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A STUDY ON LOSS IN THE SCIENCE OF ACCOUNTING

—AN INTRODUCTION TO THEORIES OF LOSS—

By Toshiyoshi OKABE*

Preface

In connection with expenses as a subject matter of income determination we can point out loss (which is conceived in the form of a mere forfeiture of value which is different from the idea of a net loss=deficit) as one problem of importance which gives rise to public discussion in the field of accounting. How to understand the term 'loss', or particularly whether it should be considered to be deducted from revenue or not, will inevitably produce a different result in income determination, and the same thing will hold true with calculations by means of a balance sheet. Furthermore, not only what should be regarded as loss covers a variety of items, but also the amount of losses frequently comes to an enormous sum. Consequently, it must be said that the way a loss is grasped really comprises an extremely important problem in the field of accounting.

However, when we come to examine how fully the problems of loss as pointed out above have been considered so far in accounting, it is not too much to say that there still remain many problems to be solved; particularly in the case of the so-called popular views with respect to loss. In short, according to these popular

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views a loss is considered *in principle* to be deducted from revenue. That is to say, loss is regarded in a broad sense as expense. But the truth is that such a way of grasping loss can not be regarded as adequate, if viewed from its primary nature, and it arouses no small doubt. As a matter of fact, there are not a few different opinions against the above-mentioned way of grasping loss. Such opinions hold that loss, even in a broad sense, should be excluded from the category of expense. Although these opinions only represent a minority view in the field of accounting, we must keep in mind that the fact there exists an opposing opinion in any event, as pointed out, against the popular views should by no means be overlooked. Though it must of course be admitted that not all problems have been fully clarified by such minority views, if I may put down my conclusion first, as far as the view of loss is concerned in the field of accounting, I can not help thinking that, at least fundamentally speaking, the above-mentioned minority views should be acceptable.

The present paper has been prepared according to my own way of thinking as described above, so as to review the various views of loss in accounting which have been formed up to the present time, clarifying the main points of the different views as well as some debatable points involved therein as much as possible. Although the subject matter of this paper is primarily concerned with loss, it must also be added that what was originally intended was *to examine and criticise the common (inadequate) concept of expense* conceived from such an idea of loss. In other words, this very last point is none other than the primary purpose of writing this paper.

A POPULAR THEORIES WITH RESPECT TO LOSS—THEORY OF EXPENSE IN THE BROAD SENSE

I

To begin with, it is necessary to give an idea of what is meant by loss, and particularly to illustrate more or less clearly and concretely how the term loss is interpreted by the *popular views*. Yet the popular views, though they are likely to be misunderstood as representing a view of only one kind, must be divided into two different interpretations, if seen from their relationships with expense, due to the difference in the way loss itself is conceived. In particular one of them holds that loss is after all expense in a broad sense (a deduction from revenue), although loss is distinguished from expense as a temporary measure, and the other holds that loss is expense by regarding loss, which is distinguished from expense as a temporary measure in the above case, as expense by denying the very concept of loss itself from the beginning[1]. Therefore, in this connection it is necessary to see these two views in brief outline before going into any further discussion.

(1) As one typical view of the former interpretation we can quote a view set forth by the American Accounting Association. The following lines describe their view with respect to expense and loss: "Expense is the cost of assets or portions thereof deducted from revenue in the measurement of income. . .Expense consists of operating cost—deductions that have a traceable association with the production of revenue, and losses—deductions that have no such association."[2] In other words, according to the view held by the American Accounting Association expenses in the narrow sense of that term are called operating costs, which are regarded as a deduction having association with revenue on the one hand and losses are regarded as a deduction having nothing to do with revenue on the other. Therefore, it is seen that loss is after all regarded as a deduction from revenue by interpreting loss as expense in the broad sense of that term, in spite of the above-mentioned distinction as a temporary measure between loss and expense. A purport of a similar nature is indicated in another example of a slightly more detailed definition of loss given by the American Institute of Certified Public Accountants (Committee on Terminology), which may be quoted here as follows: Losses are "...the excess of all or the appropriate portion of the cost of assets over related proceeds, if any, when the items are sold, abandoned, or either wholly or partially destroyed by casuality or otherwise written off." "When losses such as those described in above are deducted from revenues, they are expenses in the broad sense of that term."[3] Moreover, as to the opinion held by the American Institute of Certified Public Accountants, what are regarded as losses by them are loss on sale, loss from abandonment and forfeited (=decreased) portion of assets due to some incidental disaster such as fire, etc. and other specific circumstances (however the remaining portions after deductions are made when there are associated proceeds in each such case). And it can be said that these items at least are widely regarded as losses. Particularly losses due to incidental disasters like fire, etc. are not only clear enough to be conceived as losses but also comprise most typical ones.

