



Profile: Masayasu Uno

Bridging East and West

Taking typical Japanese differences in corporate governance, financial reporting, and auditing practices into account

Intro

As Japanese organizations become increasingly globalized, Masayasu Uno and the rest of the Japanese business community are bridging customs, standards, and regulations from very different backgrounds.

When developing and implementing global standards, regulations, and oversight, Mr. Uno argues that one should not ignore cultural background and history. A typical feature of Japanese business, for example, is that Japan has historically a somewhat closed corporate culture. The Japanese market started opening up for international trade only one hundred and fifty years ago. Having worked most of his professional life as representative director for foreign companies in Japan, Mr. Uno is well versed in explaining the sometimes significant differences in governance, financial reporting, and auditing practices between Japan and other countries around the world.

Brief Masayasu Uno bio

After his CPA exam, Masayasu Uno worked for a Japanese auditing firm for several years. Subsequently, Mr. Uno moved to the US and entered MIT's Sloan School of Management to obtain management skills and perspective for international business, graduating with an MBA in 1989. While studying in Boston, he also served as a liaison for a Japanese company, helping them to conduct business in the US.

Back in Japan, he developed his management career as representative director of the Japanese subsidiaries of various US multinationals. After being appointed as president of a local company in 2005, he managed to take the company public on the JASDAQ Stock exchange in just two and half years. In 2009, he was appointed as a member of the board of corporate auditors (*kansayaku*) of [Daito Construction and Trust](#) (listed on the Tokyo Stock Exchange). He is a member of the Professional Accountants in Business (PAIB) Committee of the Japanese Institute of Certified Public Accountants (JICPA).

Lifetime employment

Can you give a specific example of a typical facet of Japanese cultural background or history?

“Many Japanese employees used to work their whole lives for the same Japanese company and only left when they retired. This long-lasting lifetime employment system has gradually eroded, especially after the bubble economy burst in the early ‘90s, forcing the labor market to be more mobile, the same as elsewhere. But even so, many employees prefer to work for the same company their entire lives, if they can.”

Few outside directors

Investors and other stakeholders from outside Japan can find it hard to understand the differences between governance in Japan and elsewhere. According to Mr. Uno, better disclosure of the Japanese governance structure, such as board composition, to investors and other stakeholders would really help Japanese companies to be better understood.

“The lifetime employment system generated a great deal of loyalty to the employer, with a high level of integrity and a low level of fraud and betrayal. On the other hand, it also tended to make Japanese companies unwilling to appoint more independent outsiders in vital functions such as members of the board of directors. The board structure in Japanese companies is often totally different than in western companies. Japanese boards, for example, typically consist of mostly internal management—with only a few outside directors—and they are responsible for both execution and supervision.”

“When developing and implementing global standards, regulations, and oversight, one should not ignore cultural background and history.”

Board structure under debate

Does such a board structure still work nowadays?

“A current debate in Japan is whether it is appropriate for public companies, with a broad range of external stakeholders, to have such a strong combination of execution and supervision in one board without appointing external, independent board members. Some argue, regarding the appointment of external board members, that corporate decisions require a lot of knowledge and experience about the company. Without knowing the structure of a particular business, it is difficult for outside directors to participate fully in the company’s decision-making process. Others, however, point to experiences in other countries, in which outside directors are appointed to help ensure more rigorous governance. I think both these arguments are valid and both need to be reflected in continuing corporate governance reform in Japan.”

Japan’s unique corporate auditor system

Does the Japanese governance system compensate for this lack of independence?

“To fill the independence gap, Japan has a longtime system of corporate auditors (Kansayaku-kai).¹ This internal statutory auditor system in Japan is unique and has not been adopted elsewhere. It was stipulated to fulfill an indispensable role in the corporate governance of a Japanese company. Corporate auditors are appointed at the general shareholders’ meeting, not to be dictated by the board of directors, with a term of four years. The revised Japanese Companies Act of 2005 (the revised act) stipulates that at least three corporate auditors be appointed, with half of them coming from outside the company. In contrast, the old act only required one outside auditor.”

What are the roles of these corporate auditors?

“The major role of a corporate auditor is to oversee the business conduct of company directors, as well as the accounting records of the company. In order to perform that role, corporate auditors are granted various powers, such as being able to require directors or employees of the company to report on the status of operations and investigate the financial position of the company. Corporate auditors attend board meetings and are authorized to speak against or in favor of all corporate matters and business conduct. If the corporate auditor finds that a director has engaged in misconduct or that there are facts in violation of laws and regulations, the corporate auditor must report such facts to the board of directors.

