAAP in the early 2000s after a series of discussions with the US in the SII negotiations and subsequent meetings. In addition to pressure from the US, Japan was beginning to be exposed to fierce global competition and was forced to adopt internationally accepted accounting standards in the late 1990s and 2000s (Tanaka, 2010). Accordingly, Japan has revised their accounting rules and relevant commercial laws throughout the 2000s in order to close gaps between the internationally accepted accounting standards and the Japanese GAAP.

In the Meiji era, Westernised accounting standards provided the knowledge which would guide Japan to maintain its commercial integrity and to make Western countries be aware that Japan is a sophisticated nation, an equal trading partner (Chiba, 1998; Foucault, 2007). The Japanese GAAP, although based upon the American GAAP, were developed to meet traditional Japanese business practices and customs to help Japanese corporations to achieve high turnover and greater profits in the 1970s and 1980s. Based upon suggestions from the US, financing from foreign investors had to be rapidly deregulated in Japan and the importance of the standardisation of accounting standards has become increasingly emphasised among shareholders. To protect foreign investors the US urged Japan to improve transparency in its financial statements and to deregulate commercial laws and business customs so that foreign

investors would be better able to invest in Japan (SIIa, 1990). Corporate transparency is the degree to which corporate decisions, policies, activities, and impacts are acknowledged and made visible to relevant stakeholders (Crane and Matten, 2010: 77). Despite the recognised importance of this, transparency has never been a significant component of business practice in Japan where financial information was historically only available to the master of a merchant house (Hayashi, 1983: Ogura, 1962). This chapter, through organisational examples and interviews, examines how accounting is practised in contemporary Japan. The chapter also further confirms how power and knowledge dependent upon Confucian teachings reflect each other in accounting and accountability practices using the example of the Olympus accounting scandal.

7.2 Internationally Agreed Accounting Standards and their Implications for the Japanese GAAP

7.2.1 Accounting Regulations and Globalisation of Businesses

Discussions on international accounting standards started among several countries including the US, Australia, Canada and Japan in the early 1970s. The establishment of the International Accounting Standards Committee (IASC) in 1973 and the International Organization of Securities Commissions (IOSCO) in 1983 raised awareness of the significance of internationally agreed accounting standards (IOSCO webpage, 2016). The International Accounting Standards (IAS) were then established by the IASC in 1999. Internationally agreed accounting standards gained more recognition in the 2000s and the IASC was later renamed the International Accounting Standards Board (IASB). It created a new accounting framework called International Financial Reporting

Standards (IFRS) (Oguri, 2003; 2014). Before the establishment of IAS and IFRS, the US GAAP were considered to be the most influential accounting standards for Japanese corporations that sought to trade internationally (Oguri, 2014). The US GAAP were required when a company wanted to list on the US stock market and Japanese companies who wanted to open subsidiaries in the US were always expected to comply with them. The US gradually agreed to work with the IASB in order to develop international accounting principles for the first time in 2002 (Norwalk Memo, 2002).

Poor economic growth in the 1990s and early 2000s made the Japanese restructure their traditional business practices and part of their accounting standards, though it required a significant time to implement these changes (Kikkawa, 2007). For example, it took nearly three decades for the majority of Japanese companies to reduce the proportion of capital raised by borrowing from banks but still the ratio is significantly higher when compared with the Americans (Kawai, 1983; Oguri, 2014). A recent report compiled by the Bank of Japan (BOJ) indicates that 22.6% of capital in non-finance industries came from banks whereas it was 6.1% in their American counterparts in 2018 (BoJ, 2018:2). Although the proportion of financing from the stock market has risen in the 21st century, borrowing from banks is still the main source of funding in Japan due to the traditional *main bank* system.

In the early 2000s a number of reforms to Japanese accounting standards were made in order to disclose more accurate financial information to the international market (Oguri, 2014). The Japanese government and Japanese CPAs gradually accepted that internationalisation of accounting standards had

to be adopted in Japan (Tanaka, 2010). Japanese CPAs were convinced that the adoption of internationally agreed accounting standards which reflected the dominant political and economic powers would be a way to survive in the global market (Oguri, 2003). Thus, the Japanese government required CPAs to educate themselves to internationalise the accounting standards in Japan (Tanaka, 2010; Oguri, 2003). This led to the Accounting Standards Board of Japan (ASBJ) being established in 2001 in order to review and establish new accounting standards to meet international demands (Oguri, 2014). The new association was headed by prominent CPAs and accounting researchers to ensure that accounting standards were studied and implemented by practitioners. When the IFRS framework was established in 2001, the accountants of large corporations in Japan were beginning to realise that eventually they would have to comply with the IFRS in the future (Sawani, 2009).

The consensus for adopting the IFRS, called the 'Norwalk agreement', the agreement between the Financial Accounting Standard Board (FASB), IASB and the US in 2002, was aimed at creating internationally agreed accounting standards (Oguri, 2003; 2014). The Norwalk agreement encouraged the Japanese government to adopt the IFRS (Sawani, 2009; Oguri, 2003). Japan became keen to adopt the IFRS only after the US decided to adopt them. At first the US was going to revise only areas of its accounting practices which had great discrepancies with their GAAP, rather than fully adopting the IFRS (Hashimoto and Yamada, 2009). However, the US believed that the EU would make the IFRS compulsory in the mid-2000s and therefore they needed to adopt them (Oguri, 2003). Japan realised that the global influence and power of the

US and the EU over economic and political policies would soon require them to adopt international accounting standards (Oguri, 2014). Table 7-1 summarises the main changes in the Japanese commercial and accounting rules since 2000.

Table 7-1 Significant Internationalisation of Accounting Rules since 2000

	The Commercial Code (Japan) / The Securities Act	Accounting standards (Japan)	International Accounting standards	Historic Events
2000		Consolidated financial statement, cash flow statement: compulsory Abolition of the pooling-of-interests method		
2001		Market value to be used for evaluation, Interim financial statements to be issued. Accounting Standards Board of Japan (ASBJ) established	IASC* renamed IASB** and issued International Financial statements Standards (IFRS)	
2002			USA: Sarbanes-Oxley Act (SOX) of 2002	Norwalk agreement between IASB and FASB***
2004		Accounting rule for impaired assets introduced (Genson Kaikei)		Convergence agreement between IASB and ASBJ***
2005	Commercial Code to be revised			EU to adopt IFRS
2006	Company Code; Financial Product Transaction Law; Japanese SOX Law enacted	Impaired assets must be now evaluated using the Genson Kaikei rule.		
2007				Tokyo agreement between IASB and ASBJ
2009				USA and Japan agreed to adopt IFRS gradually in the future.
2016				Planned IFRS adoption: not yet compulsory in Japan nor in the US.

*IASC: International Accounting Standards Committee
** IASB: International Accounting Standards Board
*** FASB: Financial Accounting Standards Board
(Shibata, 2007:32; Oguri, 2003; 13; Oguri, 2014: 266; Murai, 2009)

7.2.2 IFRS and its Implications for Japanese Business Organisations

The promotion of financial transparency, which is highly emphasised in the IFRS, has not been fully accepted by Japanese corporations many of whom still believe that companies must keep some information from the general public and their competitors (Suzuki, 2012). Suzuki's (2012) extensive research on how Japanese managers perceived the IFRS found that listed Japanese corporations were not prepared for the adoption of the IFRS (Tanaka, 2010; Suzuki, 2012; Oguri, 2014). Suzuki investigated how the IFRS was perceived by Chief Financial Officers (CFOs) in large Japanese corporations through a series of interviews and surveys in the early 2010s. He found that a number of CFOs and senior accounting managers expressed serious concern about the introduction of IFRS and its implications for their organisations (Suzuki, 2012). They believed that too much transparency could force the company to lose focus on long-term growth. One of the interviewees from his report claimed that the full disclosure of financial information may not be beneficial for his company because recent investors tend to seek only short-term returns (Suzuki, 2012). This hesitation was also confirmed during the interviews for this research.

> The historical background of Japanese accounting is completely different to the Western countries and the IFRS approach is totally different from the traditional Japanese GAAP which were rule-based and more prescribed. IFRS made companies think how they should apply the IFRS principles in their actual accounting. It is more complicated and not straightforward for many companies. This is why there are now so many IFRS textbooks being published in Japan (Interview with I, 2015).

Suzuki's findings demonstrate the shift of power from a limited number of shareholders from the *keiretsu* group or the *main bank* to third-party shareholders.

Accountants and accounting researchers in Japan have claimed that importing Western accounting and accountability needed adjustment and constant review (Tanaka, 2010). Accounting standards of a country are developed based upon the business practices and customs of a country and, thus, the introduction of the IFRS in Japan required a substantial time to change practices as required by the IFRS. Research findings confirm the difficulty of altering accounting standards in large corporations throughout Japanese business history when the maximisation of shareholder value had been not always the prime goal for the majority of Japanese corporations (Morishima, 2004). The maximisation of group benefit and the longevity of companies had been prioritised in the past and shareholders did not complain about the lower rate of dividends (Crane and Matten, 2010). The Japanese government and corporations selectively adopted Confucian teachings where collective happiness and harmonisation are emphasised in order to accumulate wealth within organisations for reinvestment (Yoshida, 2002; Morishima, 2004). However, traditional business practices in Japan now needed to comply with the US and EU standards in order for Japan to be a member of the global business society (Tanaka, 2010). This requires drastic changes in the perception and practices of business people in Japan. The Japanese were beginning to be made aware that accounting records were no longer a private topic among inner circle members but, instead, they had to be accepted and understood by international investors (Oguri, 2003; 2014).

Although the Japanese government told listed companies to adopt the IFRS by 2015 this later became optional and the date of compulsory adoption was delayed (Oguri, 2014; Suzuki, 2012; Yamaji, 2012). Even though the Japanese

government officially agreed to adopt the IFRS, the majority of listed corporations in Japan expressed serious concern in adopting them and requested more preparation time. In 2016 only 86 companies had adopted the IFRS framework out of 3531 listed companies on the Tokyo Stock Exchange and an additional 31 companies are intending to use the IFRS framework in the near future (Japan Stock Exchange (JPX), 2016). The full implementation of the IFRS is considered to require a few more years, partly because drastic cultural change is required in some cases (Suzuki, 2012; Oguri, 2016).

> Accounting standards are getting more and more complicated. Let's say, about ten years ago, you would have read ten books on accounting rules in Japan, which was sufficient when completing company accounts. Now, you would have to read more than three times that amount of rule books in order to comply with the IFRS. This means accounting has become more complicated and only specialists are able to deal with company accounts (Interview with H, 2015).

The Japanese government never tried to convince the US and EU to follow the Japanese GAAP as international standards but, instead, they accepted the adoption of the IFRS because of the international power of the US and EU. In contemporary Japan the adoption of the IFRS is now believed to promote financial stability and is accepted in global business society despite their slow dissemination (Foucault, 2009; Hashimoto and Yamada, 2009).

Like the double entry bookkeeping methods at the beginning of the Meiji era, complying with the internationally agreed accounting principles such as IFRS was regarded by many CPAs and scholars in Japan as a key to membership of the global business society in the 21st century (Oguri, 2012). The government, most CPAs and accounting researchers in Japan were beginning to internalise

the norm which reflected the intentions of the US (Tanaka, 2010). The adoption of the IFRS has become a norm for the Japanese which makes it possible for Japan to maintain its economic status within the global market (Foucault, 2009; Tanaka, 2010). Accounting information is no longer shared among a select group of members within a company but, instead, it can be publicly and internationally scrutinised. Some of the existing Japanese GAAP have similarities with the IAS but others had to be radically changed from the early 2000s.

Examples of revised rules include the introduction of a consolidated financial statement and a cash flow statement (Hirai and Ishizu, 2013). The Accounting Standards Board of Japan (ASBJ) had to propose further changes in relevant laws and Japanese accounting standards by monitoring current practices and examining case studies from abroad. The rate of internationalisation of accounting standards was accelerated and Japanese industries were not allowed to resist these reforms. These accounting reforms are particularly referred to as the *Accounting Big Bang* in Japan in the early 2000s (Oguri, 2014). Business people were made aware that they had to change their mind-set and accounting practices. However, prevailing power relationships within corporations sometimes forced accountants to ignore the new rules, which resulted in serious accounting scandals.

7.2.3 *Accounting Big Bang* and Transformation of Accounting Standards in Japan

Japanese corporations were now facing an increasing demand for disclosure after the *Accounting Big Bang* in 2000 (Oguri, 2003). The IAS and later IFRS

demanded more accurate financial information from corporations than the Japanese GAAP previously did. For example, IAS 16 requires detailed disclosure of non-current assets, whereas the Japanese GAAP did not require the same level of disclosure (Thomas and Ward, 2009; Koga, 2009). Thus, in 2001, Japanese accounting standards were revised to reflect IAS. *Jika Kaikei*, the market rate accounting rule, became compulsory in Japan (Hamada, 2008). The use of the market rate accounting rule resulted in major concerns for financial statements in Japan by creating discrepancies between the statement of profit and loss and the balance sheet because the market value of an asset is often different from the book value. When valuing a certain type of asset, including strategically held shares (*mochiai kabu)* of one's group companies, the market value is now used instead of the book value (Hamada, 2008). The value of an asset in an organisation could fluctuate when using the market rate accounting rule, which in the past had been considered irrelevant information to investors in Japan because it was not for sale and therefore, had no market value (Tanaka, 2010). Additionally, companies were able to conceal the current financial status of a corporation by using the book value (Tanaka, 2010). Now, the new Japanese GAAP, influenced by IAS rules, have directly affected the survival of Japanese companies.