However, as to the concept of loss, there are some other views, if seen from the way it is defined, which are not substantially different from what is described above,

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1) In the former case mentioned above, if the concept of including losses can be called *expense in the broad sense*, then it naturally follows that the concept of excluding losses can be called *expense in the narrow sense*. So whenever these terms are further used in this paper, each term is always used in the above sense. Also, it can fairly be said, based on the meanings of these terms, that the concept of expense in the former case is grasped in the broad sense, including even loss therein.

2) American Accounting Association, Accounting Concepts and Standards Underlying Corporate Financial Statements, 1948 Revision (in American Accounting Association, *Accounting and Reporting Standards for Corporate Financial Statement and Preceding Statements and Supplement*, 1957), p. 15.

3) American Institute of Certified Public Accountants (Committee on Terminology), *Accounting Terminology Bulletins*, No. 4, 1957, p. 2.

but that loss means a simple forfeiture of value which has nothing to do with the purpose of an enterprise or can not be compensatable in contrast to the idea of expense (conceived in a narrow sense) in the sense of the sacrifice of value which has something to do with the purpose of an enterprise or can be compensatable[4].

Now, views such as described in brief above, holding that loss is after all regarded as expense in the broad sense, in spite of the provisional distinction from expense (that which is conceived in the narrow sense), are all maintained by some principal and representative examples of this type of view. It can be said that similar views with respect to the loss and expense in question, to tell the truth, comprise one influential common theory maintained in accounting these days as can easily be seen from a variety of published writings. (However, in this case what is regarded as loss is not always the same and this very fact should be pointed out here as an important point calling for our special attention.) In the meantime we can say that the common views with respect to expense and loss in accounting in this country evidently belong to those kinds of views just discussed above.

(2) Another view already mentioned above, i.e. the view which grasps loss as expense in the broad sense by denying the concept of loss itself from the very beginning, or in other words a theory primarily formed on the concept of expense in the broadest sense, can be traced to German accounting. This type of view maintained is stated by E. Schmalenbach, who is a representative advocate of such view, as follows: "What is meant by expense is the value of goods which has been extinguished or lost in the calculation of a certain business and it does not matter at all whether or not it had a fixed purpose, or whether it was caused inside or outside the business itself." "As far as the viewpoint of congruence of the total profit and the sum of the periodical profit is not lost, there can not exist any 'loss of assets' ('Vermögensverlust') to be entered except expense in the accounting."[5] Primarily speaking, "...there is no room for such a concept as the loss of assets to exist in opposition to that of expense."[6] (The term, 'loss of assets' mentioned here can well be taken to be synonymous, at least fundamentally, with what is usually called loss as far as the concept is concerned. Therefore, this understanding is applied here.)

Moreover, we can say that the view that grasps expense in the broad sense, by denying the concept of loss as explained before, is also found to comprise one influential popular view, particularly in German accounting. Primarily in German accounting the way of classifying revenue into purposive revenue (Zweckertrag) and neutral revenue (Neutralertrag) or by-revenue (Nebenertrag), and then correspondingly of classifying expenses into purposive expense (Zweckauf-

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4) For example, cf. Gilman, S., *Accounting Concepts of Profit*, 1939, p. 292, and views held by W.A. Paton, K. Yamashita, etc. to be to referred later.

5) Schmalenbach, E., *Dynamische Bilanz*, 7. Aufl., 1939, S. 126, und 11. Aufl., 1953, S. 67.

