Changes to the Accountability Concept in Japan's PIC Accounting Standard: Accountability to Whom, and for What?

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1. Introduction

In Japan, a major reform in the legal framework of public interest corporations[1] (PICs) took place in December 2008.[2] The goal of the reform was "to promote sound development of non-governmental/not-for-profit activities, and thus contribute to the promotion of public interest activities by the private sector" (Public Interest Corporation Commission [PIC Commission] 2014). Responding to the reform, the PIC Commission[3] of the Cabinet Office issued in April 2008 a financial accounting standard for PICs, based on the prior accounting standard of 2004. This 2004 standard did drastically change the financial accounting framework of PICs, from the stewardship accounting seen in the 1977 and 1985 standards to decision-usefulness accounting; it established the objectives of general-purpose external financial reporting. It was introduced to improve overall accountability and transparency. Since the current accounting standard is based on the 2004 standard, we need to evaluate whether the standard really improves the accountability and transparency of PIC activities.

The financial accounting and reporting regime in Japan has been generally influenced since the end of World War II by that of the United States (USA). Not-for-profit accounting in the USA shifted the focus of the financial accounting framework from stewardship responsibility to usefulness in decision-making, and so until the 1990s, the objectives of general-purpose financial reporting and the financial accounting standards were established. In the evolution of not-for-profit accounting, it should be questioned how financial reporting has improved the accountability and transparency of not-for-profit organizations; this is true also for charities in the United Kingdom (Cordery and Baskerville 2007; Cordery 2013).

This study analyzes the 1977 and 1985 accounting standards of PICs in

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[1] The term "public interest corporations" is equivalent to the term "501(c)(3) organizations" in the United States and to "charities" in the United Kingdom.
[2] Three new acts related to PICs were enacted in 2006 to replace the old system, which had been based on the Civil Code of 1896; these acts pertained to "General Corporations," "Authorization," and "Transition."
[3] The PIC Commission is also known as the Public Interest Commission.

Japan, and those of 2004 and 2008, to evaluate how changes in accounting standards brought about intended improvements in accountability and transparency. This analysis is centers on the decision usefulness theory of financial information, which attempts to describe accounting as a process of providing relevant information to relevant decision-makers, such as shareholders and investors (AAA 1966). All the setters of accounting standards—such as the Financial Accounting Standards Board (FASB) in the USA, and the International Accounting Standards Board—have been adopting this theory in setting accounting standards. This theory has even been widely adopted in not-for-profit accounting (cf. FASB 1980).

2. Public Interest Corporations Systems in Japan

(1) The Old Public Interest Corporations System

The old PIC system was introduced under the Civil Code, in 1896; the fundamental legal framework remained essentially unchanged until the reform of 2008. Article 34 of the Civil Code describes that "Any association or foundation relating to any academic activities, art, charity, worship, religion, or other public interest which is not for profit may be established as a juridical person with the permission of the competent government agency."[4] Regarding the old PIC system, various problems had been repeatedly highlighted and debated, for many years (Dongre and Deguchi 2010; Laratta and Mason 2010; Okamoto 2015; Deguchi 2016).

This study highlights two problems in particular that gave rise to the reform of 2008 (Okamoto 2015). First, there was no way for an organization that was not-for-profit and which pursued a nonpublic interest (i.e., a mutual interest) to be incorporated under Article 34. Until the major reform of 2008, the criterion of incorporation in Japan determined whether an organization was considered "for-profit" or "not-for-profit": under Article 34 of the old Civil Law, a "not-for-profit" organization was one that worked in the "public interest." Organizations such as alumni groups and trade associations were not incorporated, because they basically pursued mutual interests or common interests within a group.

Second, Article 34 allowed the government wide discretion over the establishment of PICs, by granting them "permission." Since government officials had the authority to grant permission to organizations, the arbitrariness of the actions of those in office served as a point of controversy. Under the old PIC system, the definition and interpretation of "public interest" was decided only by government officials, and by neither law nor society. Hoshino describes this administration as tantamount to "koeki kokka dokusen shugi [the state

[4] English translation of the Civil Code is based on the Japanese Law Translation Database System. http://www.japaneselawtranslation.go.jp/law/detail/?id=2057&vm=&re=02&new=1

monopolism of public interest]" (1998, 96). Misuse of this power by government officials was seen on a repeated basis, time and again.