Before the new rules were enacted the estimates of the future value of a company and unlisted shares were often overvalued in order to make accounts look healthy (Tanaka, 2010). Thus, future value was easily manipulated, especially when a company was not listed and the value of the company could be speculated (Oguri, 2014). The market value accounting rule was not very

important for shareholders to allow them to value the company when major shareholders were members of the inner circle before 2000 (Hashimoto and Yamada, 2009). However, the US kept demanding that Japanese GAAP must adopt the market value method in order to help investors to make better business decisions. In addition to the SII agreement, the Japanese government also felt it necessary for companies to recover from the burst of the Bubble Economy by disclosing their financial losses using the market value rather than historical book values (Tanaka, 2000).

The adoption of IAS made the Japanese use the 'fair value' for valuing assets. For example, Japanese accounting standards only allowed the book value and depreciation when purchasing a tangible non-current asset, whereas IAS permits the use of fair value and depreciation. The definition of 'fair value' used by IAS is a market price, replacement cost or economic value (Thomas and Ward, 2009: 28). The fair value allegedly enables investors to judge future values of invested companies, which is crucial information for investors. The new method forced a number of companies, including Olympus, to reveal their financial losses from failed investments which had resulted from the Bubble Economy (Higuchi, 2014). The new accounting standards also include abolishing the pooling-of-interests method when merging companies (Shibata, 2007: 25). The pooling-of-interests method used to be a common approach in merger and acquisition (M&A) projects in Japan. The book value was used when valuing assets of merged companies, which was often different from the current market value (Tanaka, 2010). Previously, under the Japanese GAAP, goodwill was included as an asset, although not separately presented which was

heavily criticised by the US (Tanaka, 2010). Now, only the purchase method is valid in the Japanese GAAP when mergers and acquisitions take place in Japan, thereby reflecting the international accounting standards (Shibata, 2007). The purchase method is to apply the market value when calculating the value of assets of a company and any discrepancies between the book value and purchase cost are regarded as goodwill which must be taken into consideration for depreciation in the future (Shibata, 2007).

As part of the new accounting standards, a new method for the categorisation of assets was introduced in the new accounting standards (Koga, 2009). In order to evaluate non-current assets more accurately, a new accounting rule for impaired assets was announced in Japan in 2004 (See Table 7-1). An impaired asset is defined as an asset which no longer generates the same amount of profit or its market value has been significantly reduced (Koga, 2009: 263). Under IAS 36, companies are to review non-current impaired assets using either the fair value (less costs to sell) or value in use, whichever is the higher (Thomas and Ward, 2009:227). There is a slight discrepancy when treating impairment between the Japanese rule and IAS. In the Japanese GAAP, the future cash flow before discounting is used to judge impairment as in the example 7-1 (Higashiura, 2006: 207).

Example 7-1: Non-current asset A

Book value of A: 1000

Future cash flow of asset A before discounting: 1200

Market value of A: 800

Discounted cash flow value of A: 900

The asset A is not categorised as impaired as it still has the higher future cash flow value before discounting than the book value under the Japanese GAAP. However, IAS 36 categorised this case as impaired as the discounted cash flow value is 900 which is lower than the book value. The difference between the IAS and Japanese GAAP generates discrepancies in total profits which would affect investors' returns. With the diminishing rate of cross-holding shares by inner circle allied companies, Japanese corporations were being pressured to produce financial statements based upon IAS (now IFRS) (Hashimoto and Yamada, 2009). When stakeholders of a Japanese corporation are more internationalised and become more influential, it is inevitable that the Japanese government and corporations will adopt internationally agreed accounting standards. International pressure has more power than the *main bank* or the allied companies in Japan.

7.3 Confucianism and its Implications for Employment Practices after 2000

In order to be internationally competitive and to generate greater profits, listed Japanese companies have had to transform their management systems (Tanaka, 2010). They started to end the traditional employment system based on

seniority and to adopt the Anglo-Americanised management style which allows more flexible employment terms as a means to reduce costs (Saguchi, 2015). The optimisation of shareholders' value has become the mantra for the management to bring changes in listed corporations in present-day Japan (Oguri, 2014). This has meant that traditional corporate welfare systems derived from Confucianism such as life-long employment and lucrative pension schemes had to be reviewed. The following account also stressed the dramatic change in recent employment benefit schemes in Japan.

> Japanese companies once had a very ethical employment system. Employees would get paid substantially when they started a family and needed more money for their children's education during their lifetime employment. I think this traditional system worked well at one time. However, many companies reviewed the system after the Bubble Economy. In 1995, the Japan Business Foundation announced that the introduction of American neo-liberalism should be encouraged and companies must predominantly maximise profits for shareholders rather than look after employees' benefits…The accounting system and social system have become more Americanised since then (Interview with H, 2016).

The dramatic change noted by Interviewee H was inevitable for many companies because they could no longer afford to sustain the traditional employment terms in the highly competitive global market and, at the same time, reduce financial losses from the burst of the Bubble Economy (Saguchi, 2015). To be internationally competitive, an increasing number of Japanese companies started from the end of 1990s replacing full-time employees with part-timers or contractors (Kamuro, 2015). However, in many cases Japanese employees still discipline themselves to give the same level of commitment as before and the hierarchical relationship continues to play a significant role in many large corporations (Kamuro, 2015). Confucian-led values which encourage subordinates to follow their seniors without criticism continue to exist and

employees are still expected to be loyal and compliant (Morichima, 2004; Kamuro, 2015). Interviewee D below confirmed the continuing importance of ingrained values influenced by Confucianism.

> The company is part of you and your family, which is never experienced by the British. The British may have long-term employment, but they don't have a life-long employment as such. There is a big difference between the British and Japanese employees. I am not talking about a papa-mama stores, but I am talking about large corporations in Japan. The British obviously don't have that. Nor the Americans. It's very different and difficult for the British or Americans to understand. I can understand because I am Japanese. The Olympus executives did the *Tobashi* to protect the reputation of the company. They didn't do it for their personal wealth, however wrong they were (Interview with D, 2015).

People with power, namely employers or boards of directors, are able to create calculable people through management accounting (Foucault, 1977; Hoskin and Macve, 1986). A corporation selectively uses Confucian teachings to improve efficiency. For example, employees internalise norms within their organisations and voluntarily get involved with the QC activity (Morishima, 1982; Kikkawa, 2007). Employers also have the power to disclose partial accounting information as a means to make employees more docile. Many companies decide not to fully disclose their financial positions to their employees and restructure their salary and welfare system based upon inaccurate and misleading financial positions (Interview with H, 2016). Thus, a company's accounting information can be used to convince employees to accept worse terms and conditions by asking them to support their companies to become more competitive (Kamuro, 2015).

Accounting knowledge is not commonly available for employees and, thus, accounting figures are easily manipulated to make one's employees believe false financial positions. Interviewee V (2017) admitted that his company reduced the number of full-time employees and, instead, hired hourly paid workers in order to reduce costs by convincing employees that the company needed to make these changes to become more efficient and profitable. His company told its employees that profits were declining, which convinced the employees that they had to co-operate with its new policies which would save both the company and their jobs (Interview with V, 2017). In contradiction to the poor profitability communicated to the employees, Interviewee V's company is a Nikkei listed corporation and the company is known for being sustainable and ethical. Pressure from the management to reach targets sometimes encouraged wrongdoings in accounting practice such as in the Kanebo scandal.

Traditional Confucian-led values that implicitly give more power to employers and senior members of staff prevent employees from resisting or rebelling, most especially by Confucianism providing the values that can be used to conceal employers' power (Maruyama, 2006). The result is that Confucian teachings can sometimes lead to the exploitation of employees' welfare and human rights. Working hard without expecting too much compensation is considered to be a noble act in Confucian teachings, which companies may capitalise upon. The following phrase is a quote from Confucian teachings which is often used to persuade people to be devoted.

> Confucius taught that it is heavenly if one respects benevolence. If one ignores benevolence, one never becomes a wise person (Analects of Confucius, Chapter 4, Rigin IV-1). (Yoshida, 2002)

Although the government has started encouraging companies and their employees to revise their work-life balance, working for long hours is still expected in many industries and is highly regarded in Japanese society (Maruyama, 2006; Kamuro, 2015). Interviewee M dismissed the idea of having an interview meeting during weekdays by saying, "Oh, no, no, I cannot possibly have a meeting after work on weekdays. I am a Japanese 'salaryman', so it is the norm to work until 10 or 11 pm on weekdays. My colleagues and I feel loyal to the company" (Interview with M, 2016). Displaying very obvious evidence of the continued fundamental importance of Confucian values, Interviewee P (2016) also proudly commented that "I feel loyal to my company and work extra hours even sometimes without being financially compensated''. Employees have never explicitly been trained by their bosses or organisations to apply Confucianism or to become 'docile' employees. Instead, they have voluntarily internalised the norm and become 'Japanese salarymen' or docile people because they want to conform to values shared with other colleagues (Maruyama, 2006; Abe et al, 2012). Interviewees who belonged to Japanese organisations felt honoured to be members of large Japanese organisations.

Many Japanese are unaware of the extent to which Confucian teachings, including elements of Buddhism and Shinto, are deeply embedded in Japanese traditional values (Yasumaru, 1974; Maruyama, 2006). Even though Confucianism is not outwardly discussed or demonstrated in Japanese society, its influence continues to prevail across all social classes among the Japanese. Comments below from interviews confirm the importance of Confucian teachings within Japanese society.

> I think being appreciative is extremely important in life. You must always remember and be thankful to your ancestors without whom you would not be here. You should regularly visit your ancestors' graveyard to show your appreciation. Do you attend religious ceremonies? I think everyone should respect one's ancestors (Interview with W, 2017).
>
> I regularly attend religious rituals for my ancestors even though I am secular. Traditional values are embedded in my heart (Interview with Y, 2017).

Although Interviewee W holds two extremely high academic and professional qualifications in science and regards himself as secular, he openly expresses strong devotion to his ancestors and Heaven, which is not unusual among intellectuals in Japan (Komuro, 2000). Traditional values heavily influenced by Confucianism are embedded in his mind (Yoshida, 2002). Interviewee W's traditional view towards ancestors further reflects a similar response obtained by researchers from a number of Japanese business people including the younger generation (Yoshida, 2002). It is important to note that Confucianism is often selectively applied by people with power. Although Confucianism encourages trust and obedience towards one's seniors, its original teachings do not encourage blind obedience or unethical conduct. A senior has to be a virtuous and trustworthy person to gain their subordinates' devotion (Kaji, 2005). However, recent business and accounting scandals have exposed the preparedness of those at the top of the hierarchy of a company to ignore their duty to be virtuous and demand full devotion unconditionally from their subordinates. Most recently, this was very obvious in the Olympus scandal in 2011.

7.4 Olympus and the Betrayal of Accountability in Japan

7.4.1 Inner Circle of Olympus

The origin of the Olympus scandal dated from the period when the appreciation of the Japanese yen against the US dollar rose by more than 40 % in the mid-1980s, which significantly reduced the profitability of Japanese businesses (Kikkawa, 2007). Olympus earned a profit of 6.8 billion yen in 1985 but in the following year their profits fell to 3.1 billion Yen (Woodford, 2013:182). Like many other Japanese organisations whose main source of profits came from exporting their goods, the management of Olympus in 1986 was desperate to find a way to improve profitability (Higuchi, 2014). Purchasing financial products was a common solution during this period to increase profit, a practice which Olympus adopted (Tanaka, 2010). They started investing in various types of financial products such as bonds and shares to make up for losses. When the Bubble Economy was at its height, Olympus subscribed to more risky products such as future bonds and foreign currency swaps (Watanabe et al, 2012). However, when the Bubble Economy crashed in 1991, the management of Olympus realised that these financial products had incurred great losses totalling 95 billion Yen (about 841 million US dollars) (Watanabe et al, 2012).

To compensate for the financial loss from these financial products, Olympus continued purchasing highly complicated and risky derivative products which also failed to generate profits (Higuchi, 2014). Consistent with Japanese practices, only a very small group of senior management in the company were able to identify the seriousness of the problem in the late 1990s. This was because the old Japanese GAAP allowed the concealment of financial losses lawfully by using the book value of assets (Tanaka, 2010). It was revealed that successive presidents passed this secret financial information only to their inner

circle members on the board of directors (Watanabe et al, 2012). Financial specialists advised the then Olympus president and his close inner circle members to initiate several *Tobashi* schemes, creating financial funds and acquiring companies at inflated prices (Higuchi, 2014).

Illegal *Tobashi* schemes, which involve selling negative equity or financial assets to a third-party in order to cover financial losses, had been adopted at Olympus (Higuchi, 2014). By employing *Tobashi* schemes, Olympus was able to create acceptable annual financial statements after the burst of the Bubble Economy (Higuchi, 2014). This was a criminal offence, and Tsuyoshi Kikukawa and his close allies were prosecuted when the scandal became public (Nikkei, 2017). Olympus's funds were configured by several different financial institutions to mask its past losses which would be systematically written off over 10 years (Abe et al, 2012; Higuchi, 2014). A small group of the inner circle members of the then president disciplined themselves to be docile and remain quiet about the concealment. However, the *Accounting Big Bang* forced Olympus to disclose their financial positions more accurately using the market value.

In March, 2001, Olympus had an opportunity to publish, in their financial statements, their losses from the failed investments when the new accounting regulations were implemented (Watanabe et al, 2012). However, the Olympus executives chose to continue the concealment and further adopted the *Tobashi* scheme. To avoid the full disclosure of their financial position, the then president of Olympus allowed only his close allies to access the real accounting information. The unchallenged powerful position of successive Olympus

presidents allowed them and their close inner circle members to abuse accounting knowledge which helped them to conceal excessive losses.