6) Schmalenbach, E., *Dynamische Bilanz*, 7. Aufl., 1939, S. 126.

wand) and neutral expense (Neutralaufwand) or by-expense (Nebenaufwand) is extensively accepted. Therefore, it can be seen from these illustrations that as far as loss (even if it is of a temporary=incidental nature) under such circumstances is regarded to be disposed of in income determination, loss is ordinarily regarded as neutral expense, correspondingly as part of expense. And so as a result there would be no other way to form the concept of expense than to think of it in the broad sense[7], and thus the way expense is conceived in the broad sense in German accounting as described above could be illustrated by the foregoing explanation.

II

Viewed from the above discussion, if follows that the difference between two above-mentioned views lies in the following points: while the former maintains that loss after all is expense in the broad sense (though not necessarily all of it)[8] in spite of the provisional distinction of loss from expense (that which is conceived in the narrow sense), on the other hand the latter has an interpretation of expense in the broad sense by denying the concept of loss itself from the very beginning. Now, viewed from the difference between the two views, it should rather be evaluated as an adequate grasp that the former, at least as far as the concept is concerned, distinguishes loss from expense (that which is conceived in the narrow sense), but it is evidently inappropriate that even the concept of loss in itself is denied by the latter, and it must be said that the inadequacy of such a way of grasping expense can not after all be free from criticism. (Further discussion of this point will be taken up later.) Be the matter as it may, the two aforementioned different views might as well be classified, based on the above-described difference in the ways of thinking, into the following two types: the former—the *American view* and the latter—the *German view*.

Yet, it can further be seen that neither of these two views is fundamentally different as regards the point that loss is interpreted as expense in the broad sense, and correspondingly that expense is also primarily grasped in the broad sense. In addition it can also be seen from the above points that *actual deductions* from revenue in income determination—in other words what is regarded as expense in the broad sense—in each case are substantially the same, although it must be admitted that there exists some difference between them, as pointed out already, in the respective ways of thinking. Moreover, as far as the problem in question is concerned, it

7) For example, cf. Kosiol, E., Ertrag, in Nicklisch, H. (Hrsg.), *Handwörterbuch der Betriebswirtschaft*, 3. Aufl., 1957, SS. 1686–1689; Schmaltz, K., Gewinn- und Verlusterechnung, in Nicklisch, H., *a.a.O.*, SS. 2361–2370; Walb, E., *Die Erfolgsrechnung privater und öffentlicher Betriebe*, 1926, SS. 34–37.

8) About this point, see footnote 9.

follows that this very point that expense is in fact grasped in the broad sense must be brought to our special attention as an important characteristic common to the two opinions. Therefore, from these facts we might just as well generally call the above-mentioned two types of view *a theory of expense in the broad sense* (or *a theory of loss=deduction from revenue*)[9].

III

However, even if so, *why* is it that those advocates of the above-mentioned theory of expense in the broad sense regard loss which has nothing to do with revenue (particularly in the case of the American view, this way of thinking has been acknowledged by such advocates themselves) as expense to be deducted from revenue (in other words expense conceived in the broad sense)? In this connection a point which gives rise to a further contentious problem is none other than this

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9) But it is not right to say, similarly among advocates who hold the theory of expense in the broad sense, particularly the American view that not all of take up such loss that is excluded from expense (that which is conceived in the broad sense) and that accordingly is in principle regarded as not to be chargeable to revenue. In other words, also in the case of these advocates an incidental loss of an enormous amount in particular is accepted as comprising loss of such a kind. Therefore, in this case loss of this kind is considered to be deducted from profit= earned surplus of the current or future fiscal year, earned surplus in the past, capital surplus, and still further from capital stock. (For instance, cf. Hatfield, H.R., *Modern Accounting*, 1911, pp. 217–218; ditto, *Accounting*, 1927, pp. 275–277; Sanders, T.H., Hatfield, H.R. and Moore, U., *A Statement of Accounting Principles*, 1938, p. 40; American Institute of Accountants, *Restatement and Revision of Accounting Research Bulletins*, No. 43, 1953, pp. 63–64; Norris, H., *Accounting Theory*, 1946, P. 52, p. 60.) However, which one of these should be selected as item from which the loss is deductable according to each advocate is not always decided in a similar way and it will be shown later that in this very point there evidently lies a debatable matter.