(2) The New Public Interest Corporations System

In response to these problems, three new acts related to PICs were enacted in 2006—and brought into force in 2008—to implement a reform; this reform helped replace the old PIC system under the Civil Code. The PIC Commission describes the purpose of this reform as "build[ing] a society in which no-governmental public interest activities prevail, through authorizing new Public Interest Corporations and ensuring proper operations thereof by appropriate and prudent regulation in accordance with the new laws" (PIC Commission 2014). The Act on General Corporations (*Ippan Hojin*) stipulates the establishment and governance of general corporations.[5] The Act on the Authorization of Public Interest Corporations (*Koeki Hojin*) stipulates the criteria and requirements regarding both the authorization and regulation of PICs.[6] Finally, the Act on Transition stipulates the procedures under which former Civil Code corporations (*Tokurei Minpo Hojin*) were transitioned to the new system.[7]

By virtue of the new legal framework under these three new acts, many of the aforementioned (and long-argued) problems were finally resolved. First, one can now easily establish in Japan a general corporation that is a not-for-profit organization, and register it as a juridical entity through the Registration Office. A general corporation does not need to take the public interest; it can pursue mutual or common interests within a group.

Second, the new laws ushered in a new system of PIC authorization, thus abolishing the "permission" system previously overseen by government officials. Under the new laws, a general corporation could become a public interest corporation through the authorization by the Prime Minister or a Prefectural Governor, in consultation with the PIC Commission or the Prefectural Councils;[8]

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[5] Act on General Incorporated Associations and General Incorporated Foundations (Act No. 48 of 2 June 2006).

[6] Act on Authorization of Public Interest Incorporated Associations and Public Interest Incorporated Foundation (Act No. 49 of 2 June 2006).

[7] Act on Arrangement of Relevant Acts Incidental to the Enforcement of the Act on General Incorporated Associations and General Incorporated Foundations and the Act on Authorization of Public Interest Incorporated Associations and Public Interest Incorporated Foundation (Act No. 50 of 2 June 2006).

[8] The nature of the authorization process depends on the area of activity of those general corporations that are applying for PIC status. A general corporation that operates in more than a single prefecture (i.e., nationwide) falls under the jurisdiction of the Prime Minister, and the PIC Commission is in charge of the consultation. A local general corporation that operates in a single prefecture falls under the jurisdiction of the relevant Prefectural Governor, and the Prefectural Councils are in charge of the consultation (PIC Commission 2014).

such status was no longer determined by government officials. Such authorization is decided based on the reported recommendations of the PIC Commission or the Prefectural Councils, as to whether the application meets the criteria set in the Act on Authorization of PICs (PIC Commission 2014; Okamoto 2015). This newly adopted authorization system was based on the model of the Charity Commission in England and Wales.

As of March 31, 2016, 9,416 corporations have been authorized as PICs (PIC Commission 2016). Of those 9,416 corporations, 1,038 were newly established after the 2008 reform, and 8,378 were corporations under the old Civil Code.

3. Accountability

Generally speaking, the importance of PIC accountability under the new laws remains identical to that under the old Civil Law. PICs have always been expected to be responsible for their activities and be held accountable to their stakeholders. However, the elements of accountability between the old and new systems are very different.

In the old system, PICs were expected to be accountable for their activities—not to the public, but to the competent government agency, because the agency had the authority to permit and maintain their PIC status. The competent government agency was considered the foremost stakeholder, among all other stakeholders (e.g., donors, other resource providers, creditors, and customers [i.e., recipients of services]). Legally, PICs were not compelled to report on or disclose their activities to stakeholders other than the government agency, although voluntary disclosures were recommended. One could say that the PICs indirectly discharged their accountability to the public, through reports to the government, and the government's approval of the same.

Under the new PIC system, PICs are explicitly expected to be accountable not just to the government, but also to the public; as such, they are to discharge their accountability through various reports and disclosures. According to the Act on Authorization of PICs, PICs must publicly disclose various documents (e.g., business plans, budgets, business summary reports, inventories of property, lists of officers and employees, financial statements, articles of incorporation, and member lists). These documents are also to be submitted to the government.

Under the new PIC system, PICs are expected to govern and operate transparently—in line with the laws and their own articles of incorporation—as an independent existence, so as to serve society; this societal dimension was much more pronounced than was previously the case. PICs need to rely on their own activities and operations with regards to the public by making direct disclosures to them—even though, under the old system, government agencies once guaranteed PIC reliance on them. As people come to better understand PIC activities and operations through various means of disclosure, public support will increase.