The then president and his confidantes, with the assistance of a financial adviser, set up foreign funds into which they could move their financial losses. For example, Olympus founded GC New Vision Ventures (GCNVV) in 2000 for this purpose (Woodford, 2013: 185). Olympus also purchased companies called Altis, Humanlabo and News Chef at an overpriced value of 73.4 US billion dollars through one of these financial companies (Woodford, 2013: 144). According to the report of a committee set up by Olympus to investigate the company's financial problems, their prices were over inflated by 22 times for News Chef, 115 times for Altis, and 287 times for Humanlabo (Watanabe et al, 2012: 11). By paying the inflated prices to financial companies, which had been established by Olympus, Olympus was able to illegally remove bad debts from the Olympus accounts (Woodford, 2013: 186). This was possible because these acquired companies' accounts did not appear in Olympus's consolidated financial statement. This was the *Tobashi* scheme of Olympus.

7.4.2 Transparency of Accounting Practices at Olympus and Exposure

Accountability existed only on the surface in Olympus. Thus, their public financial information presented a far from accurate portrayal of the reality. Kikukawa and his subordinates chose to ignore the significance of accountability because accounting information was considered by them to be private information and they believed that only senior management should have access to it (Abe et al, 2012). Important concepts of accounting such as faithful

representation were not taken seriously among the management of Olympus. According to the report of the Third Party Committee set up by Olympus (Higuchi, 2014) their accumulated financial losses and cost for the various *Tobashi* schemes over 20 years mounted to 135 billion Yen in 2011 (about 1.7 billion US dollars)[11] which the president of Olympus did not want to disclose to the public (Woodford, 2013: 188; Higuchi, 2014: 190). The president in the late 1990s had the power to conceal accounting information and to use Confucian teachings selectively to avoid any accusations from his subordinates or shareholders. The hierarchical relationships and strong bonds among the Japanese board members continued into the next decade.

The Olympus scandal became public when Michael Woodford, who was the company's first non-Japanese president, learned about a number of extraordinary mergers and acquisitions projects. Woodford had worked for the Olympus group in the UK for thirty years before he was appointed president by Kikukawa (Woodford, 2013). In 2011 although Woodford was the president, Kikukawa, his senior, always maintained the highest position in Olympus (Higuchi, 2014). When Woodford found out about the scheme through a whistleblower, he was not able to obtain any further information from the Olympus board members (Woodford, 2013). Kikukawa and his Japanese subordinates tried to silence Woodford by saying it had nothing to do with him and that he should not worry about it, even though he was the president and he had to understand the financial position of the company (Woodford, 2013). Woodford continued not to have any access to accurate financial information of

[11] This figure may vary slightly depending on reports.

Olympus from the past which was made available only to people in a select, trusted group in the organisation (Abe et al, 2012).

Woodford was not in the select group despite his official position as the president of the company. Being a non-Japanese board member, he was not included as part of the inner circle (Woodford, 2013:33). When Woodford suggested that he should investigate past suspicious financial dealings, Kikukawa and other board of directors dismissed his suggestion completely (Abe et al, 2012; Woodford, 2013; Higuchi, 2014). Immediately after their disagreement, Woodford was removed from his position because he did not work in a harmonious way with other board members whose values were obviously influenced by Confucian teachings (Tu, 2000; Bellah, 1985; Higuchi, 2014).

By the time Woodford was removed by the Olympus board in October, 2011, both Western and Japanese media reported the excessively high advisory fee of 687 million US dollars for just one merger and acquisition case and there were the other highly questionable acquisitions of companies called *Altis, Humanlabo and News CHFF* in 2008 (Woodford, 2013: 144). With the high amount of pressure from the media and shareholders, in November, Olympus was forced to appoint a Third Party Investigation Committee consisting of three principal lawyers, six additional lawyers and four CPAs who had no vested interest in Olympus (Watanabe, 2012: 1). Although shareholders in Japan were generally patient about decisions by their invested companies, they became very vocal after the scandal was exposed by the media. The committee carried out their investigation and the official report was published in January, 2012. The

report details how Olympus became responsible for the extraordinary financial concealment. Some of the Olympus board members revealed how they had knowingly colluded in this scheme for a number of years (Watanabe, 2012:34). Confucian teachings had been applied conveniently by board members of Olympus and Woodford was expected to behave like other Japanese board members even though he was not included in their inner circle (Abe et al, 2012).

Kikukawa originally expected Woodford to discipline himself and to become docile by remaining silent about any doubts he had, just like any other Japanese subordinate (Woodford, 2013). Instead, unlike obedient Japanese employees, he turned to the press after being declined any explanation by Kikukawa, the then chairman, or other fellow board of directors. From the perspective of Japanese business people who rely upon traditional Japanese values, Woodford should never have publicised the illegal accounting management of his superior and the inner circle members. He should not have disappointed Kikukawa, who had appointed him to become his successor at Olympus (Ishida, 1739, edited by Adachi, 1935).

Japanese interviewees for this study, who worked in traditional Japanese organisations, also confirmed and admitted that they would agree with Kikukawa and his predecessors, thereby confirming the extent to which Confucian-led values and its implications for business and accounting practices still prevail in contemporary Japan.

> Olympus executives wanted to write off accumulated financial losses without telling anyone if they could. They manipulated their accounts and then tried to write them off, without gaining any personal benefit. I don't think they did anything wrong (Interview with I, 2015).

> Employees pretended that they knew nothing even when they knew about the wrongdoing of the company. This is typical in any Japanese organisation. The Japanese are embedded with traditional Confucian teachings and have moral standards, and they all were able to identify the scandal within their company. The Japanese do not necessarily challenge their seniors or companies' wrongdoings but instead, just let it go. Western people who join the organisation would probably speak up (Interview with Y, 2017).

There was a clear chasm between Western accounting practice of pursuing transparency and the traditional Japanese accounting practice of protecting the reputation of the company and its managers in the case of Olympus. Kikukawa wrongly assumed that Woodford would not oppose Kikukawa's decision about the illegal transactions (Higuchi, 2014). From Kikukawa's perspective, he was considered to be a pseudo-father to Woodford and, thus, Woodford should have obeyed whatever Kikukawa suggested. Any sensitive accounting information should have been kept only within the inner circle and Woodford was expected not to question this when he found out about it through the whistleblower (Woodford, 2013). Kikukawa's expectation of Woodford, however, was to be betrayed. Interviewee F's comment below was supported by a number of other interviewees.

> The biggest mistake which Olympus made was that they appointed Mr. Woodford, a foreigner, as the president. If Kikukawa's successor had been a Japanese who worked for Olympus Japan, the financial scandal would never have become public. You know, there are many other Japanese companies that lost money after the burst of Bubble Economy in the 1990s, so I was not surprised (Interview with F, 2015).

Successive Olympus' presidents had the ability to manage accounting and never disclosed unwanted past financial information to the public. They had the power to make their immediate subordinates discipline themselves to internalise norms and to act upon them by not disclosing any damaging accounting information. This power relationship is skilfully disguised by Confucianism to make everyone feel that they are doing the right thing. The comment below confirms this enduring expectation of traditional Japanese employees.

> One's entire life depends on the company where one works. One would feel obliged to dedicate oneself. Some employees even killed themselves in order to keep the secret of their company's illegal operation. They would have felt that they had to sacrifice themselves for the company because they belonged to the company. This reminds me of Samurai warriors' dedication to their lord in the Edo era. It is a sense of loyalty from Confucianism (Interview with N, 2016).

In the Olympus case, Kikukawa and the attitudes of his inner circle members would never have been shared with Woodford. Although Woodford was fully aware of Japanese business culture and customs, he was unable to adhere to the inner circle's decision in regards to accounting and accountability for which he had full responsibility as the president of the company (Woodford, 2013).

Kikukawa's assumption of not being challenged by subordinates is witnessed in other Japanese organisations according to findings from the interviews for this study. However, Kikukawa ignored the fundamental teachings of Confucianism which advised that leaders must be virtuous and righteous (Analects of Confucius Satoni Volume 4:16).

> In Japan, because the management and the directors are all working within the same group, it's not separated, I don't think the shareholders are getting much help or benefit from the management to get the best deal, and the management almost acts entirely for their own group of people… (Interview with C, 2015).

The more selfish, practical reasons for devotion to a select group of people were identified by Interviewee S.

> In my old company, one's company pension would be tripled or even more after six years of service as a board member. Therefore, it was wise to stay conservative and to follow precedents, avoiding any new challenges (Interview with T, 2016).

The company pension system, the intent of which reflected Confucian teachings, made board members become conservative and more secretive. However, global competition has become fierce and shareholders are no longer kept out of the inner circle members. Owing to constant pressure from the US and other foreign investors, a number of Japanese companies are beginning to shift from the traditional management style to a more Anglo-American model.

7.4.3 Japanese Management Style and Accountability

It was obvious that Kikukawa and his predecessors had not acted on behalf of the Olympus shareholders. However, Japanese society and the media did not severely attack the board members of Olympus who were seen, according to Confucian teachings, as behaving honourably (Abe et al, 2012). It was socially accepted that Kikukawa and his inner circle members rarely thought of the wellbeing of shareholders. Thus, they felt for Kikukawa instead of Woodford (Woodford, 2013:153). Olympus' board members claimed that they implemented the *Tobashi* scheme to save the company and to ensure its

employees' job security, not for their individual benefit or for profiteering (Watanabe et al, 2012). The concealment in order to protect one's company and not for personal benefit gained the support of the general public in Japan (Morishima, 2004; Hamada, 2008). Several of the Japanese interviewees for this study believed that it was Woodford who broke the social expectations and betrayed the company and its employees. Interviewee H acknowledged that Olympus breached the law, but he defended Olympus by saying that they had to do it to save the company.

> Of course they should not have hidden it in the first place. This kind of thing shouldn't have happened. But I think the successive presidents at Olympus were desperate to hide them to protect their company when they first found out about the huge losses. Well, to tell you the truth, I don't think these Olympus executives did anything wrong. They did it for the company. Their external financial advisors must have earned a huge amount of money, but I don't think the executives from Olympus made any money out of this scandal (Interview with H, 2015).

Interviewees suggested that Olympus needed time to write off these losses, otherwise the loss might have resulted in bankruptcy twenty years previously. This clearly indicates how embedded values in society can play a significant role in determining attitudes. Although Interviewee H defended the board of directors because they did not gain any personal profit out of the Olympus scandal, he never mentioned any damage to Olympus' shareholders.

The way in which successive Olympus presidents treated accounting as a private matter allowed them to conceal the financial losses. Strikingly, one interviewee did not think the case of Olympus was extraordinary because he saw similar financial irregularities elsewhere, although they were on a much smaller scale.

> When I analysed the financial statements, I found out lots of lots of accounting fraud, you know. This is not good enough, I said…It was not too difficult because we usually see the financial statements at least for five years or so. We just analyse those figures and calculate cash flow…calculate some KPI. (I) can find irregular figures…We have lots of experience, you know, about industry. This figure shouldn't be like this in this particular industry (Interview with B, 2015).

In testimony before the investigating committee, Shuichi Takayama, the then executive director at Olympus, argued that he was right to support Kikukawa's decision to prevent any confusion in managing the company (Watanabe et al, 2012; 98). Takayama admitted during the investigation that his superior's request for concealing the losses had far more significance than complying with accounting standards (Higuchi, 2014). He also clearly said to Woodford that he worked for Kikukawa, not for Woodford when Woodford asked him to investigate the suspicious financial dealings before they became public (Woodford, 2013: 20). Even though Woodford had worked for Olympus UK for three decades, he was still considered to be an outsider by these Japanese board members. The traditional Japanese employment system is prone to prevent the board members of a company from being more transparent about the management of accounts. Interviewee C below expressed his concern about way his company was managed.

> The board of directors consists of pretty much the same sort of people who run the business in many Japanese corporations. They work more on behalf of the workers, or more on behalf of themselves rather than for shareholders. That's why they are in a position to carry out such fraudulent activity in Olympus, and are willing to do so, I think (Interview with C, 2015).

The above comment was supported by other Japanese executives interviewed for this research. They believed that embedded values and norms continue to

affect accounting and accountability practices and that they should continue to do so.

Board of directors in many Japanese corporations are traditionally not independent from operational divisions and they tend to be long-serving ex-employees (Kikkawa, 2007; Oguri, 2014). In the case of Olympus, it was evident that all of the executive directors were once long-serving Olympus employees from the same inner circle and shared similar norms. When one is a Japanese 'salary man', a company employee, and then becomes a board member, one would consider oneself to be a representative of the employees of the company. Accordingly, Kikukawa's priority was not necessarily the shareholders, even though he was the chief of the board of directors. The maximisation of shareholder value was rarely discussed in the past in Japan. Interviewee T, who worked for one of the largest corporations in Japan as a senior manager, admitted that this was a new concept which had never been discussed among the senior managers before.

> To tell you the truth, I have never thought about our investors when I worked there. Never. Investment activity projected a negative image and I felt that gaining money through investment was disrespectful. In my company, employees were very proud and they all thought the company belonged to them instead. Well, nowadays it may be different. Perhaps, when you become a board member, you will be trained and your perception would change. In my case, (for senior managers' level), my boss has never discussed investor returns in our meetings and I never thought I was working for the benefit of shareholders (Interview with T, 2016).