But, be the matter as it may, similarly in the case of those who maintain the theory of expense in the broad sense (at least some principal groups of them), there is the above-mentioned incidental loss of an enormous amount, as a loss excluded from expense in the broad sense though admitted as loss. However, it is merely an exception in which the loss in question is excluded from expense in the broad sense in the case of advocates of this group. Consequently, it can definitely be said that these advocates hold the view *in principle* of regarding loss as expense in the broad sense as invariably as ever. And so when seen from such a viewpoint, it follows that the theory of expense in the broad sense as defined by the present writer should denote, exactly speaking, the way of such thinking that *in principle* regards loss as expense in the broad sense.

In addition, it is necessary to add a few explanations with regard to terminology. That is, it is to be understood in the further discussion in the paper that the three items as a whole, including the above-mentioned earned surplus in the past, capital surplus and capital stock, and the corresponding assets on the debit side signify the principal (as proprietorship or net assets) *from the viewpoint of each fiscal year* (*accounting period*). Therefore, it may also simply be called *periodical principal*, and so whenever the term principal is further used in this paper, it means what is explained above. Furthermore, the three above-mentioned items may be called *periodical capital* whenever so necessitated.

question, but it is not too much to say that so far practically no sufficient consideration in detail has been given, generally speaking, to this problem as just pointed out in the above, though it must be admitted that there are a few exceptional cases (which are to be discussed later). It can be said that it is rather ordinary, so to speak, simply to regard loss as expense without basing it on any theoretical grounds. (It may further be added here that the very fact pointed out in the above case furnishes one convincing illustration which eloquently shows a traditional common weakness in accounting where groundless assertions are in the habit of being calmly advocated far and wide.)

But, loss (at least what should be regarded as such), primarily speaking, should be a mere forfeiture of value (or price) which has no economic contribution and it should by no means be regarded as expense (which in every case has a certain positive or social meaning) even when it is to be interpreted in the broad sense. For example, supposing that out of ¥50,000,000 used for equipment (assets) as principal, a portion equivalent to ¥20,000,000 is burnt to ashes, the loss in this case caused by fire (¥20,000,000) is nothing but a simple forfeiture of value without rendering any contribution to the operation of an enterprise, or particularly to the acquisition of revenue or specifically profits, and so it only means a forfeiture of that much principal (see footnote 9 about the meaning of the term principal). Consequently, supposing that there was a total amount of ¥100,000,000 of proprietorship as principal in the above case, it was obliged to be reduced to the amount of ¥80,000,000 when the fire broke out. (In other words, what happened in this case is a decrease of capital = a forfeiture of principal, and not an accruing of expense which may be regarded as being chargeable to revenue). Consequently, it must be considered, as could be assumed from the nature of this kind of loss, that loss of this nature *should naturally be deducted from principal* (therefore, as for a balance sheet, deductions in this case should be made from capital on the credit side, particularly from owned capital in the form of periodical capital mentioned in the previously indicated footnote), and such loss should not be regarded as something having the qualities of expense which could be deducted from revenue. Or, taking another example, supposing that profit amounting to ¥10,000,000 was gained up to a certain time in the fiscal year concerned and ¥2,000,000 was stolen under the said circumstances. Since the stolen portion is, needless to say, again a simple forfeiture of value, making no contribution to the business operations, it should by no means be regarded as expense. Yet, in a case like this where the profit of a certain fiscal year concerned is to be taken into consideration, *putting aside the principal in the foregoing example*, that portion which was stolen should be deducted from profit, speaking from the aspect of accounting, in the same manner as in the case of disposal of deficit with profit, through the *appropriation of surplus (or distribution of net profit)*, by thinking that much profit once gained was simply forfeited. In other words, although there exist differences in determining the source of deduction as described above, i.e. the principal (capital, particularly periodical capital) or profit (particularly the profit of the fiscal year concerned), since the loss should be grasped primarily in the way already described above, it must be concluded that it is utterly groundless and hence unreasonable to regard such loss as expense (that which is conceived in the broad sense) to be deducted from revenue[10].