¹ Not to be confused with the external auditors; see below.

“The corporate auditor is also entitled to prohibit a director from proceeding with any action that would cause substantial damage to the company. If the corporate auditors fail to fulfill their duties, they are liable to pay compensation for damages. Corporate auditors also monitor the independent external auditors in Japan. Corporate auditors are required to examine the results of audits by independent external auditors and report such results to the board of directors. Corporate auditors are also required to report the results of their own audits at shareholders’ meetings (see also ‘Roles of corporate auditors’).”

“The transformation of Japanese corporate governance reform toward a system with more checks and balances is still underway.”

Roles of corporate auditors (*Kansayaku-kai*)

The Japanese Companies Act protects the positions and designates the duties and responsibilities of the corporate auditors:

- In attending a board meeting, corporate auditors must express their opinion for/against any matter in the meeting as mentioned above.
- In case a corporate auditor suspects that a board member is engaged in misconduct or is in conflict with applicable laws and regulations, the corporate auditor must report such suspicion to the board of directors.
- Corporate auditors are also entitled to prohibit a board member from proceeding with any action that might cause substantial damage to the company. If a corporate auditor fails to fulfill this duty, he or she is subject to be liable for related damages.
- Corporate auditors are required to monitor and examine audit reports by external auditors, and to report the results of such reports to the board of directors.
- In addition to audit reports by external auditors, corporate auditors must present their own audit results at the general shareholders’ meeting.

Corporate auditor or audit committee

Don’t the corporate auditor roles look similar to audit committee roles in other governance structures?

“In order to provide more flexibility for companies in terms of the design of corporate governance structure, the revised Companies Act made it possible for a company to either install an audit committee, which was intended to be more independent from the board of directors, or to appoint corporate auditors as described above. To install an audit committee, the revised act requires the majority of an audit committee with at least three members to be independent from a company. If a company establishes an audit committee, it must also set up a nominating committee and a remuneration committee at the same time.”

How has this increased flexibility worked out so far?

“In spite of the revised act allowing an audit committee system, out of 4,000 listed companies in Japan, including 2,200 listed companies on the Tokyo Stock Exchange, only three percent have adopted the committee system as of today.”

More independence for the board of directors

What else has been done to further improve governance in Japanese organizations?

“In December 2009, the Tokyo Stock Exchange (TSE) enforced a revision of the ‘Provision for Corporate Governance’ applied to all listed companies, in order to further reinforce corporate governance structure. The revision calls for all companies to make notification of the appointment of at least one independent director within the board of directors, as well as within the corporate auditors, by March 2010. An independent director is defined in this provision as an external director who does not have a conflict of interest with shareholders. Directors from a parent company are also excluded to ensure the independence of corporate governance from the parent.

“In addition, this revision states that board members from a corresponding bank, major partners, clients, or customers are not qualified as independent directors, since they are likely to have a conflict of interest. The Japan Association of Securities Dealers Automated Quotation (JASDAQ) also announced the same provision and enforced it on the same day. There is a penalty included in the provision, if notification of the appointment of an independent director is not made after the one-year grace period.”

Japanese corporate governance reform is still under way

Are investors and other stakeholders generally happy with the current governance situation in Japan?

“Generally speaking, they look favorably on the revision of the Companies Act. However, there are still outstanding issues in Japan that require further improvement beyond the legislative matters mentioned above. Although the new law—which seems strong on paper—is enforced throughout Japan, the challenge is that the authority of corporate auditors is still in reality limited in many Japanese companies. As a result, the transformation of Japanese corporate governance reform toward a system with more checks and balances is still underway.

“Historically and customarily, the majority of Japanese management has long regarded corporate auditors as an honorable position for employees or managers after contributing to a company. Although the revised act stipulates vigorous duties and responsibilities for corporate auditors, no professional qualifications are required. As a result of this, many corporate auditors currently appointed even today have no background or experience in finance, accounting, or law.”

Culture and history shaped employee loyalty and company stability

What could the international business community learn from developments in Japanese governance?

“The Japanese corporate governance system differs from the western model, since it has evolved while preserving Japanese culture and history. It also provided sufficient incentive for employees to be loyal to a company and enhance the company’s stability. It should be noted, however, that Japan has its own way of measuring the governance system against the western norm, while overcoming significant differences in culture and history from the west.

“The lifetime employment system has worked well to plan the training of talented employees well in advance. Based upon their contribution and achievement, along with the assessment of their potential,

such talented employees rotated their jobs periodically to gain experience and practice in different functions, and were promoted to roles with more responsibility. The seniority system was the core of governance structure under the lifetime employment. Culturally, senior people are admired and respected by subordinates to fulfill the job mission. This makes senior managers more conscious of governance and compliance matters.”