This suggests that the traditional Japanese management style assumes that a company belongs to employers and their employees rather than shareholders. Boards of directors are close to most of their long-serving ex-colleagues who

joined the company at the same time when young (Morishima, 2004; Kikkawa, 2007). Also, they are promoted by their superiors rather than by shareholders (Kikkawa, 2007). In the Anglo-American model of accountability, the board members are distinctly separate from the operational divisions and they are expected to act on behalf of shareholders (Kikkawa, 2007). Olympus was also trying to follow this model when Kikukawa appointed Woodford as the president of the company (Woodford, 2013). However, according to various publications, Woodford was a president more for public relations purposes to make Olympus look global and Westernised (Abe et al, 2012). Nevertheless, all other board members considered Kikukawa as the true head of Olympus (Woodford, 2013; Higuchi, 2014). Even though Olympus adopted a superficially sophisticated Anglo-American type of accountability, strongly established norms influenced by Confucianism always existed in the company.

Like many Anglo-American corporations, Olympus had a group of external board directors in 2011 when the scandal was revealed (Higuchi, 2014). However, they were not totally independent; some of them had a close business relationship with Olympus while others were medical professionals without any business experience (Higuchi, 2014). According to the Third Party Committee's report, they had either direct or indirect financial interests in Olympus and did not play an active supervisory role on the board (Higuchi, 2014). All three of the non-executive directors had a vested interest in Olympus and, thus, it was difficult for them to govern the corporation independently (Watanabe et al, 2012; Woodford, 2013). During the

subsequent criminal trial of Olympus board members they claimed that they could not detect any irregular transactions (Nikkei, 2017).

At the request of Kikukawa, the chief internal auditor was also involved with the concealment because he was one of Kikukawa's subordinates and did not challenge him (Watanabe et al, 2012). This further confirmed that in Olympus the accountability process was superficially modernised to meet the international requirements. However, the overall accounting and accountability practices of Olympus were carried out by a small group of board members who were members of Kikukawa's inner circle with limited accountability (Woodford, 2012). The traditional management style in Olympus was a major factor which resulted in limited accountability, which is also witnessed in other Japanese organisations.

> The most problematic issue with the then Commercial Code was that it allowed a company to appoint its executive auditor from highly promoted employees. He would have liked to become a board member such as CEO or the Managing Director, but it was not possible. Hence, he is not a qualified auditor in that sense, but instead, one of inner circle members of a board (Interview with N, 2016).

Confucian-led values and traditional business practices delayed Olympus becoming transparent about its accounts because Kikukawa and his immediate Japanese subordinates did not pursue the shareholders' interests (Ogura, 2014; Tanaka, 2010).

7.4.4 Auditing and Japanese Business Practices

According to the report by the Third Party Committee, Olympus' external auditors held no responsibility for the mismanagement of the Olympus accounts. The report claimed that Azusa LLC (Azusa), the external auditors at Olympus, did not get involved any of the *Tobashi* schemes (Watanabe et al, 2012:109). According to the report, Article 396 of the Commercial Code stipulates that the identification of fraudulent accounts is not the external auditors' direct responsibility, although they have to check the appropriateness of financial statements prepared by their clients (Watanabe et al, 2012: 109). Thus, it is rare for external auditors to be held responsible unless they directly get involved with a clients' fraud. It meant that Azusa was unable to detect all the *Tobashi* schemes at Olympus or to rectify their activities. However, in 1999, a whistleblower notified Azusa about serious *Tobashi* schemes of about 30 billion Yen (about 264 million US dollars) and Azusa managed to advise Olympus to rectify their accounting practice (Watanabe et al, 2012: 119).

Olympus concealed other schemes which Azusa was unable to investigate because Azusa was not given access to the relevant information (Higuchi, 2014). Nevertheless, as long as Olympus was an important client of Azusa, and that a client is presumed to be right, Azusa would not have been prepared to enforce a detailed interrogation of Olympus's management (Hamada, 2008; Abe et al, 2012). Azusa's reluctance was to be severely and unavoidably challenged when during their routine annual auditing in 2008 and 2009 Azusa was able to detect an unreasonably expensive purchasing cost of three mergers and acquisitions projects and excessive advisor fees (Watanabe et al, 2012: 61).

The extent of this deception in the accounts forced Azusa to change its position. However, before Azusa could adversely comment on these transactions, they were replaced by a new auditing company, Shin Nippon Auditing LLC which subsequently approved Olympus' financial statements without being aware of their historical *Tobashi* schemes (Watanabe et al, 2012: 123; Higuchi, 2014). Olympus management had the power to change their external auditors instead of correcting their flawed accounts that included the concealment of the past financial losses. Interviewee H, a member of the Japanese banking sector with many years of experience with banks and prominent auditing firms, confirmed that companies could simply choose external auditors who would agree with their financial statements.

> Their (auditors') job is basically to give advice… They are supposed to be truly neutral…but...they are not. In the case of Olympus, for example, .well, either Azusa were extremely, extremely naïve or they knew about it and they've been lying. Even with Toshiba's case, auditors weren't questioned, right? So many people criticised Toshiba, but nobody criticised their auditors, right? Because they know they are just a rubber stamp…The press was asking me what the external directors and the auditors were doing? And my answer was that they were there physically. They were nominated but were non-existent and powerless (Interview with H, 2015).

External auditors are meant to comply with internationally agreed accounting standards and, yet, Azusa initially had acted in a way which again, in a very destructive manner, allowed Confucian values and related expectations of the power hierarchy to justify the values and practices of Japanese businesses. This forced Azusa until 2009 not to challenge their clients. They were in a subordinate position that prevented a fair and thorough audit of Olympus. The top management of Olympus had tremendous power to decide the level of transparency. The research findings show that transparency in accounting can

be only achieved by having values that prioritise transparency among all stakeholders, including the board members of the company, their external auditors and society. Interviewee H, from the banking sector, was extremely critical about the role of auditors because he did not believe external auditing functioned as it should have in many of his past experiences with employers.

> Well, the auditors' role was questioned as they have just rubber-stamped it. And auditors themselves are saying that. They would just rubber-stamp it. So, it's just a waste of time and money… you realise some kind of checking device is needed. To your earlier question, when the auditor rejects the financial statement, as with the case with Olympus and Kanebo, they can be replaced by another auditor. Hey, we can't hide it any more. But what's interesting is that always another auditor raises his hand to do the job. This is a total lack of correct business procedure on the auditing side. This is the very negative side of the Japanese…This is a total lack of correct business procedure on the auditing side in Japan (Interview with H, 2016).

The considerable business experience of some of the interviewees suggests that it was not only the unique Confucian nature of Japanese society and business which may have led to Azusa failing to expose and report Olympus's failings. Not all auditors are able to detect deeply concealed losses from the past. The report by the Third Party Investigation Committee of the Olympus case wrote that the financial fraud at Olympus was extremely complicated and it was impossible for external auditors to detect it in advance (Watananbe et al, 2012).

Interviewee I, who at the time was appointed to examine the accounting records at Olympus, claimed that identifying accounting frauds has become more difficult due to the complexity of accounting standards (Interview I, 2015). Also, an auditing system did not work effectively in many fraud cases because it was very hard to spot flaws, especially when Olympus hired professional financial advisers to devise complex *Tobashi* schemes in which even a

professional accountant found it difficult to prove inappropriate behaviour (Watanabe et al, 2012).

> When I checked Olympus' accounts and mergers and acquisitions projects, I felt they all looked so legitimate. There were hundreds of mergers and acquisitions projects at Olympus, and these three problematic mergers and acquisitions projects did not stand out. Well, we must note that the calculation of goodwill and future potential turnover can be easily manipulated in our accounting rules (Interview with I, 2015).

This suggests that a financial fraud can be made possible if a company's management decides to understate it. No Japanese board members apart from Woodford interrogated Kikukawa about past transactions. Confucian teachings suggest that one should not accuse one's boss of some wrongdoing but, instead, to believe that their decisions are always to be respected and not questioned. This represents the negative side of Confucianism, thus hindering the Olympus management from being accountable for their financial performance and their actions as managers. Although norms created by the Olympus management looked as if the company's management style was Westernised, the negative side of Confucianism was still present which induced reduced sustainability for the company. Share values dropped significantly when the scandal was revealed in 2011 and shareholders were left with huge financial losses (Abe et al, 2012).

Olympus ex-board members were prosecuted but only four of them were held responsible after the trial which lasted for four years (Kato, 2017). The lower court in Tokyo ordered ex-board members and ex-advisors to pay 58.7 billion Yen to Olympus for the losses they made (Kato, 2017). The result of the investigation, which was publicly displayed on the Olympus' company website,

declared that Olympus in response would establish a robust Corporate Social Responsibility (CSR) committee and that they were determined to prevent any further wrongdoings (Olympus, 2018; Sasa, 2018:7). Although the report expresses their sincere regret and reflection, there was another scandal at Olympus China in 2018. Their Chinese subsidiary breached the law on bribery but they did not reveal it until it was exposed by a whistleblower (Economist, 2018). This recent case indicates how challenging it is to transform prevailing values in the company even after they replaced most of the board members and introduced various accountability training courses. Thus, embedded traditional values have continued to significantly influence accounting and accountability by Olympus. Internalised norms imbued by every employee can only be transformed by people with power, the top management.

7.5 Accounting Standards and Accountability in Contemporary Japan

Although the Japanese managed to continue their accounting practices according to Japanese accounting standards, the Japanese government agreed to modify accounting standards in the early 2000s to enforce 'management's responsibility to provide an account of the way in which the resources entrusted to them have been used' (Thomas and Ward, 2009:35; Shibata, 2007; Oguri, 2014). After the *Accounting Big Bang*, Japanese CPAs and governmental officials who were very aware of the importance given to accountability by the US sought to persuade Japanese corporations to strengthen their accountability. The US also suffered from major accounting scandals which made them compose the American Public Company Accounting Reform and Investor

Protection Act of 2002 (SOX Law) (Hamada, 2008). The professional body of CPAs in Japan followed suit and a Japanese SOX law was introduced in 2008 (Hamada, 2008).

Owing to international pressure, especially from the US, the Japanese government have shown their determination to improve accounting and accountability practices in Japanese corporations in recent years. However, Japanese companies and their employees have to understand their reflective relationship with Confucian teachings if they intend to enhance their accountability according to international standards. Some organisations may still want to find a way to achieve their financial targets by deliberately misrepresenting accounting results. As Interviewee I admitted below, creating fraudulently misrepresenting accounts is possible for professional accountants if they wish.

> It is easy to create a financial statement showing a dramatic improvement in profitability. When shareholders are asking only for a short-term return, the management would deliberately create numbers by moving losses and profits across financial terms. By doing this manipulation, profitability of the company may look dramatically increased. Accounting and accountability can be very subjective, so a high ethical standard is required (Interview with G, 2015).

Despite the international media coverage of the Olympus scandal, another Japanese corporation was caught in another serious accounting scandal in 2015 (Jennings, 2015). Toshiba, a leading electronic and technology corporation headquartered in Tokyo, was accused of overstating their profits by 1.2 billion US dollars over 7 years (Toshiba webpage, 2017; Jennings, 2015). Toshiba once had a very positive reputation in Japanese society and promoted impressive

social activities to fulfil their philanthropic responsibilities. However, in 2014 the president of Toshiba suggested to his immediate subordinates that financial information had to be used to make the company look more profitable, assuming that accounting and financial information were private and could be manipulated (Jennings, 2015). This prevented them revealing the true financial position of the company, thereby, ignoring their legal responsibility to their shareholders. Following Confucian teachings, their subordinates had no choice but to follow their seniors. They also did not want to risk their careers by challenging the instruction. The cases of both Olympus and Toshiba show how Confucian teachings are prone to be misused by the top management with power by creating accounting information which looks legitimate and trustworthy.

Senior members of Olympus, Toshiba, Kanebo and Yamaichi effectively made use of Confucian teachings which encouraged employees to be obedient and not to be critical of their superiors. Prevailing values influenced by Confucian teachings make employees discipline themselves to become docile and to stop being critical about the manipulation of accounts in order to achieve the objectives of the corporations. Accounting was used to disguise results of their failed management and to make financial statements look legitimate. The senior management abused their power to convince their subordinates to manipulate their financial statements. Although the Japanese management style has been significantly modernised over the last twenty years, the interviews for this study with senior Japanese business people consistently emphasised how Confucian values still prevail in accounting and accountability practices even

though Western values have been imported and are rigorously practised in contemporary Japan (Yasumaru, 2004).

Power relationships founded on Confucian values between people in senior positions and their subordinates ensure that they are not equal partners but, instead, senior members are discreetly and significantly more influential (Foucault, 1977; Fukuyama, 1995). Employees might obey their superiors even if their requests are illegal, as in the Olympus and Toshiba's cases. Power was exercised without making employees feel they were being exploited or manipulated because of the legitimacy given to senior management from Confucianism. Employees felt as if they were acting positively for their companies (Abe et al, 2012). Olympus and other accounting scandals indicate how easily employees' internalised norms are set by their employers, selectively using Confucian values. There are, however, an increasing number of Japanese corporations that have tried to implement new management systems in the 2010s. Interviewees J and V have witnessed recent positive changes.

> Our company established a more robust board, hiring a group of non-executive directors who have never worked for us. Our company is trying to ensure that the board becomes more independent and transparent (Interview with J, 2016).

Japanese corporations have introduced Western management and accounting standards and some have been especially positive in implementing them.

> Since our company was publicly listed, we became fully aware how important it is to record our accounting records. Our top manager clearly instructed that we ought to comply with new accounting rules and our records must be fully accepted by all stakeholders (Interviewee V, 2017).