In addition, if further viewed, some advocates (particularly those who stand for the American view) exclude from all types of loss only the incidental loss of an enormous amount from expense conceived in the broad sense as already described before, exempting this kind of loss from the category of deductions from revenue. As far as it is primarily a loss (which can not be regarded as expense), irrespective of the fact whether it happens to be an incidental loss amounting to an enormous sum or an ordinary loss of a petty amount, there should substantially be no difference whatsoever. It is of course permissible as an exception occasionally to make a suitable disposal of a small loss of a trifling amount, in accordance with the so-called principle of materiality observed in accounting, but this exception is a mere procedure for convenience's sake in every respect. Consequently, it follows that, as far as the incidental loss of an enormous amount is excluded from expense in the broad sense and is regarded as not to be deducted from revenue by those advocates, the same must be held true at least *theoretically* with all other ordinary losses, and furthermore such an assertion would be an extremely natural conclusion from the logical aspect.

Nevertheless, those who stand for the theory of expense in the broad sense have so far given practically almost no consideration to the above-mentioned matters with respect to the nature of losses which should have been fully weighed and, making it worse still, they have simply proceeded carelessly to regard loss as expense (that which is conceived in the broad sense) without even confirming whether there are the essential grounds for doing so. In other words, it can be said that this is the way the argument is developed by those who accept the theory of expense in the broad sense. Let it be what they may want to argue, but can they be confident of convincing anybody by developing their argument in such a manner?

IV

But, even with such a way of advancing their argument it is not entirely im-

10) What is meant by principal (capital, particularly periodical capital) in the above sentence denotes, as already explained before, capital as proprietorship in each fiscal year concerned, but needless to say loss under certain circumstances may occur in borrowed capital = liabilities. However, by reason that only certain ordinary cases where a loss may give rise to debatable points are taken up here, I want to be understood in sucn a way.

possible to find some ground or presupposition on which the advocates of the theory of expense in the broad sense take loss as expense, and as far as my view is concerned, I think that it is possible to cite the two following more or less popular grounds as examples: (a) the way of thinking as seen in the *so-called* theory of increase in the net worth in which whatever may bring an increase or decrease to the net worth (owned capital) is all regarded as revenue or expense, apart from an increase or decrease in relation to investors, and (b) the way of thinking as seen in the theory of value-recovery or the theory of capital-maintenance in which it is advocated that any decreased or declined portion of value (or price) accrued in business administration should all be in principle recovered, even if it belongs to loss, and that the capital should be maintained in such a manner. But firstly as to the former, I have already made it clear at a separate opportunity that the so-called theory of increase in the net worth which is commonly explained originally involves in itself many debatable points[11]. It is definitely inadequate to regard loss as expense particularly according to the way of thinking as held in this theory for the reason that a decrease in the net worth may be accrued, and it must be said that it is utterly impossible to find any grounds therein which would be acceptable. Also as to the latter way of thinking, i.e. the theory of value-recovery or the theory of capital-maintenance, it will be easily understood that these contentions too are by no means acceptable so simply and easily from the discussion to be taken up shortly(with respect to the opinions of Katsuji Yamashita and others).

However, it is not entirely true to say that there exists absolutely no assertion stated in a clearly stated form which can be regarded as grounds among advocates who stand for the theory of expense in the broad sense, if viewed from a wider angle. Of course the ground of this kind is only seen in a limited circle as an exceptional case, but what is going to be discussed below might as well be taken at least as illustrations of important grounds of this kind. (However, since neither of them is of course acceptable from my viewpoint, what I shall further discuss is in short a refutation of what are supposed to be their gounds as described above from my point of view.)

