



The National Institute of Accountants
Submission to the Australian Department of Foreign Affairs and
Trade on Problems Doing Business in Japan
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The National Institute of Accountants

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- setting and enforcing professional and ethical standards; and
- promoting issues of importance in the accounting profession.

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Executive Summary

The NIA believes that the main barriers to entry for Australian financial services businesses to enter the Japanese market are:

- the 'closed shop' attitude of the Japanese accounting industry including strict restrictions on entry to work for foreign qualified accountants;
- traditional conservative attitude; and
- strong political and bureaucratic control and influence.

An Australia-Japan Free Trade Agreement (FTA) is a good opportunity to introduce Australian professional services to Japan and alleviate the pressure of increasing demand for professional accountants in corporate sectors in Japan. The NIA believes Japan will benefit even further from the high standard of professional services provided by qualified Australian accountants and by working together Australia and Japan can have greater influence on the development of accounting standards than they could achieve separately.

The NIA's submission is divided into three components. The first identifies the limitations of the accounting industry in Japan; the second introduces relevant proposals in the Asian Gateway Initiative released by the Japanese Government; and the last part highlights the recommendation from the NIA.

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Introduction

Japan plays an important role in the global economy. According to statistics from DFAT, Japan was the world's second-largest economy measured in US dollars and the fourth-largest economy measured in purchasing power parity terms in 2006. Japan's services sector, including financial services, now plays a far more prominent role in the economy and accounts for about 70 per cent of GDP. Japan has been Australia's largest export market for more than forty years. It is a key market for resources and agricultural exports. However, due to different cultures and business operation traditions between the two countries, significant barriers exist in bilateral trade and investment conditions, especially in areas of professional services such as accounting.



Background

The Japanese Government and corporate sector have traditionally had a long-term view with a conservative culture and governance structures that are different from those now found in Australia. While Australia over time has opened its economy to greater international competition, Japan has maintained to a large extent protective measures in areas it believes are culturally or economically significant. The Japanese accounting industry is particularly known for its conservative character. The Japanese Institute of Certified Public Accountants (JICPA) is the sole accounting organisation which was originally formed in 1949 as a self-disciplinary association body in Japan. Whereas in Australia there are three professional accounting bodies and a tradition of participating in international accounting developments.

Accounting professionals are in increasing demand in Japan due to continued corporate growth and the involvement of Japanese companies expanding overseas. With the growing adoption of international accounting standards it is becoming even more important to have accountants with knowledge and experience of these standards and who take a world view of accounting.

Japan is highly dependent on exports for continued growth. Over 20 per cent of Japan's exports are destined for the US, however, the slowing of the US economy will dampen US imports from Japan. Japan, together with Germany, are major exporters of industrial machinery that feed the growth of China's booming economy. However, as China exports heavily to the US, any downturn in the US economy may affect this growth which will in turn affect its demand for Japanese industrial machinery.

In order to reduce the potential side-effects on the domestic economy from the US recession, Japanese enterprises need to explore alternative business opportunities and enhance the existing cooperative relationships with other countries. It will generate increasing demand for accounting professionals who are familiar with foreign company structures and the International Financial Reporting Standards (IFRS). The limited number of current Japanese CPAs will not be able to fulfill the demand.

The aging of the Japanese population is another factor that contributes to the demand for accounting professionals in Japan. According to the statistics from the Ministry of Public Management of Japan, 10.0 per cent of the total Japanese population are senior citizens of 75 years and above, as at 21 November 2007. Skilled and experienced employees in many industries, including the accounting profession, are increasingly in demand in Japan.

The Japanese Government and corporate sector have realized the importance of integrating with the global economic environment. To be part of the global economy it needs a skilled workforce that is accustomed to working in a global environment, skills that many of those brought up under Japan's closed structure may not possess. Japan is facing the realization that it may have to draw on this international experience to achieve further success in the future.