Interviewee V commented that he has not been aware of his company ever intentionally manipulating numbers throughout his 20 year career as a member of the accounting staff and a manager. Instead, he said that he witnessed the top management's positive and strong will to be an equitable company as well as a profitable company. Their commitment was shown when his company publicly announced that the IFRS would be immediately adopted when the government announced their introduction (JPX, 2016). When the new accounting standards were introduced, Interview V and his colleagues were all well trained and made fully aware of the consequences if the new standards were not followed. In his organisation the compliance with IFRS and the management of accounting and accountability are considered to be extremely important.

Rakuten Co. Ltd. (Rakuten), a relatively young IT and E-commerce listed corporation founded in 1997, is a recent example of a company with a reputable management and accounts department (Rakuten, 2017). Rakuten claims that they rigorously seek a balance between investors' wealth and the well-being of its employees (Rakuten, 2017). They produce separate financial statements based upon both the accounting standards called *non-GAAP*, which have already been adopted by a number of large US corporations, and the IFRS, which is not yet currently widespread amongst Japanese corporations (Rakuten Report, 2018; PwC Report, 2016). There is a significant gap between their IFRS profit and the *non-GAAP* profit as in Table 7-2.

Table 7-2: Rakuten Profits in 2017

IFRS profits	Non-GAAP profits
149,344 million yen	167,010 million yen
Non-GAAP profits – depreciation of intangible assets – expenses for stock options and others – extraordinary item = IFRS profits	

Rakuten Financial statements in 2017 (Rakuten Report, 2018:8,9)

Rakuten claimed that they are using the version of the *non-GAAP* methods recommended by the US Securities and Exchange Commission to ensure that a fair representation of their financial state is presented (Rakuten Report, 2018: 8). The value of goodwill in their accounts appeared to be reasonable according to the IFRS rules and their accounting practice was commended by many Japanese CPAs (Interview with P, 2016). The financial statements of Rakuten indicate their positive readiness to establish trust with all its stakeholders and the general public. It is only possible for internationally agreed accounting and accountability practices to penetrate Japanese corporations when they are introduced by the senior management with strong determination. When Confucianism is embedded in society, employees conscientiously follow their superiors will discipline themselves to obey them. Therefore, the role of a leader in an organisation is extremely important.

7.6 Conclusion

The Olympus example did not shock many Japanese business people, particularly for those who are familiar with Confucian teachings which emphasise the need to protect an institution from any embarrassment or accounting scandal (Yoshida, 2002). Thus, it would have been rare for the head of a company to publicly announce a scandal in his company. Woodford's action in revealing his company's illegal transactions was against the traditional values of Japanese business practices, which was shocking behaviour to Olympus board members and many Japanese business people (Tsuchida, 2012). They preferred to use traditional business values based upon Confucian teachings and accountability to justify their actions. When the ex-presidents of Olympus decided to illegally use accounting information, none of their subordinates who had access to this information challenged them (Abe et al, 2012; Watanabe et al, 2012). Their main interests were to serve Kikukawa, their long-term 'fatherly figure' and superior who would protect their interests as well as their company. It was not surprising that the Western media were mystified when the Olympus management claimed they did it to protect the company. However, it must be noted that although Kikukawa and the board members did not gain any direct personal financial benefit from these illegal transactions, they did it to secure their employment as board members (Abe et al, 2012).

Traditionally, Japanese shareholders, who were predominantly allied group companies and inner circle members, did not believe that corporate transparency was vital. The prime concern of investors in Japan was not necessarily short-

term return and they did not complain if the company distributed certain profits among its employees rather than among shareholders (Okazaki, 1996; Abe et al, 2012). However, external pressure such as SII negotiations forced Japan to internationalise business and accounting systems. Recent accounting and accountability practices in Japan reflect the dramatic globalisation of accounting standards but it is still true that Japanese companies find it difficult to change their traditional accounting practices. Although the internationalisation of accounting and the IFRS framework have been globally promoted in recent years, many Japanese corporations still find it hard to immediately adopt the IFRS (Suzuki, T, 2012; Yamaji, 2012). When the number of international transactions surged in recent years, it was inevitable that international business partners and foreign investors would request more transparent financial information. However, Japanese corporations perceived IFRS as principle-based standards and sometimes difficult to judge without detailed rules like the Japanese GAAP (Hashimoto and Yamada, 2009).

When the *Accounting Big Bang* took place in 2000, listed companies in Japan realised that they had to reform their traditional business practices to ensure the survival of their business (Oguri, 2003). The Anglo-American view of accounting and accountability is being adopted by Japanese companies reflecting the attitude of recent shareholders who are concerned more about return on equity (ROE) (Koga, 2009). Although Japanese business people still maintain Confucian values and a strong emotional attachment to their companies, the importance of internationalised standards of accounting and accountability has been identified and a growing number of companies have

tried to improve their accounting and accountability practices (Oguri, 2003; Oguri, 2014).

The relationship with external auditors is another major concern in accounting scandals in Japan. The traditional feudalistic relationship between master and servant can cause a situation where an external auditor finds it extremely difficult to criticise the accounts prepared by their clients. However, the national culture and history of accounting practices and business customs need to be set aside in order to comply with modern international requirements. Yet, research findings have confirmed difficulties of overcoming traditional business customs in Japan (Hamada, 2008; Ikeo, 2009; Kameoka, 2011).

At the height of business globalisation in the 21st century, the Japanese government considered that internationalisation of accounting standards and accountability, including the introduction of the IFRS, as the *raison d'État*, the essence of the state (Foucault, 2007: 257). IFRS also promote the transparency of financial information which the government believed that would help them to reduce accounting scandals (Hashimoto and Yamada, 2009; Tanaka, 2010). Internationally agreed accounting and accountability practices would ensure the integrity of Japan as a valid member of a global business community (Foucault, 2007; Hashimoto and Yamada, 2009). Accounting is an effective and subtle mechanism to impose discipline and to make people knowable and calculable (Bigoni et al, 2018). Accounting is executed in order to secure the wealth of individual corporations and also the nation (Foucault, 2007; Bigoni et al, 2018). However, it is vital to recognise that Confucian teachings are still deeply embedded in modern Japanese values and accounting practices. When

Confucian teachings are applied selectively, they can be used to justify intervention in accounting and accountability practices in many traditional Japanese corporations.

There are both positive and negative implications of Confucianism. Confucianism has always advocated loyalty, working ethically and collectively, which has become a powerful source of normalising power in Japanese society since the Edo era (Yoshida, 2002). Interview findings indicate that this has worked far more effectively than repressive power or social contractual power in Japan. In Olympus, only senior managers had access to the true financial status of the company. They also had power to disguise accumulated financial losses to enable them to disappear from the accounts using numerous *Tobashi* schemes. Accounting and accountability practices are easily manipulated by people with power and Confucianism enables any form of resistance to be diffused. A similar accounting scandal could be repeated in the near future unless the effect of Confucianism and power-knowledge mechanism is distinctly identified and confronted by managers in Japan.

Chapter 8 Conclusion

8.1 Introduction

This research has critically examined the development of accounting and accountability in Japan since the Edo era (1603-1868) and how they were influenced by traditional values, using Foucauldian perspectives of disciplinary power. This has provided the means to identify the different ways in which disciplinary power has been enacted in Japan by the Japanese government and Japanese corporations since the Edo era. Power and knowledge generated by accounting practice was historically and subtly used to control a nation, business owners and their employees. Foucault (1976) proposes power and knowledge are intrinsically linked, which suggests accounting knowledge and power impact on each other. The research, using historical documents, organisational examples and semi-structured personal interviews, focuses on how traditional values and religions, namely Confucianism, Buddhism and Shintoism, have influenced various aspects of accounting and accountability in Japan. Both primary and secondary documentary sources on accounting and accountability are examined to identify historical evidence. Most importantly, the interview results provide an understanding of how accounting and accountability are perceived and practised by contemporary Japanese business people. The analysis of interview results with the grounded theory approach highlighted the strong but implicit influence of Confucianism on Japanese accounting and accountability practices.

This research contributes to a subject which has rarely been investigated in critical accounting literature by applying Foucauldian perspectives on disciplinary power.

There is very limited critical accounting research relating to Japan and its reflective and historical relationships with power and discipline. Previous studies have mainly applied Foucault's ideas on power in relation to organisations in the West. Foucault argued that disciplinary power has worked far more effectively than sovereign power and social contractual power in modern society (Foucault, 1977: 137). According to Foucault this has been especially evident in power exercised through disciplinary means in institutions such as schools, prisons and hospitals (Foucault, 1977: 141). In these institutions surveillance systems are essential to make subjects feel that they are observed, hierarchised and rewarded based upon their docility (Foucault, 1977: 147). Power is exercised from innumerable points within society and organisations, and power comes with a series of aims and objectives (Foucault, 1976: 94). Ultimately, disciplinary power is exercised in order for people to discipline themselves to achieve an expected social norm (Foucault, 1977).

A number of accounting researchers have demonstrated that accounting has been a means to exercise disciplinary power to control society for centuries (Bigoni and Funnell, 2015; Loft, 1986；Napier, 2006; Fleishman, 2013: 16; Foucault, 1977; Bigoni and Funnell, 2015). These studies have shown that the accounting system of a nation is not neutral in its intent but, instead, it reflects the intentions and objectives of those in power (Bigoni and Funnell, 2015; Oguri, 2014; Fleishman, 2013). An institution with ultimate power in society, including the government and military forces, are always able to influence accounting rules and have the power to create knowledge and truth (Foucault, 1976; 1980). The findings of this thesis indicate that accounting has been used as a disciplinary power to achieve the

objectives of a nation and organisations. In order to achieve goals collectively, Confucian-led values were discreetly used to discipline people in Japan. Power is very effective when it is difficult to identify (Foucault, 1976). Confucianism in Japan has been a controlling mechanism used by institutions with power to subtly influence people in both positive and negative ways. Power does not reside in one place, but instead it flows from one place to another in line with circumstances (Foucault, 1976). Confucianism helped the Japanese government to create a docile society, which was further reinforced by the adoption of new accounting and accountability practices.

Accounting reflects the intentions of those with authority in order to achieve their objectives. In business corporations accounting knowledge represents power which can be manipulated by senior managers, which may give rise to accounting scandals such as the Olympus case. Confucianism has also influenced accounting and accountability practices in order to achieve the objectives and intentions of successive governments in Japan. This research indicates that Confucian teachings were selectively used in Japan for centuries to conceal the face of power. Confucian-led values helped the Japanese to obtain self-regulation and self-cultivation in a more pervasive, enduring and accepted form than was evident in the West. This research confirms previous findings from studies on disciplinary power in Western accounting (Hopwood, 1987; Miller and Rose, 1990; Hosking and Makve, 1998; Bigoni et al 2013; Bigoni and Funnell, 2015). The thesis also reveals that in Japan Confucian teachings have historically played a pervasive but vital role in disciplinary power within accounting and accountability practices.

8.2 Confucianism and Accounting in the Edo Era

Confucianism became a powerful source of normalising power for the Edo government, allowing it to direct its subjects to learn and apply Confucianism in their daily lives. It became the basis of national norms and a code of conduct for Japanese business society. Confucian teachings, which advocate asceticism and working collectively and loyally (Yoshida, 2002), helped people to achieve economic goals set by the government and business owners. To discipline themselves and their employees using Confucian teachings, business people in the Edo era voluntarily composed the *kakun*, the house law. The comment below is an extract from a *kakun*, a house law, which instructed employees of a family business to understand the teachings from Buddhism, Shintoism and Confucianism.

> You must respect Buddha and Shinto deities and study
> Confucianism to improve your lives.
> (Translation of Miyamoto, 1982:124-125)

Disciplinary power was clearly evident with the employees of merchant houses in the Edo era who had limited freedom and lived on the premises where they worked (Hayashi, 1983). These restrictions further enhanced the effect of disciplinary power (Foucault, 1977).

The internalised Confucian-based values in society influenced business people's perceptions of accounting and accountability in the Edo era. In the Edo era there were no national accounting rules or textbooks and, therefore, each merchant house created its own accounting rules (Chiba, 2009a). Accounting methods using multiple accounting books were developed throughout the Edo era by prominent merchant houses as their business increased in volume and became more complex (Kawahara, 1977). Accounting records from prominent merchant houses reveal

that financial information of business transactions were retained in separate books such as cash books and ledgers based upon a form of double-entry bookkeeping that was unique to Japanese businesses (Ogura, 1962; Tsumura, 2003). The basic form of double-entry bookkeeping was especially useful for merchant houses that conducted business using credit facilities and cheques. Accounting allowed them to record all their complicated business transactions.

Accounting was able to provide merchant houses with visibility of their overall businesses and help them to survive in the feudalistic society. For merchant houses, accounting information was vital to sustain their business by helping business owners to ensure that they complied with the intentions of the government to enhance management. Accounting promoted self-disciplinary acts within merchant houses that reflected the disciplinary watchful gaze of employers. Accounting information, such as donations to temples, indicated the level of discipline within the lives of business people in the Edo era (Egashira, 1992). However, the owner of a business during the Edo era kept the financial information within a group of selected employees. A secret language called *fucho* was used by a number of merchant houses to ensure that only selected members of each merchant family were able to understand accounting information. In many merchant houses strict and regular internal auditing took place, which indicates that accounts had to be meticulously recorded and reviewed (Ogura, 1962; Sakudo, 1979; Miyokawa, 2004). Historical documents demonstrate that accounting was always treated as a vital activity in business, although accounting information was not publicly available.