Financial reporting better discloses financial situation of companies

What has happened in Japan in the area of financial reporting?

“Compared with ten years ago, the current Japanese financial reporting process really helps to better disclose the financial situation of Japanese companies. To a large extent, this has to do with the increasing awareness among boards of directors of the importance of accounting practices, which has risen since the time when the Japanese economy was in trouble, some ten years ago. This has resulted in a much better clarification of the company’s financial situation than before.”

Roadmap for IFRS

How is Japan progressing on the way to a global accounting standard?

“Japan is in good shape regarding the move towards the International Financial Reporting Standards (IFRS), because the Accounting Standards Board of Japan (ASBJ) is steadily converging² the Japanese accounting standards with IFRS. For this reason, the European Union (EU) now permits³ the use of Japanese GAAP as equivalent standards for IFRS as adopted by the EU in European capital markets.

“In June 2009, the Japanese Financial Services Agency (JFSA) released a new roadmap, indicating that the use of IFRS is permitted from March 2010 for consolidated financial statements by listed companies for which financial or operational activities are conducted internationally. The decision for the mandatory use of IFRS will be considered around 2012 and there will be a transition period of at least three years, with 2015 or 2016 being the target year to make IFRS compulsory for the consolidated financial statements of listed companies. This is still being debated.

“It is understood that the main principles of IFRS still have room to be discussed and adjusted until finally being agreed to by the participants. Therefore, most of them are keeping a close eye on how things are going (see also ‘Outstanding issues in the Japanese adoption of IFRS’).”

² Follow the progress of the ASBJ convergence project at https://www.asb.or.jp/asb/asb_e/project_progress/.

³ See EC Press Release, *European Commission grants equivalence in relation to third country GAAPs*, December 12, 2008.

Outstanding issues in the Japanese adoption of IFRS

Mr. Uno identified the following main issues that need to be resolved for the move to IFRS:

- **Solution for small- and medium-sized companies:** “Before the move to IFRS is finalized, there is a strong argument to limit the scope, of the companies to which it applies, to listed companies. If IFRS is applied to all enterprises, it will cause a heavy burden on small- and medium-sized companies, which account for more than 1 million enterprises in Japan—a significant majority.”
- **Alignment with tax authorities:** “The adoption of IFRS necessitates the agreement of the tax authorities in Japan, if it is applied to financial reporting of a single entity where corporate tax is levied beyond a consolidated basis. The financial reporting system in Japan is utilized for two different purposes: one is for disclosure for investors and stakeholders, and the other is for filing taxes and dividend calculation. In Japan, taxes are calculated and submitted in a different format, which starts from earnings after tax in the profit-and-loss account. Different concepts in IFRS from the current Japanese GAAP, such as earnings, allowances, leasing, and revenue recognition, might lead to radical changes in Japan’s corporate taxation system. Furthermore, the Companies Act sets limits on distributable profits based on net assets of companies. This means that companies are only permitted to distribute profits in the form of dividends on the condition that they satisfy certain criteria.”
- **From a rules-based to a more principles-based approach:** “Some parts of the current Japanese accounting standards are rules-based rather than principles-based. For example, ASBJ Guidance No. 10, *Guidance on Accounting Standards for Business Combinations and Accounting Standards for Business Divestitures*, spans 132 pages including 45 illustrative examples. As a consequence, conversion to IFRS also requires a conversion from a rules-based to a more principles-based approach and mindset of financial reporting. This will be another issue for the coming five years.”

Improved comparability between foreign and Japanese companies

Are investors and other stakeholders generally happy with the move to IFRS in Japan?

“Some Japanese analysts welcome IFRS because it improves comparability between foreign and Japanese companies. In addition, multinational enterprises with securities that are registered both in Japan and in the US report their financial results both in Japanese GAAP and US GAAP. The move to IFRS will eliminate dual financial reporting systems in Japan, and will help investors compare the performance of companies more easily without making adjustments between US GAAP and Japanese GAAP.”

Support of fair value accounting

What is the general opinion on the use of fair value accounting in Japan?

“JICPA strongly supports the use of fair value in accounting, publishing an official statement that accounting standards should be established to provide stakeholders with information on financial

statements properly reflecting a company's economic condition. I agree with that. However, it is not always supported by various other parties from the perspective of their own interests and the impact on the financial statements. For example, for small- and medium-sized enterprises (SMEs), which account for more than 99% in numbers of companies in Japan,⁴ fair value accounting looks too complex and causes additional burden of cost and time. Since SMEs are private companies and do not have compulsory external audits, it is argued that the use of fair value accounting is not necessarily important for them."