One of them to start with is the aforementioned interpretation of E.Schmalenbach. Although it may be true that his interpretation is chiefly of a specific nature formed from his own thinking, having not so much popularity (as to this point, see footnote 12), I still think that there is a necessity to discuss it here. As mentioned before, he is a leading advocate of the theory of expense in the broad sense who specifically holds the German view, under which the concept of loss itself is

11) cf. Okabe, T., "Criticism on the Concept of Income in Tax Law", *Accounting (Kaikei)*, Oct. 1954; ditto, Criticism on the so-called Theory of Increase in the Net Worth, in Osaka Municipal University Laboratory of Accounting (ed.), *Collected Essays in Commemoration of the 61st Birthday of Professor Wasaburo Kimura—The Problems of Current Accounting*, 1963.

denied. What can be assumed as the grounds of which even such a concept is denied, is based, as can be seen from the foregoing discussion, on the so-called *principle of congruence* asserted by him, which maintains that total profit and the sum of the periodical profit should be congruent. For precaution's sake his own writing about this point may be repeated here. "As far as the viewpoint of congruence of the total profit and the sum of the periodical profit is not lost, there can not exist any 'loss of assets' to be entered except expense in accounting."[12)]

However, his assertion to deny the concept of loss based on his principle of congruence quoted above is, in truth, such a simple statement. Besides, putting it another way, the above quotation shows the fact that he has not given any consideration in detail to any appreciable extent to give *the reason* why the very concept of loss itself must be denied, if the principle of congruence is applied, and we must keep in mind that such a way of thinking as is involved in his argument can not simply be free from inviting our particular attention in the sense pointed out above.

But, be the matter as it may, it is possible that the concept of loss can be totally denied, as asserted by him as the inevitable conclusion of the principle of congruence in question? Such a thing, needless to say, can not account for anything in reality. Essentially speaking, even if the principle of congruence is to be used as a base, such a principle has nothing to do with the determination of acceptance or denial of the concept of loss. As already made clear in a case where a portion of existing assets (capital) was lost in a fire, as far as that portion which was burnt to ashes should be considered to be a forfeiture of principal, the necessary deduction should naturally be made from principal. Then, by doing so any problem which may arise in such circumstance, or particularly necessary accounting procedures required for its proper disposal, can easily be settled without being concerned with the total profit and periodical profit. Again, as to the loss caused in a case of theft, one proper procedure to be carried out is the disposal by deduction from principal in a similar manner as in the foregoing case. Furthermore, even if such a deduction were to be made by distribution of the profit of the current fiscal year concerned as mentioned before, it would not give rise to any problem which might be concerned with the relationship between total profit and periodical profit.

Now, then, it can be said that the foregoing discussion shows clearly that the principle of congruence at issue has originally no bearing upon the determination

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12) As far as my knowledge is concerned, I have not heard of any specific objection made by other advocates who deny the concept of loss in a similar manner by holding the German view against Schmalenbach's above-mentioned opinion, on which grounds he appears to have denied the concept of loss. Consequently, it can be assumed, viewed from such a fact, that his view mentioned above is likely to be accepted or supported by the advocates of this group (if not by all of them, and at least tacitly or negatively). However, this is my personal presumption.

of acceptance or denial of the concept of loss itself. Speaking from this viewpoint, it must be clearly understood that it is inadequate to deny the concept of loss on the grounds of the principle of congruence. The denial of the concept of loss issued by E. Schmalenbach on the basis of such a principle of congruence, in truth, can originally be ascribable to his careless or erroneous denial or neglect of those losses which do exist in reality as indisputable facts, and so I can not help thinking that his fault is beyond being covered.

V

Another main type of opinion which may be taken to provide the grounds for the theory of expense in the broad sense can be represented by such views as held by Katsuji Yamashita (Professor of Kobe University) and Yasuichi Sakamoto (Professor of Kobe College of Commerce) in this country. (However, the views that are to be taken up in this section as brought forth hereafter—which should be considered as a kind of theory of value-recovery or theory of capital-maintenance—are not merely the assertions of these two professors, but we can say, as far as the common view is concerned, that above-mentioned views are accepted by a comparatively large number of supporters, although they in general are not set forth in a particularly very clear statement. And for that reason it follows that we must examine such views with particular attention.)