In the Edo social hierarchy, business people were officially a subservient class,

however wealthy they became. The Edo government insisted that the social hierarchy should remain stable, and business people were expected to feel content about their official humble status despite their business success (Egashira, 1992). The feudal Edo government, which had significant sovereign power, encouraged business activity to create wealth, provided that business people respectfully remained in the lower ranks of the social hierarchy (Miyamoto, 2007). Confucian teachings convinced people that they should be content with their hierarchical positions in life and at work (Egashira, 1992; Miyamoto, 2007). Wealthy business people knew that they should not become a threat to those in power. The government would criticise them or ban their business if they retained too much wealth for themselves or failed to contribute to social welfare. Hence, based upon Confucian teachings and fearful of the supervisory gaze of the government, accounting records of successful business people show how accounting information helped them to identify excess profits which they eventually spent on donations to local communities and to religious institutions (Miyamoto, 1964; Egashira, 1992; Ogura, 2003).

8.3 Accounting in the Meiji Era and before the End of the Pacific War

In the Meiji era the government came to understand that most Asian countries were being colonised by Western nations and that Japan could be the next colony (Jansen, 2000). The Meiji government believed that their priority was to educate the Japanese and to industrialise the nation in order to protect the sovereignty of the country (Kudo, 2015). Western countries had more economic and military power than Japan and, thus, in order to avoid being colonised, the Japanese government had to adopt Western business practices, including their accounting methods (Chiba,

2009b, Foucault, 2007:258; Nishikawa, 2012). The Westernisation of accounting became a priority for the Meiji government and large businesses (Tsumura, 2014). Thus, the government, anxious to become an equal trading partner with Western countries, demanded the rapid Westernisation of Japan, including the introduction of Western double-entry bookkeeping methods (Tsumura, 2014). Western accounting knowledge was regarded as an effective source of power in the Meiji era and Confucian teachings of self-cultivation helped the Japanese to accept this new knowledge as necessary for the prosperity of the nation (Chiba, 2009b; Irokawa, 1970; Morishima, 1982).

The Japanese basic double-entry bookkeeping methods were considered to be outdated when Western accounting methods were introduced at the beginning of the Meiji era. Therefore, a number of schools of commerce were opened to teach Western double-entry bookkeeping methods (Kudo, 2015; Nakano, 2013). Western double-entry bookkeeping methods were translated and taught by invited Western lecturers and practioners so that Japanese businesses could match their Western trade partners. This was not easy for many businesses because traditional Japanese accounting methods had been embedded in many merchant families from the Edo era (Tsumura, 2014). Accordingly, surviving accounting records indicate that the establishment of Western double-entry bookkeeping methods took a considerable amount of time for many Japanese organisations to implement (Yamaji and Fujimura, 2009; Chiba, 2009b).

Accounting enabled business owners to supervise and manage costing and budgeting more efficiently (Napier, 2006) in the sophisticated manufacturing plants which were

constructed to secure both national wealth and international recognition (Jansen, 2000). Government officials and business owners of large corporations in Japan felt it vital to learn Western accounting methods (Chiba, 2009b; Asajima, 2005). Accounting made it possible for the *zaibatsu* groups to create 'calculable men' and, thereby, accumulate wealth, which was in line with the intentions of the government. Schools, factories and military forces based upon Western principles were systematically introduced (Sawai, 2007) and established in the Meiji era, and through these institutions disciplinary power was further developed and exercised (Foucault, 1976; Loft, 1986). The military forces in the pre-war period, which had great political and economic power in Japan, were fully aware of the importance of accounting in order to be prepared for a series of wars (Abe, 2007). Military forces in the early 20th century created their own accounting rules for their suppliers in order to reduce the cost of procurement and to improve logistics (Chiba, 2010b). However, the concept of external auditing was rarely discussed and accounting records of public companies from the Meiji era demonstrated little concern for public transparency and accountability (Tsumura, 2014).

Despite their original objective of the Westernisation of Japan, Japanese society maintained Confucianism in the Meiji era. Confucian values were adopted to ensure that the Japanese worked hard in order to accomplish national goals (Irokawa, 1970). Disciplinary power was employed to achieve the intentions of the Meiji government by using Confucian teachings in order to create docile people (Foucault, 1977; Morishima, 1982). To achieve this, accounting was considered to be one of the most subtly effective techniques to govern and manage wealth in business organisations and the nation in the Meiji era (Iino, 2006; 2008). However,

accounting information was only intended for members of a company's inner circle. This exclusivity of access to accounting information was forcefully challenged only after the US occupied Japan at the end of the Pacific War.

8.4 The US and Nationally Agreed Accounting Standards after the Pacific War

The GHQ transformed many aspects of Japanese society after 1945. The impact of an external power, the GHQ, upon the development of the new constitution, and business practices, including accounting, was very significant in Japanese society between 1945 and 1952 (Sawai, 2007; Someya, 1996). The GHQ demanded that Japan must be democratised in order to allow people greater freedom in their lives, including the ability to choose their religion (Maruyama, 1969). This meant that Japan no longer had a state religion and, thus, religion has had far less impact on modern business. However, the findings from interviews for this thesis indicate that embedded Confucian values are still present in the Japanese society and workplace which helped the Japanese collectively to achieve new norms imposed by the GHQ. Confucian values also encouraged the Japanese to preserve some traditional values such as maintaining the hierarchical order and filial piety within the institutions.

The US officers in the GHQ and ESS used their political and sovereign power over the Japanese in the post war period to change Japanese business practices, issuing detailed instructions for the Japanese government to follow in creating new accounting standards (SCAPINs, 1945a; 1945b). Thus, they strongly recommended that the Japanese should introduce nationally agreed accounting

standards for the collection of corporate taxes (ESS, 1947; Tanaka, 2004). After the war, profit and loss statements were given more importance for investors to protect their investments (Endo, 1962). The Japanese law, the Commercial Code of 1950, forced corporations to introduce the external auditing of company financial reports which before this time had not been systematically audited by a third party. (Kawakita, 2008). Implementing this major reform depended upon the introduction of the new qualification of certified public accountant (CPA) in 1949 (ESS, 1949: 8205; Kawakita, 2008: 17). However, the full adoption of external auditing using CPAs was not implemented in a number of corporations for many years after the stipulation of the Commercial Code of 1950. This was partly because the law was not precisely written or reinforced but also because external auditing was a concept which Japanese business people found hard to accept and implement (Someya, 1996). The necessity of external auditing had rarely been discussed among business people because accounting information was traditionally kept only within a selected group of senior people.

The US lost their significant influence when the GHQ office was closed and Japan regained its sovereignty in 1951. With the US influence weakened, the government allowed Japanese industries to interpret accounting standards to meet their own economic objectives and business customs. The Japanese GAAP contained a number of unique rules which reflected the intentions of the government and corporations, although the Japanese GAAP were originally based upon the US GAAP (Oguri, 2002; 2014). For example, Japanese GAAP accepted high depreciation charges that allowed corporations to retain high levels of reserves, a practice which became the business norm (Hiki, 1996; Tagaya, 2014). This mirrored the objectives

of the nation, one of which was to become an advanced developed country where the power of accounting is significant (Tanaka, 2004).

The Japanese GAAP allowed Japanese corporations, including Panasonic, to retain profits for reinvestment without distributing dividends to shareholders who traditionally had not demanded short-term returns (Tai, 1983; Morishima, 2004). Therefore, increasing dividends for shareholders was not a company's first priority. This was possible because the major shareholders of a company were the same inner circle group members, including its *main bank,* that were also owners of cross-holding shares of the company. The *main bank* provided the company with secure capital and financial supervision (Tanaka, 2004). These *keiretsu* companies were supposed to work harmoniously and help members of their own inner circle in various ways, such as financial and personnel matters (Kikkawa, 2007). Confucian-based beliefs continued to prevail and to assist the Japanese to work collaboratively with the *keiretsu* group companies.

The Japanese government has always been protective towards national industries and, therefore, it did not eagerly promote a change of accounting standards that would have provided advantages to foreign investors. However, accounting standards reflect the most influential party's intentions, in the case of Japan, the US (Tanaka, 2010). In the 1980s, the US started a series of negotiations with Japan to remove trade barriers and to reform various business practices, including accounting standards (SIIa, 1990). A central accounting concern raised by the US government was that Japanese corporations lacked transparency in financial reporting (SIIa, 1990). There were a number of areas in Japanese GAAP which the US strongly

requested Japan to review in order to achieve the fair representation of the financial position of an organisation.

Before the 2000s, some of the Japanese accounting standards made it easier for companies to manipulate their accounts. These previous accounting standards did not require consolidated accounting information and book values were used for valuing the assets and financial losses of a company before 2001 (Tagaya, 2015). Thus, some companies were able to conceal accumulated financial losses because their accounts showed only the book values, not market values, of their financial assets (Tanaka, 2010). When there was negative accounting information, such as excess stock, a company was often able to conceal it in its subsidiary's accounts, as in the Kanebo example. This operation was often conducted just before a financial report was publicly issued (Hamada, 2008). The role of auditing was considered to be of little importance within many Japanese corporations, especially before the *Accounting Big Bang* took place in the early 2000s in Japan (Endo, 2015).

8.5 Accounting Scandals and Confucianism in Contemporary Japan

Confucian values helped the Japanese to achieve a great recovery after their defeat in the Pacific War. Confucian teachings that were subtly absorbed by the Japanese had both positive and negative implications for the management of corporations. Strong, devoted teams in companies led to high efficiency and continued improvements in labour productivity (Kikkawa, 2007). Confucian teachings promoted a patrimonial form of business management which encouraged business owners to be fair and ethical (Efferin and Hopper, 2007). Employees and their employers regarded companies as a big family and most organisations were managed

paternalistically (Morishima, 2004; Efferin and Hopper, 2007). Corporations introduced a number of fringe benefits for employees, including life-long employment and other welfare systems, in order to retain industrious staff and to achieve the economic goals suggested by the government. In return, their employees were expected to be highly loyal and to prove their dedication to the business, which is also one of Confucian teachings, that of reciprocity (Morishima, 2004). Devotion to the culture of long working hours, combined with the lifelong employment system, helped employees to accept that their company was a very special entity as a 'second home' expressed by several interviewees. Emotional attachment to companies can generate unique expectations from both sides. Employees would devote themselves fully to work in order to save their 'second home', or their fatherly figures, that is their employers or superiors.

The continued success of a corporation is given priority in Japanese society over individual goals and benefits (Maruyama, 1974; Shibata, 1971). This is considered to be one of the reasons why a number of corporations, including Olympus and Kanebo, resorted to creating fraudulent accounts. ChuoAoyama, Kanebo's external auditor, which was once a highly regarded international auditing company in Japan, failed to prevent Kanebo from continuing its fraudulent activities. Although external auditors were supposed to exercise responsibility and guide their clients, this was often distorted by the negative side of Confucianism; the need for obedience and respect for seniors and clients. This could prevent employees from being critical about their superiors. Confucianism is selectively applied to employees to exercise power over them. Power possessed by employers and employees has never been equal, even though society has been democratised

(Kamuro, 2015). The organisational hierarchy strongly influences how employees still internalize the intentions and norms of employers. In the course of the interviews for this thesis an employee from a leading manufacturing company admitted that it would be rare to decline a request from one's superior in the organisation. If the manager instructs employees to carry out a specific order it has to be done without asking questions.

In the Olympus case, prevailing traditional values hindered effective management and transparency and encouraged the long-term concealment of financial losses. Recent accounting scandals in Japan may have been prevented if senior managers had not imposed the negative side of Confucianism, the blind obedience to one's seniors, on their subordinates. These senior managers expected their subordinates to be docile without fulfilling their role as superiors who were supposed to be moral leaders that should not indulge in fraudulent activities. When the Olympus accounting scandal was first revealed, the reaction of Japanese society and media was sympathetic towards the Japanese Olympus board of directors. It was claimed that their manipulation of financial information was to protect the reputation of Olympus, rather than gaining personal benefits. In stark contrast, the actions of Olympus's management were not readily accepted by Woodford, the British president of the company at the time, or by the British and American media.

Business transactions and financing take place globally and the demand for more transparent accounts has been increasing in recent years (Hamada, 2008). If Japanese accounting practices do not fulfil global expectations, this could have significant and negative consequences for the nation and its businesses (Oguri et al,

2003; Tanaka, 2010). The EU required the adoption of IFRS by all listed companies from 2005 and, thus, IFRS became more important for multinational corporations in international markets. Hence, a number of Japanese companies are preparing to adopt IFRS. However, it always takes time for a nation and its organisations to change accounting practices because of traditional beliefs and values (Yamaji, 2012). A number of Japanese interviewees identified the necessity of educating people to enhance their awareness of accounting and accountability because the subject of accounting is often considered to belong to specialists, not ordinary people.

> I think people should be more educated on accounting and the subject of money. The Japanese tend to avoid this subject because traditionally, talking about money is considered to be vulgar (Interview with Z, 2017).
>
> I believe we need to educate ourselves, especially on how to read financial statements in order to avoid being exploited by employers or others. The importance of education on money and accounting should be emphasised in society. I still think the Japanese should argue more on serious consequences of failed accounting and accountability practices (Interview with AA, 2017).

Interviewees pointed out the necessity of education and changes in the mind-set of business people if Japan is to survive and excel in global business market.