With the significant revisions to the *Japanese Company Law (2006)*, it is getting easier to establish a business in Japan. However, the Japanese accounting industry has remained very conservative compared with other countries. The accounting profession was one of the first truly international professions to develop and in many respects, together with IT, is one of the driving forces of globalization. Japan, however, remains one of the 'final frontiers' for this internationalization of accounting services. It has a very limited number of qualified accounting professionals – approximately 20,000 CPAs out of a total population of 127 million in 2006 at a ratio of 1:635. In comparison to other first world economies, for example, the ratio in Australia is 1:110, that is, about 190,000 qualified accountants (members of the NIA, CPA Australia and the Institute of Chartered Accountants in Australia (ICAA)) out of a total population of 21 million in 2006. To cope with an increasingly globalised economy, Japan will need to address this shortage of qualified accountants, a shortage that is unlikely to be met, at least in the short term, by Japanese graduates.



1. Limitations of the Accounting Industry in Japan

The main limitations of the Japanese accounting industry are 1) an 'over-protected closed shop' that protects incumbents and keeps out new players and places strict restrictions on foreign trained accountants working in Japan; 2) a traditional and conservative culture and 3) a tradition of strong political controls and influence with a heavy handed role played by the bureaucracy.

1.1 Strict restrictions on foreign qualified accountants

Throughout most of the first world economies the accounting profession is dominated by the so called 'big four' firms, with the 'second tier' firms following closely behind them. These firms are characterized by transfers of employees across the globe with Australian accountants working in London, British accountants in South Africa and elsewhere the world over. The employees of these firms are from all over the world, united by accounting. In Japan the picture is starkly different. Based on statistics from the JICPA, there were only four registered foreign CPAs in the JICPA in 2006, which indicates the conservative and overly self-protective attitude in the Japanese accounting profession. The Ministry of Finance's control of the CPA examination has led to extremely low pass rates. It has been contended that the Japanese Government keeps the accounting profession small in order to reduce the potential risk of a large number of highly mobile professionals undermining the cultural value of company loyalty.

According to Article 16-2 in the *Japanese Certified Public Accountants Law (2005)*, qualified foreign accountants have to have their qualifications approved by the Prime Minister. The Prime Minister shall have the Certified Public Accountants and Auditing Oversight Board give the examination or conduct the screening, in accordance with the Cabinet Office Ordinance. Therefore, it is very difficult for qualified foreign accountants to achieve the Japanese CPA qualification and to practice in Japan. These draconian restrictions effectively result in a very high barrier to entry into the Japanese accounting profession.

Unlike the big accounting firms, which have successfully expanded globally by being open to accountants from around the world, Japanese accounting firms are becoming increasingly uncompetitive as the Japanese accounting profession remains effectively closed to foreign trained accountants.

1.2 Traditional conservative attitude

Japanese companies are known for their conservative and long term view; employees are encouraged to be loyal to the company, with the expectation that they would then have work for life with that company. Loyalty within a company group is expected to be paramount. In line with this culture, a Japanese company and its CPA firm usually maintain very close relations.

As a traditional virtue of the Japanese people, loyalty contributed significantly to the recovery and development of the Japanese economy post World War II. However, an over-emphasis on this trait can lead to the domestic economy being isolated from other economies, thereby acting as a constraint on the further development of the Japanese economy. Gradually, many Japanese international firms (particularly those in the automotive industry) have discovered that they need to be open to new ideas and new ways of doing business. As they have expanded overseas they have learnt to adopt new ways. However, the accounting profession has not had the same degree of integration with overseas companies so they have not been exposed to new ways of thinking and doing business. This conservative approach may have the effect of increasingly leaving Japanese accounting firms isolated from the rest of the accounting fraternity.

1.3 Strong political control and influence

Although the Japanese Government has little direct involvement in the operation of the private sector, through its ministerial bureaucracies it maintains tight supervision of firms via regulations and mandatory administrative guidance. It manages industrial policy by directing various sectors into suggested areas of enterprise and facilitating their entry by providing seed money and research, technical and regulatory support.

This culture of support has helped Japanese firms to grow and to put money into research and development. However, while there has been a degree of political oversight, the most competitive Japanese firms are those that have faced internal domestic competition (think the electronic and automotive industries). The lack of competition within the accounting firms has led to them becoming staid. While the 'big four' dominate the accounting profession worldwide they compete strongly between themselves and there is the ever present danger of one of the second tier firms taking business share.