Internal control over financial reporting

Has the financial reporting process also improved in Japan?

"After the financial accounting scandals around Enron and other companies, Japanese investors and other stakeholders paid more attention to internal control and internal and external audits. Like in other countries, there were legislative changes, such as the implementation of a Japanese version of SOX in 2008.

"Listed companies in Japan are now required to conduct management assessments on the effectiveness of internal control over financial reporting, and prepare an Internal Control Report which, in turn, has to be audited by an external auditor. The external auditors then prepare an Internal Control Audit Report and express their opinions on the management assessment. Investors now use these internal control reports for their investment decisions. This seems to work very well. Of the listed companies for the fiscal year ending in March, external auditor's reports with a qualification of material deficiencies were issued for only about 50 companies out of 2,700 companies."

Accounting Advisors for SMEs

What about the quality of the financial reports of the smaller Japanese companies?

"To improve the adequacy of the financial statements of small- and medium-sized companies, the 2005 revised Companies Act established the function of accounting advisors who internally prepare, jointly with the directors, the financial statements of a company, and issue a report pursuant to the provisions of the applicable Ordinance of the Ministry of Justice. Accounting advisors must be professional accountants."

What are the experiences so far? Did the establishment of accounting advisors improve the adequacy of the financial statements of small- and medium-sized companies?

"As of December 2009, only 1,200 professional accountants were appointed as accounting advisors for 2,100 SMEs, out of 1.4 million SMEs total in Japan. This fact proves that this piece of legislation is not well adopted and supported by the SME sector, as of today. One reason behind that is that the appointment of accounting advisors is not compulsory. Because of the low adoption rate, it is also questionable whether it helps improve the adequacy of the financial statements of SMEs. In my opinion, it is more important that accounting advisors raise the awareness and understanding of financial

⁴ According to the [2009 White Paper on Small and Medium Enterprises in Japan](#), issued by the Small and Medium Enterprise Agency, the number of SMEs accounts for 99.2%, and large enterprises for only 0.8%, of the total enterprises in Japan.

accounting in the SME sector, distinguished from tax accounting. This will improve the overall quality of the financial statements in the long run.”

Quarterly financial reporting

What other financial reporting improvements have been made in Japan?

“In order to facilitate timely disclosure for various stakeholders, compulsory quarterly financial reporting for listed companies and related professional accountant reviews were implemented in Japan in 2008. In addition, all listed companies are required to disclose quarterly performance within 45 days after closing the books. The Tokyo Stock Exchange encourages listed companies to disclose summary reports of quarterly results within 30 days, as a guideline for the purpose of timely disclosure.”

Independent external auditors

Does the Japanese governance system also provide for external auditors?

“Due to the complexity and importance of financial auditing, the Companies Act requires that large Japanese companies appoint independent external auditors to reinforce the accounting audits conducted by (the board of) corporate auditors. The external auditor must be a professional accountant or an audit corporation. External auditors are elected by the shareholders at their annual meeting, subject to the agreement of (the board of) corporate auditors.”

What is the role of these external auditors?

“Unlike corporate auditors, the scope of the audit by an external auditor under the Companies Act is limited to the accounting records. The external auditor is also required to inform the corporate auditors of any and all fraudulent and/or material illegal acts of directors identified in the course of an audit.”

Financial auditing is transforming

What has happened in Japan in the area of financial auditing?

“The Japanese Financial Services Agency (JFSA) determines the Auditing Standards—the basic framework for auditing standards in Japan—and JICPA determines the implementation guidance.

“The globalization of business and capital markets has completely transformed the auditing regime in Japan, including auditing standards. In 2005, the Auditing Standards were significantly revised, among other things, to introduce a risk-based approach that focuses on business risks. The current direction in auditing is a move from a rules-based approach toward a more principles-based approach. Before that, Japan had a rules-based auditing system in which, for example, every auditor had to perform very detailed procedures (see also ‘Convergence of financial auditing developments in Japan’).”

Convergence of financial auditing developments in Japan

According to Mr. Uno, Japan is also working on convergence with international auditing standards and other international standards for professional accountants:

- Japan is on the right track with the International Standards on Auditing (ISAs). With respect to auditing standards, convergence has been accelerated on a global basis with ISAs.
- Japan is now converging with IFAC's *Code of Ethics for Professional Accountants*.
- With respect to the International Education Standards (IESs) for professional accountants, Japan is aiming to convert to them as well. There is a challenge in this conversion, however, because laws and regulations need to be changed.