8.6 Concluding Comments

This research has applied Foucauldian perspectives in order to understand how the complicated and reflective relationships between accounting, society and Confucianism in Japan has shaped accounting and accountability in order for the nation and individual businesses to achieve their economic and political objectives. Accounting is not a neutral representation of economic events. Instead, it implicitly

expresses the intentions of those who rule and their economic goals (Napier, 2006; Fleishman, 2013: 16; Lai et al, 2012). Accounting is a powerful disciplinary device that is always influenced by the intentions of a ruling institution (Hoskin and Macve, 1986).

Through sophisticated and complex relationships between employers and their employees, the Japanese historically established a very pervasive form of disciplinary power in business and accounting practices (Foucault, 1977; Morishima, 1982). Power relationships between employers and their employees extended to all aspects of their business lives, which Confucian teachings reinforced (Foucault, 1977; Fukuyama, 1995). The research significantly indicates that even when Japan became modernised and secular after the Pacific War, the Japanese preferred to live as a docile population and to work collectively (Watsuji, 1973; Morishima, 2004; Maruyama, 2006). This has become a social norm which the Japanese have internalised over time. Accounting and accountability practices in Japan are clearly affected by this social norm as well as the objectives of individual organisations.

The research concludes that it is evident that traditional values influenced by Confucian teachings have played a subtle but significantly effective role in accounting and accountability practice. They helped the Japanese to adopt new accounting standards and to work hard in order to achieve collective economic goals of the nation. Research findings also suggest that selective adoption of Confucian teachings indirectly contributed to the acceptance of several fraudulent accounting practices in Japan. The power of Confucian beliefs has been effectively masked and, therefore, implicit in accounting and accountability practices in Japan. It is

recommended that managers and senior personnel should acknowledge potential consequences of weaknesses in Confucianism when dealing with company accounts.

8.7 Future Research

Follow-up research could investigate how Confucian values are utilised in order to adopt the IFRS in Japanese organisations and their implications for accounting and accountability practice in Japan.

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Appendices

Appendix 1: Questionnaire

NAME JOB TITLE/type

Nationality JOB EXPERIENCE

Purpose of the investigation:

To identify the current accounting issues (e.g. Olympus) in the area of corporate governance in Japan and to explore possible reasons and solutions.

To identify what and how the Japanese belief system have influenced accounting and accountability in Japan.

Questions:

1. Have you had any training or experience in business ethics or corporate governance? (internal/external)

2. What influences your moral standards and business ethics?

3. What are your beliefs and attitude to the company accounts? Does your organisation instruct you on this? Could you elaborate?

4. Do you follow any specific religious or ethical codes which would influence your perception of these accounts? If yes, could you elaborate?

5. How do your superiors influence you? How often do you meet with them and do you hear their beliefs on business? Have you exchanged your views or were you just listening to them?

6. In your experience, what are the typical accounting issues which might arise in organisations?

7. Has there been a notable incident in company accounts concerning your organisation? If yes, has your boss or senior members disclosed it? How much transparency can you expect from your institution on accounts?

8. Do you feel you are well informed on the financial situation as communicated in company accounts? How much do you know? How much do you think your company want you to know?

9. Have you encountered any significant differences in viewing accounts in the company in comparison with your previous experiences? If yes, could you elaborate it? Was it because the management changed the method and do you know the reason? (e.g. Changing philosophy or attitudes towards accounting)

10. Could you tell me which financial scandal in Japan or any other country strikes you most and the reason? How did you feel about it? Could you elaborate?

11. What is your suggestion to improve corporate governance in the accounting domain?

Appendix 2: List of interviewees

Interviewee	Date	Brief Background	Years of business experience	Nationality	Gender
A	July, 2015	Senior manager at a Japanese subsidiary in the UK	32	British	M
B	July, 2015	Business consultant for Japanese companies	13	Japanese	M
C	July, 2015	Manager at a large Japanese corporation	3	Japanese	M
D	August, 2015	Ex-senior banker in the UK	28	Japanese	M
E	September, 2015	Ex-senior officer at a prominent Japanese manufacturer	20	American	F
F	September, 2015	Senior Manager in a large financial institution in Tokyo	9	Japanese	M
G	December, 2015	Ex-President of an engineering company in Japan	32	Japanese	M
H	October, 2015	Senior manager in European HQ of a large Japanese conglomerate	18	British	M
I	December, 2015	Senior Researcher on Accounting and Professor at Business School in Japan; had profound knowledge about Olympus and its accounts	28	Japanese	M
J	January, 2016	Senior manager at a Japanese manufacturing company in the UK	33	Japanese	M
K	January, 2016	Researcher in Accounting (Japanese business organisations)	3	Japanese	M
L	January, 2016	Senior manager of a small trading company who supplies materials to large pharmaceutical companies	41	Japanese	M
M	January, 2016	Legal officer at a large Japanese corporation	8	Japanese	F
N	March, 2016	Chartered Accountant and researcher	6	British	F
O	April, 2016	Senior researcher on accounting and Professor at Business School in Japan	30	Japanese	M
P	April, 2016	CPA and Sales person at a prominent Japanese corporation	6	Japanese	M
Q	April, 2016	Business Analyst at an European bank in Tokyo	8	Japanese	M
R	April, 2016	Ex-analyst and CPA at a multinational	7	Japanese	F

		accountancy firm in Tokyo			
S	June, 2016	Chartered Accountant with international experience	31	British	M
T	September, 2016	Ex-senior manager at a large Japanese corporation	23	Japanese	F
U	September, 2016	Business consultant on Corporate Governance and ex-manager at a large Japanese corporation	22	Japanese	M
V	January, 2017	Accounting senior manager at a large Japanese corporation	28	Japanese	M
W	January, 2017	ex-MD of a Japanese manufacturing company in the UK	37	Japanese	M
X	August, 2017	Board of director at a Japanese company	40	Japanese	M
Y	September, 2017	Ex-manager of a publishing company, business researcher in Japan	18	Japanese	M
Z	October, 2017	Personal Assistant to the president of a large Japanese corporation	13	Japanese	F
AA	October, 2017	CPA, Ex-Accounting analyst at Japanese corporations	32	Japanese	F
BB	August, 2017, follow-up March, 2018	Ex-member of the US-Japan trade negotiation, extensive experience with Japanese corporations	40	American	M

APPENDIX 3: Sample Transcription

JOB TITLE/type ex-manager at a prominent manufacturing corporatino in Japan

Nationality Japanese

Interviewer: Orie Miyazawa (OM) Interviewee: U
Questions:

1. Have you had any training or experience in business ethics or corporate governance? (internal/external)

U: Well, long-standing Japanese corporations are generally similar in terms of business ethics and corporate governance. However, newly established corporations such as Rakuten and Yahoo are quite different. Established corporations share characteristics that Olympus had. One reason for this is that they tend to promote original members who joined companies when they finish their degree and have stayed there since. They are not willing to hire people for key positions from outside. Hence, it is crucial for employees to be liked by their bosses. Otherwise, they have no hope for promotion.

OM: Do you mean they have to be favoured by their bosses in order to be promoted?

U: Yes, that's right.
OM: This is interesting as I heard exactly the same comment from someone else. It is really important to employees to be liked in their organisation.

U: That's right.
OM: If ability is similar, the one who is favoured by his/her boss will be promoted.

U:Well, my observation is slightly different. It doesn't matter whether this person has ability or talent. Anyone who follows your opinion is a good subordinate. The boss will promote him because he favours him.

OM: Do you really think that is still happening as of 2016 in Japan?

U: I think so. Look at the Olympus scandal. It happened not long ago. I don't think it will change. It is in Japanese culture and it won't change.

OM: Have you experienced it in your organisation?

U: Yes. For example, if there is a division or department which does not perform well, a team is set up in order to strengthen the weak department. The leader of the team would select his favoured members and then all of these members are able to be promoted once they achieve the agreed result. This is a typical structure of a project.

OM: I see.

U: There are departments that attract lots of attention from clients and generate profits. However, there are also departments that are not generating profits at all. If you happen to be in the latter type of department, you cannot be promoted even if you are talented.

You cannot change which department you want to work in a Japanese organization.

If you want to move to where you want to work within the organization, you need to politically create the situation by convincing your boss and other senior members.

There is a system called 'job rotation'. But you have to be an excellent employee to be promoted.

The job rotation is a good system but in Japan, it is always the case that employees who stay in the same department are promoted. Hence, it is important for employees to stay in the same department rather than taking the job rotation system.

OM：Do you mean that it is crucial for an employee to work for the same boss or in the same department?

U: Yes, yes. Well, apart from the case where you move to the department with your boss. Otherwise, people would rumour by saying he must have done something wrong in his old department. If he were an excellent employee, his ex-boss or division wouldn't have released him.

OM: Oh, I see.

U: Therefore, if it is not a part of the job rotation scheme, people would say there must be something wrong if there is a new employee from a different department. It would be then extremely difficult for him to be promoted in the new department.

OM: Oh, I see. That reminds me of the comment by an employee who used to work for a company in the ex-Zaibatsu group. The hierarchy of the organization is completely established, so once you join the company at the age of 22, you will know your progression within the company until your retirement age.

U: Yes, yes. There is a personnel system that decides your progression route. For instance, you should be in this particular position after three years. If you are not promoted as planned, people would speculate that there was something wrong with you.

Also, there are some discrepancies between the head office and business divisions. If you are in a division that generates substantial profits, there should be more available positions. It seems like the head office tend to have more positions when the company on the whole is doing well. The number of

positions in each business division depends on how well its business is doing and also how powerful the division head is.

OM: How many employees joined the company when you started the company K?

U：550 employees joined at the same time in my case.

OM: That's a lot of employees.

U: Yes, but this number does not include operators at factories.

OM: I see. Many colleagues. 550 administrative employees.

U: It was during the Bubble Economy in Japan.

OM: I see. Do you know how many of the 550 left the company?

U: Well, I quit the company after 16 years, but I guess about 70% of them are still in the same company. I don't think many left the company.

OM：I see. How many employees were there at that time?

U: About 17,000.

OM: It's a large company.

U：Yes, therefore, it is difficult to promote newly employed people because there are lots of existing employees in the first place.

OM: Joining the company after working for a different organisation is not very common yet?

U: Yes, that's right. Even though changing jobs to another company is becoming more common, the number of positions in any one company is limited. Therefore, there are division managers who have subordinates but also there are people who receive division manager's salary and package but they have no subordinates. In other words, there are not enough positions for everyone.

OM:Yes, I heard about it too.

U: Yes, yes. Think about the number of people who were employed during the Bubble Economy. A company cannot create more positions for them all. Therefore, it is extremely difficult for those who joined the company after working for some other organizations for several years.
OM: Oh, I see.

U: Yes, I understand that the company hire people who have experience in other

companies with good reason. Perhaps there is no suitable existing employees for a certain job. Such as someone who speaks fluent English or in some particular function which requires specific knowledge. But, it is difficult.

OM: Since you became a consultant for Corporate Social Responsibility (CSR), you have seen many companies both in the UK and Japan. Have you seen any changes in large Japanese corporations?

U: Yes, large companies must manage their corporate social responsibility based upon the corporate governance code. In Japan, they created a steward code based upon the British steward code.
In theory, investors pressure corporations to engage it. Of course, corporations must take initiative too. The Corporate Governance Code states how corporations must manage corporate governance and how they need to structure it. So, they know they must enhance their corporate governance.
Awareness among Japanese corporations has been strengthened.

OM: Do you think it is improving?

U: I cannot really say if it is improving.

OM: Despite the fact that awareness has been heightened?

U: Yes, their awareness has been enhanced. For instance, they know they need to hire external board members. Yet, I don't think it is easy for external board members to maintain their independence.

The system of board members is not the same as in England. In England, board members are independent.
However, the majority of the board members in Japan are the head of a business division. These board members are often called executive director or managing director. But the degree of independence is different. Their subordinates work in relevant business divisions and they still have direct influence on them.

OM: I see. In England, the board members are completely separate from ordinary employees. Also, it is quite normal to change jobs. An employee does not necessarily have strong emotional attachment to the company. In Japan, it is still normal for an employee to stay in one company from graduation to retirement.

U: Yes, you are right. There is little liquidity in the job market. Newly established companies would hire experienced personnel, but established corporations tend to employ newly graduates. Sometimes, established companies may hire experienced people by an order of the president.
Also, even if they hire someone from outside, their existing salary system does not accommodate such new comers in some cases. Also founding families are too strong in managing companies.
OM: I heard that Idemitsu is having lots of problems in their M&A project. Their founding family is against the project.
U: Yes, the project on Showa Shell. Hence, the awareness is being enhanced

but the reality is not working.

OM: Do you think it will take more time?
U: Yes, it needs a substantial amount of time.

2. What influences your moral standards and business ethics?

   OM: Do you have any beliefs or religion that affect your decision-making, business ethics and moral?

   U： As an CSR consultant, I do not purchase goods just because they are cheap or make any business decisions based on price.

   For example, if there is a sustainability mark or fair trade mark on a product, I would choose it although it may be more expensive. It can reduce a food mile.

   I make a decision considering overall sustainability.

3. What are your beliefs and attitude to the company accounts? Does your organisation instruct you on ethics on accounting? Can you elaborate? You could refer to the Olympus accounting scandal and Toshiba accounting scandal, if you wish.

   U: After all, any company must behave ethically as a good company.
   For accounting, transparency and accountability must be ensured. If there are investors, accountability must be ensured, so especially large listed corporations must provide accountability and transparency.
   Also, company reports are more comprehensive. Not only financial reports but non-financial reports such as environment and social information are promoted. Corporations are encouraged to be aware of social and environmental issues.
   Well, this is a new concept, so it is not perfect. Yet, it is important to emphasise the importance of comprehensive reports.