4. Accounting Standards of 1977 and 1985

The financial accounting standard for PICs was established in 1977, for the first time in the long history of the government-run PIC system (i.e., the Liaison Council of Ministries and Government Agencies); this standard was established on account of many scandals, such as those involving fraud, the "window dressing" of financial statements, and inappropriate accounting practices and/or reporting. The 1977 standard was introduced as a unified accounting standard to be used in instruction and supervision, in order to ensure proper financial management of PICs from the viewpoint of government agencies. In this standard, financial statements consisted of (1) budgets, (2) income and expenditure statements, (3) balance sheets, and (4) inventories of assets.

Soon after the 1977 standard was issued, there were criticisms from academics and professional practitioners regarding the complicated nature of the standard, and difficulties inherent in applying it to for-profit businesses, *inter alia*. In response to these criticisms, the 1977 standard was revised in 1985. In the 1985 standard, financial statements consisted of (1) budgets, (2) income and expenditure statements, (3) statements of changes in net assets, (4) balance sheets, and (5) inventories of assets.

The 1977 standard and the 1985 revision served both internal and supervisory purposes with regards to financial accounting and reporting guidelines; they helped contribute to competence vis-à-vis government agencies' instruction and supervision of PICs, rather than serve a general purpose with regards to PICs' external financial reporting. This is why a system based on government accounting—characterized by a budget and an income and expenditure statement—was adopted. Additionally, in cases where PICs received subsidies from the government or contributions from donors, cash-basis financial statements (e.g., income and expenditure statements) were very useful for governments or donors who had contributed financial resources: they could use these statements to check on subsidy or contribution use, and whether spending aligned with original planning or intentions, given that income and expenditure statements explicitly broke out item use and amounts.

These standards are characterized as being in line with stewardship accounting. A PIC, as a steward, receives financial resources from providers such as government agencies and donors; it then uses these resources in support of the public interest, in line with a budget that describes in monetary terms the PIC's business plan. Periodically, PICs report to their resource providers on how those resources are being used, by way of reports (e.g., business reports and financial statements), to hold themselves accountable to resource providers. To this end, the provision of cash-basis statements (e.g., budgets and income and expenditure statements) is quite crucial to the discharge of accountability. With stewardship accounting, disclosures to the public are not as important as reporting financial statements to certain stakeholders, such as resource providers.

5. Accounting Standards of 2004 and 2008

The 1985 accounting standard was revised in 2004, to update the almost 20-year-old standard and meet social demands for public disclosure. Especially in the 10 years leading up to the 2004 revision, the public was indicating a desire for public disclosure by government administrations and government-affiliated corporations, and so PICs gradually came about. The great Hanshin Awaji Earthquake occurred in Japan in 1995 and "unveiled the defect of the legal system" in promoting various not-for-profit activities in the community (Deguchi 2016).[9] In 1997, the government published the very first white paper on PICs as a whole, in response to the public disclosure. The Administrative Information Disclosure Law was introduced in 1999, and as of 2001, the government started to require that PICs disclose information to the public.

In response to public demands for disclosure, the revised 2004 standard was established by the government (i.e., the Liaison Council of Relevant Ministries related to the Instruction and Supervision of PICs), in the same manner as that seen with previous standards; as a result, in 2008, a new PIC authorization system was created by the PIC Commission of the Cabinet Office. One significant difference between this system and previous ones is in the underlying theory: accounting theory, which the 2004 and 2008 standards adopt, is a decision-usefulness theory of accounting,[10] and not stewardship accounting. With decision-usefulness theory, accounting is defined as "the process of identifying, measuring, and communicating economic information to permit informed judgments and decisions by users of the information" (AAA 1966), and the role of accounting is to provide information useful to decision-makers. The 2004 standard was strongly influenced by the outcome of FASB financial accounting research in not-for-profit accounting—particularly by concepts statement No. 4, the financial accounting standard No. 117, and others (FASB 1980; FASB 1993a; FASB 1993b). The objective of financial reporting has shifted from "supervision by the government" to "disclosure to the public." The new

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[9] Defects in the legal system, which had been laid bare in the wake of the great disaster, resulted in 1988 in the Law to Promote Specified Nonprofit Activities—usually called the "NPO Law"—and ultimately specific nonprofit activity corporations (called "NPO corporations").