“In addition, corporate scandals involving listed companies relating to financial reporting, which happened around 2002-2003, have brought additional changes to further prevent fraudulent accounting. The focus was placed on further strengthening the oversight role of external auditors, the revision of auditor liability, the enhancement of quality control and governance, disclosure by audit corporations, and the reinforcement of the independence of auditors. The Certified Public Accountants and Auditing Oversight Board (CPA AOB), established in 2004, is a public oversight body that monitors and oversees professional accountants and JICPA's quality control review.

“Generally, investors and other stakeholders appear to be satisfied with the revision of the Auditing Standards and the enforcement of oversight of professional accountants, in order to ensure and improve the quality of audits.”

Future corporate reports will encompass corporate social responsibility

What could the international business community learn from the financial auditing developments in Japan?

“The International business community could learn about the corporate social responsibility program of Japan in the near future. Japan aims to lead auditing practices in other fields. Among business society as well as consumers, consciousness about corporate social responsibility has been steadily on the rise for the last decade, because safety and environmental protection are regarded as fundamental obligations to conduct business. Now, many companies voluntarily disclose corporate social responsibility (CSR) reports, which depict corporate activities more comprehensively than financial reports, by referring to business sustainability, compliance, and measures for environmental issues, and accompanied with a commitment to CSR by top company management. This trend and notion might lead to the development of more comprehensive corporate reports that encompass current financial reporting in the near future. Along with this development, how and if assurance is provided for CSR reports is currently being studied.

“In order to improve the reliability of CSR information, JICPA has published several research reports on assurance services regarding sustainability information. JICPA also plans to develop practical guidance on assurance services on sustainability information, taking note of the revision of the International

Standard on Assurance Engagements 3000, [Assurance Engagements Other than Audits or Reviews of Historical Financial Information.](#)

Management commentary

What is your view on management commentary in Japanese business reporting?

“Management commentary in Japan is often too long and not sufficiently focused on material issues and organizational risks. A solution is for companies to move additional information to, for example, the company website.”

Would the [exposure draft on management commentary](#), as recently issued by the International Accounting Standards Board (IASB), help to improve the situation in Japan?

“The ASBJ proposed the following in its comment letter on March 2, 2010: ‘It is very difficult to use the high-level guidance on management commentary without application guidance and illustrative examples. Therefore, the IASB should develop comprehensive guidance on management commentary, which includes application guidance and illustrative examples, as well as the guidance proposed in the exposure draft.’ As of today, JICPA does not comment on the letter, while assessing the feedback from the field.”

XBRL helps investors to extract different types of information

How is XBRL developing in Japan?

“All Japanese public companies must use the Electronic Disclosure for Investor’s NETwork (EDINET) to file annual securities reports and other regulatory reports with the FSA. All disclosure documents submitted through the EDINET system can be browsed via the Internet. Companies are required to submit financial statements in the eXtensible Business Reporting language (XBRL) format to EDINET from fiscal years beginning on or after April 1, 2008. The introduction of XBRL will really help investors to extract different types of information. The assurance of the XBRL data is still a challenge, however.”

Finally

“In the future, JICPA and IFAC should try to further develop finance and accounting competencies of individuals serving on boards and management, as well as awareness of the ethical issues surrounding business and accounting practices. In further improving the financial reporting supply chain, however, we must keep our eye on the unique situations in various countries.”

Key recommendations from Masayasu Uno

1. When developing and implementing global standards, regulations, and oversight, one should not overlook relevant cultural background and history.
2. Corporate auditors should have a background or experience in finance, accounting, and/or law, and preferably also a professional qualification.
3. Board composition should be a balance between (internal) directors who really understand the structure of a particular business, and independent directors who help ensure more rigorous governance.
4. For discussion of IFRS applicability to small- and medium-sized companies, a certain solution needs to be found to avoid a heavy burden on them.
5. The use of fair value in accounting should be supported because it provides stakeholders with information properly reflecting a company's economic condition.
6. Special accounting advisors should raise awareness and understanding of financial accounting in the SME sector, distinguished from tax accounting. This will improve the overall quality of financial statements in the long run.
7. Increased consciousness about corporate social responsibility should lead to the development of more comprehensive corporate reports.
8. It is very difficult to use the high-level guidance on management commentary without application guidance and illustrative examples. Therefore, comprehensive guidance on management commentary including application guidance and illustrative examples should be developed.
9. XBRL will really help investors to extract different types of information. However, the assurance of the XBRL data is still a challenge.

We welcome your feedback on these recommendations. To provide us with your feedback, please complete this brief [survey](#).