   OM: Not just considering accounting, but all aspects must be included. A corporation must be a good organisation for society.
   U:Yes.

4. Do you follow any specific religious or ethical codes which would influence your perception of these accounts? If yes, could you elaborate?

U: I do not follow any particular religion as such, but I follow my heart.

OM: When you say you follow your heart, is it coming from discipline from your parents or school? What is your basis of your criteria?

U: Yes, I said I would follow my heart. This is not taught by one's parents or school. That would be limited even though they may be a positive influence. Well…my wife is a councillor and therapist and, therefore, I was told that understanding and believing in oneself would help oneself to be nice to other people in society. Does this make sense?

OM： Are you saying that you try to create a win-win situation for the the business rather than obtaining a benefit to yourself.

U: Yes. Also, if I see anything extremely cheap, I would suspect exploitation. Therefore, I will purchase from a sustainable source even if it is more expensive.

5 and 6; How do your superiors influence you? How often do you meet with them and do you hear their beliefs on business ethics and corporate governance? You could tell me your past experience.
In your experience, what are the typical accounting issues which might arise in organisations?

U: There was no such thing as corporate governance in the past, so there was no discussion.

OM: How about the recent trend? For instance, large corporations have been training their employees on business ethics.

U: Oh, I see.
OM: I heard that the training is done through a PC. Therefore, it is difficult to know if the training is effective or not.

U:Yes, you are right.

OM: So, when you were working at the company K, they did not provide anything like that before?

U: That's right.

OM:How about a meeting?

U: There was no meeting on a business ethics but there was a general meeting.

OM: Do you think that employees were allowed to speak up? For instance, if your supervisor told you to take illegal action in accounting, would you feel pressure to do it?

U: That would happen. I have experienced a similar case before. It was about inventories. If the accurate number of inventories was revealed, the company would have gone into the red. Hence, we hid the inventory.

OM: I heard about it. Before the introduction of consolidated financial statements, inventories were often hidden in the subsidiary companies.

U: Yes, yes, it was common.

OM: Some other companies called it as 'space travelling'. Hiding inventories often took place depending on industry.

U: I will tell you what. We all know it has to be revealed at some point, but if I were to do it, I would not be promoted. Hence, no one wants to reveal it. There are one or two minority members who would do it, thinking about the future of the company. Unfortunately, these people would be downgraded or sent to a small branch.

OM; Does that mean that an employee who really thought about the future of the company might be downgraded because of his ethical conscience?

U:Yes.

OM:On the other hand, someone who concealed an excess inventory would be promoted.

U:Yes. He would become a top executive.

OM:This sounds familiar. In the Olympus case, successors of CEO have been hiding their financial losses for decades. They might have thought why this was wrong? Well, it might have been ok if they only had Japanese shareholders and customers. They now have overseas investors and customers.
Before, 'the main bank' system was the main source of their finance, but now it is not so much from the main bank.
U:Yes, Yes.

OM So, is it correct in thinking that hiding inventories was common as an accounting issue? They are hidden in subsidiaries or associated companies?

U：Yes, and also in the distributor's warehouses or in their accounts..

OM：I see.

U: Are you sure that my name and other personal information are protected?

OM：Yes, of course. Following the strict ethics rules of University of Kent, your personal information is protected.

U: I am relieved.
OM: If there was any inventory issue, did your boss explain or communicate it with you?

U: Well, if you were working in that particular department, perhaps he would say something, but otherwise, no.

OM: There was no company communication.
U: I don't think so.
OM: When I investigated the Olympus case, ordinary employees knew nothing about it and they only got the information from the media. Therefore, they felt frustrated. Also, there were a number of M&A projects at Olympus, so any ordinary employee could not investigate it if it were outside the scope of his job description.
U: Yes, especially, only the person in charge and his manager knew about the M&A case.
OM: Yes, it would not be released until the very last minute.

U: Well, they may give a general explanation, but perhaps a person in charge may not know everything.

OM：As mentioned earlier, communication attracts lots of attention in Idemitsu case. It is said that communication is often an issue.

7. Has there been a notable incident in company accounts concerning your organisation? If yes, has your boss or senior members disclosed it? How much transparency can you expect from your institution on accounts?

U: For sustainability activity in a company, it is often the case that the company does not quite understand why they need to do business in a sustainable manner.

The comprehensive business report is not yet fully understood. Reports on sustainability must be interrelated with their business, but they cannot see the link. So, they often ask why they have to do certain things.

Sustainability projects are not managed in such a way that employees feel they link in with the main business.
Or, they may not consider that sustainability is the main thing they need to prioritise in business.

OM: Are you saying that board members must really buy in the concept of sustainability?
Did the company K communicate with you and other employees about accounting philosophy or accounting information?

U: Well, they would have if I had needed to control the budget.

OM: Did they control the budget closely?

U: The management of the budget in a large organisation in Japan is similar to what governmental offices would do. The budget would be reduced if it is not spent. Well, there may be exceptional cases, but generally, we would have to spend everything.

OM: I see. That's like a council office. Of course, depending on external factors, you have to significantly spend more or sometimes you cannot spend as much.

U: Well, you cannot spend too much or too little, but once the budget is set, it will need to be spent. Otherwise, it will be reduced next year. For example, if it is a sales department, the national economy would affect sales and you may not be able to spend all the budget.

OM:Which department were you at the company K?
U: I was at HR division for ten years and then the sales department in the subsidiary.
OM: Would a managing director of a subsidiary be sent from the parent company?
U: Yes, if the subsidiary is a start-up.

Also, it might be an employee who could not get a position as a division manager in the parent company.

OM: I see. Do you think the managing director of the subsidiary wants to prove himself to the parent company?

U: Of course. The subsidiary is also invested by the parent company.
OM: I see. There is a definite hierarchy.

U: Yes, yes.
OM: So, if you are employed by the parent company and working for the subsidiary, would you check how the parent company sees you?

U: Yes. Otherwise, you will be accused by the parent company and then replaced by someone else. You need to fight for your position.

OM: I see.
U: At the end of the day, the managing director of the subsidiary must explain about the financial situation to the board members in the parent company.

OM: It is interesting to see that Japanese organisations have a strict hierarchy such as a parent company and its subsidiaries.
Unlike Western corporations, the structure of organisations in Japan is more hierarchical.

U: Far from being flat. When I was talking to my boss a long time ago, it was the norm that an employee who was not in a managerial position could not speak directly to someone at a senior position. He could speak only to his immediate boss or equivalent.

OM: I see. So, there was an unwritten rule where an ordinary employee cannot speak with a division manager.

U: It used to like that. This has changed and I was able to speak directly with senior managers. However, it was not so before.
OM: I see. The company you used to work was established about 100 years ago?

U: Yes. More than that. It was their 100 years anniversary when I was working there. Now, it must be about 120 years old.
OM: A traditional company like that must have a tradition and distinct culture. Is it difficult for a new person to change them in any way.

U: Definitely.

OM: Going back to the Olympus case, it must have been extremely difficult for Mr. Woodford to change their traditional culture and behaviour overnight. According to Mr. Woodford's account, all board members at Olympus were listening to Mr. Kikukawa, the Chairperson and ex-president of Olympus rather than listening to Mr. Woodford despite that Woodford was the CEO at that time.

U: Yes, it is quite normal.
OM: Mr. Woodford was hired as a figurehead, because he would project a good image such as 'global company'. Yet, the actual management decisions were made by the traditional and long-serving board members. In that sense, it was not a peculiar case but it could have happened in any Japanese company.

U: Yes, I agree with you. The ex-president became the chairperson, and then his influence is still strong.
OM: If you had been working for Olympus and Mr. Kikukawa for many years and if he promoted you, you would be loyal to him and the company. Although Mr. Woodford was with Olympus UK for many years, his mentality may not be exactly the same as Mr. Kikukawa's Japanese subordinates.
In Britain, I do not think employees are expected to offer the same amount of loyalty like they did in Olympus. They would rather see the objective of the company. I don't think British managers promote someone based upon their liking or preference only.

U: I feel so too. Also, the structure is rather flat and the distance between an employee and his boss is shorter.

OM: For expressing one's opinion, if your boss says something, it is often the case that no one would question it. From my experience with manufacturing companies, it happened a lot.

U: Yes, that could happen. It depends on the boss. In my case, I was rigorously creating health and safety standards with the division manager. He was a listening manager and very easy to talk to.
Having said that, if someone came from a different division, it might have been difficult. In fact, other colleagues from the different division said they could not propose any suggestion to their division manager. Therefore, it depends on the division or organisation.

OM：I see. I see.

8. Do you feel you are well informed on the financial situation as communicated in company accounts?

U: Not really. I was not in the financial department and we did not discuss it.

9. Have you encountered any significant differences in viewing accounts in the company in comparison with your previous experiences? If yes, could you elaborate? Was it because the management changed the

method and do you know the reason? (e.g. Changing philosophy or attitudes towards accounting)
U: Not much I can say.
OM: I see.

10. Could you tell me which financial scandal in Japan or any other country strikes you most and the reason?

U: Enron, World.com and Olympus.
OM: Any particular reason?
U: For the Enron scandal, I was reading about articles in the Nikkei Newspaper before and it was expanding further and further. I was really impressed before. And then, suddenly its name was tarnished. I was shocked.

World.com came after that. It was even worse. I remember how much I was shocked to read it.

The Olympus case happened recently. That was after I became the CSR consultant. I was interested in corporate governance at that time. Hence, I read the article by FACTA and I attended a talk by Mr. Michael Woodford.

OM: What was your impression of Mr. Woodford in the talk?
U: It is very similar about what he wrote in his book.
He was talking in front of the Japanese, so he did not say any negative things about a Japanese company. He was explaining about his experience in the Olympus scandal.

OM: After he received compensation from Olympus, he no longer speaks about the scandal. Some people were wondering if he really didn't know anything about the accounting scandal.

U: He was able to find out about it because he was appointed as the president of the company according to the article from FACTA.

OM: In that case, financial reports at Olympus were not well publicized.

U: Yes. I think Shin-Nihon Auditing Company should have identified the skeptical accounting manipulation at Olympus.

OM: They must have known about it for many years. They became so complacent and these external auditors could not correct accounts at Olympus if Shin-Nihon Auditing Company received millions from Olympus as a fee.
U: Perhaps.

11. What is your suggestion to improve corporate governance in the accounting domain?

U: The system and rules have been changed. It is called Three Committee. Not all companies have started yet, but it will be adopted eventually. Unlike a conventional auditing system, Three Committee system should be able to convince overseas investors.
However, only a small number of companies are adopting the Three Committee system at present. Their businesses are not particularly doing well. So, some people are saying the new system is not so good and the conventional system is better.

However, the name, 'Three Committee' system has now been changed in order for overseas investors to understand it easily. It is now called Appointing Committee. The new system suggests that a company should hire at least half of their board members from outside. It is now slowly changing in Japanese organisations.

OM: Since when?
U: This was established in 2015.

OM: A very recent thing. The name is changed too.
U: Also, the structure of an auditing committee has changed. It is a transitional period now, so a number of companies will be changing their structure soon. A board member will become more independent. This is not the traditional Japanese way. It will be a more Western type of management where board members would be completely separate.

It is often the case that board members are also in charge of business divisions in traditional Japanese companies. However, board members will become more independent and a company will appoint more external board members. It will be a more Western type of management.

OM: That would be quite different from the traditional Japanese management.

U: It would be completely different. This is not happening quite yet in Japan. In the UK, for instance, the board members are not involved in day-to-day operations.

There are always external board members. The system of Three Committee is not exactly the same. Yet, with the increase of the number of overseas investors and globalisation, Japanese corporations need to change their management style and improve their corporate governance.

OM: Do you think the board system in Japan must to be changed in order to improve corporate governance? Otherwise, there will be another case like the Olympus scandal or Toshiba scandal?
U: Yes. On top of that, the labour market must become more flexible in order to have more transparency and better governance.

OM: I see. At the end of the day, employees protect each other because they have been working for years together. They would listen to their boss.

This may work well in some cases, but not good when it comes to accounting problems. With regard to the job market, more people change jobs and they don't necessarily stay in one company any longer?

U: It may depend on companies.
OM: Are you saying that newly established companies hire their managers from outside, but traditional companies tend to stick to their hierarchy?

U: Yes. But, it depends on their policy.
OM: I see. For example, do you think Japanese companies appoint managing directors for their UK subsidiaries from their head office in Japan rather than hiring someone locally in the UK?
U: I don't think that is a common thing.
OM: Do you think it would be difficult to get a job as a managing director in a Japanese subsidiary in the UK or anywhere else?
U: They may hire foreign managing directors.
OM: Like Mr. Woodford.
U: Yet, mostly they send someone from Japan.

OM: Yes. They would hire ordinary employees but from managers and above, Japanese from the head office.
U: It would be extremely difficult for established companies to hire someone locally.
OM: Is it because of the trust they have in their employees from Japan?
U: Yes. Also, they want to directly control overseas subsidiaries through those Japanese managers, so they would send someone from the head office.
OM: For the open labour market, it is extremely hard for external people to obtain a good position in a company as the company would rather promote someone who has been in the same company for many years.
U: Yes. Especially in Japan, yes.

OM: How about diversity in Japan?
U: Well, there is a language problem. Not many people can speak fluent English. Also, the Japanese rarely appoint female managers or board members. Extremely low numbers. Not just in the accounting area, but overall.
OM: Are you saying that we need to improve the entire employment culture in order to improve accounting systems. Thank you so much for your time today.

U: It's not just an accounting problem but throughout business organisation. No problem.