[10] With decision-usefulness theory, it is important how disclosed information affects decision-making by stakeholders (e.g., financial resource providers) and eases and eliminates information asymmetry, as stakeholders are external and need information if they are to provide limited financial resources both effectively and efficiently.

2004 and 2008 standards promote more transparency of activities, make PICs more accountable to financial resource providers, and better measure the efficiency of activities. The accounting standards assist in the provision of general-purpose external financial reporting and statements; this sets it apart from the supervisory and internal purposes of previous standards.

Under the 2004 and 2008 standards, financial statements consisted of (1) balance sheets, (2) statements of changes in net assets (statements of activities), (3) statements of cash flows,[11] and (4) inventories of assets (excluded from the 2008 standard).

6. Discussion

As mentioned, the purpose underlying PIC financial accounting standards has changed from a supervisory purpose to a general purpose, and from an internal and managerial purpose to an external (disclosure) purpose (Saito 2011). In this course of transition, we can see changes to the elements of accountability.

With the old PIC system and the 1977 and 1985 accounting standards, PICs were expected to be primarily accountable to the government agency, and so their top priority was to report to the government on how they carried out their activities according to their budget (plan). It was very obvious to whom the PICs were accountable, and for what they were responsible. To fulfill this responsibility, traditional stewardship accounting was useful in not-for-profit accounting. An income and expenditure budget was considered to play an important role in showing how money would be spent, based on a plan; an income and expenditure statement, on the other hand, showed the amounts actually spent.

A budget was, however, excluded from the financial statements required as per the 2004 and 2008 standards, since it was considered essential to fulfilling internal, managerial, and governing (i.e., controlling) purposes. In addition, income and expenditure statements were excluded, for two reasons: (1) the purpose of accounting information is generalized and set for external financial reporting, and (2) in terms of assisting stakeholder in decisions-making (i.e., by helping them measure and evaluate the efficiency of activities), accrual-basis information on statements of changes in net assets (i.e., statements of activities) are considered more useful than income and expenditure statements.

Under the new PIC system and the 2004 and 2008 accounting standards, PICs are expected to disclose information about themselves to a wide variety of

[11] Statements of cash flows were needed only from PICs when working with accounting auditors, in cases where the PIC had annual revenues of JPY100 billion or more, annual expenses of JPY100 billion or more, or liabilities in excess of JPY5 billion (Article 5 (12), Act on the Authorization of PICs; Article 6, Order for Enforcement of Act on the Authorization of PICs).

stakeholders—this means the public, not just the government or donors.[12] The contents of financial statements are not as specific as those associated with previous standards, because the accounting standard is of a general-purpose external financial report. With respect to accountability, we can say that PICs are accountable to the public. There is no special focus on specific stakeholders, although financial resource providers (i.e., donors) are indeed considered important. Therefore, the contents of the disclosed information will be of a general nature, because the information recipients are not identified. As a result, it is not so obvious for what PICs are truly responsible.

7. Conclusions

This paper argues that in Japan, public disclosure became crucial for PICs in the course of transitioning to the new PIC system. As public disclosure progressed, the nature of the disclosed information changed from specific to more general, on account of changes to the recipients who were targeted.

This financial reporting has served two purposes. One is to inform a wide range of information-hungry stakeholders about the organization and its activities, based on the "right to know"; the other is to fulfill obligations with regards to accountability for its activities. The former relates to public disclosure; the latter relates to accountability or stewardship responsibility, and has the characteristic of an accountability report.

In response to changes in the PIC system, the accounting standards also changed the nature of the information disclosed through financial reporting. The nature of financial reporting has changed from accountability reporting to certain stakeholders, to public disclosure to a wide range of stakeholders. For example, information with regards to revenue and expenses (which can be used to evaluate the efficiency and the effectiveness with which financial resources have been used) are now more highly valued than cash-basis information on incomes and expenditures (which can be used to evaluate adherence to a budget).

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[12] Although both the 2004 and 2008 accounting standards tried to set up financial reporting for public disclosure, there is a difference between them. The 2008 accounting standard was revised for the purpose of facilitating the procedures by which new PICs were authorized, and so it now has the characteristic of an accountability report to the PIC Commission for supervisory purposes.

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