In many instances, the other outcome of overt bureaucracy is that firms become even more conservative. It becomes easy to just follow directives rather than develop procedures of their own. Political controls led to accountants and others factoring in concerns of the bureaucracy over the concerns for professionalism, which can lead to sub-optimal results for the firm.

A clear example of where this has harmed Japan in the past was the property bubble that was followed by a long period of economic stagnation. Values were inflated but in order to protect the firm and its related entities, accounting methods disguised the true position of many companies until it was too late.

2. Asian Gateway Initiative

The Japanese Government has realized the effect of its population shrinking on its economy as well as the importance of promoting exchanges and integration with other countries. An Asian Gateway Initiative was launched by the Asian Gateway Strategy Council in May 2007 which proposed 10 major policy priorities and 7 priority areas in order to boost the Japanese economy. The following relevant reform proposals are recommended in the Initiative:

2.1 Create a financial and capital market highly attractive to Asian Customers (Item 5, Ten Major Policy Priorities)

Relevant proposed subjects include:

- create a professional financial market and foster financial professionals;
- improve access to the Japanese market as an international financial center; and
- improve financial regulation and the administration system and their transparency.

The subjects listed above reflect the awareness by the Japanese Government of the important roles that professionals play in the financial market and the necessity for reform of its current financial regulation and administration system. This is a suitable time for Australia to raise financial services issues in the FTA negotiation. The object is to discuss and ensure the inclusion of financial services and reciprocal recognition of professional qualifications into the FTA.



2.2 Strategy for human resource development (Item 2, Seven Priority Areas)

Relevant proposed subjects include:

- acceptance and development of international human resources considered as the primary source of innovation; and
- change the basic position toward highly-competent human resources from acceptance-oriented to acquisition-oriented, and view them as highly desirable people rather than merely admissible people.

The subjects noted above identify the willingness of Japan to alter the traditional attitude of resistance towards foreign companies and employees. Support from the Japanese Government is important to open the door and facilitate the procedures of acceptance and recognition of foreign sources by the Japanese corporate sector.

Australia can act as an excellent source of human resources, especially accounting professionals, as Australian accounting professionals have the following advantages:

- high professional and ethical standards;
- ability to provide high quality services;
- familiarity with western corporate structures and governance;
- English speaking;
- Australia is close to Japan geographically compared to other western countries; and
- a strong post-war relationship not just at the Government level but also between people generally.

Japan will benefit from attracting Australian qualified accountants to work in Japan. One of the greatest benefits will be alleviating the pressure of the skills shortage of accounting professionals.



3. Recommendation

For Japanese companies to fully realize their potential as part of the global economy they need to start to open up to international norms in relation to accounting and other business practices. Japan needs to look to overseas accountants to fulfill, at least in the near term, its economic potential. This is not just a measure that is good for Australian accountants but is good for Japan as well. However, without the Japanese Government's support and policy intervention, Japan will remain an accounting 'backwater'. The Japanese Government needs to act as an agent of change to promote greater co-operation between Japanese accountants and their international brethren. The Japanese industry is unlikely to act without the Governments intervention. Therefore, the following procedures are recommended to be integrated with the Australia-Japan FTA to facilitate the negotiation:

- Include professional services and an open approach of mutual recognition of professional qualifications as generic terms in the Australia-Japan FTA . This will open the door for effective and progressive negotiations leading to finalization of the FTA.
- Initiate reciprocal recognition/exemption negotiations on professional qualifications between the recognised accounting professional bodies in the two countries with the support from the respective governments, that is, between the JICPA and an Australian accounting delegation (the NIA, CPA Australia and the ICAA).
- Set up schedules and an implementation plan for reciprocal recognition/exemption negotiations, if necessary, involve the relevant government authorities and agencies in the two countries.



Conclusion

Accounting professionals are increasingly in demand in Japan due to the shrinking and aging of the Japanese population and the trend of the local economy integrating with the global economy. In accordance with the Japanese Government's willingness to improve its financial services and administration policy as reflected in its Asian Gateway Initiative, the Australia-Japan FTA should include professional services and an open approach for mutual recognition on professional qualifications, as generic terms. Relevant schedules and an implementation plan should also be set up with the necessary support from relevant government agencies in the two countries.

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Appendix A – Asian Gateway Initiative

Appendix B – *The Certified Public Accountants Law, Japan (2005)*



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