Now, I shall see about the points which can be taken to be the grounds mentioned above according to the opinion of Katsuji Yamashita, who can be regarded as a representative advocate of such views. His contention runs as follows: "...The content of income determination should be primarily concerned with the calculation of the decrease or increase of the total sum of business capital brought about by using capital in the form of activities for the purpose of business oprations," but in reality "it is not always limited to the circle of dealings which may be made by using capital as activities for the purpose of the business itself. There is a practical necessity to consider that dealings of funds which might be made collaterally in the course of activities for the purpose of business or special hazards of such nature as losses from bad debts which might arise in accounts receivable in business transaction, should also be in the field of income determination. ...Still further, in a sense that such incidental losses due to fire or natural calamity, etc. that could be considered as a common hazard to which every enterprise is exposed, must also after all be replenished from revenue, there also is a practical necessity to include these incidental losses in the field of income determination." He is careful enough to explain the nature of the loss in question in stating that "the concept of expense must strictly be distinguished from that of a simple waste of expenditure or loss" and at the same times further adding, for the reason that "the simple waste of expenditure or loss" mentioned above "mean the mere forfeiture of the value of capital" which has no association with "the intention of an enterprise", there is not a source to which "this kind of wasteful expenditure or loss can be charged for its recovery." Yet, though thinking that such loss is viewed as described above, he holds that "the determining factor to govern the existencc and development of an enterprise is the proper maintenance and keeping up of invested capital", and as far as this matter is concerned, he after all maintains his opinion of viewing even loss as expense (that which is conceived in the broad sense) in conclusion, because he thinks that "even if it is the forfeiture of the value of invested capital, there is no way for it recovery or replenishment other than making deductions from revenue, and the only possible way for its disposal in reality is to process it as expense in income determination"[13]. Now, if viewed from the purport of the opinion of Yamashita's as described above, his view in short may well be classified as a kind of theory of value-recovery (theory of capital-recovery) or specifically as a kind of theory of capital-maintenance.

But, let it be as it may, if I were now asked again about the adequacy of the above-mentioned view of his (or views held by other advocates of a similar kind), in which even loss is regarded as expense (in the broad sense), I should have no word to describe it by other than inadequacy.

In other words, his argument runs in brief as follows. In spite of his opinion that loss has no source (this means revenue as seen in the above) from which it can be recovered, he maintains that loss should be treated as expense, because he after all thinks that even loss must be replenished from revenue. Needless to say, such reasoning, substantially speaking, can not be a well-grounded argument at all, either in the theoretical or practical sense. Essentially loss not only has nothing to do with revenue as already discussed, but its replenishment is not always to be made from revenue, even if it is necessary to do so: at least as one means its replenishment can be made from profit (of the respective fiscal year concerned), that is, by means of the distribution of net profit. Furthermore, as far as loss is defined by himself as "the mere forfeiture of the value of capital", loss of such a kind should naturally be disposed of by means of capital (principal), if the profit of the respective fiscal year concerned is to be put aside as already discussed before. As far as the nature of loss is conceived from the above-mentioned viewpoint, it must be concluded in short that it is impossible to find any good reason why such loss should be recovered or replenished from revenue.

Of course, as can bc seen from what was discussed before, the reason why he thinks that even the loss referred to in the above explanation must be recovered or

13) Yamashita, K., *General Theory of Accounting* (New ed.), 1963, p. 20, p. 36 and p. 38. About a similar view held by Yasuichi Sakamoto, see ditto, "The Concept of Expense and its Allocation and Matching", *Financial and Cost Accounting* (*Sangyo Keiri*), March 1958.

replenished from revenue is in truth because of "a practical necessity" rather than because of theoretical grounds. In other words, as to the recovery or replenishment from revenue, he has never even thought of its theoretical grounds from the very beginning, and it can be understood that the "practical necessity" referred to in the above by him after all means, if seen from his foregoing statement, "the proper maintenance and keeping up of invested capital" as "one determining factor for the existence and development of an enterprise", the fact of which, putting it in other words, will lead to the conclusion that what he means in this connection is *the maintenance of capital* in an enterprise. Moreover, it also can easily be seen, from what has been discussed above, that the important grounds of his argument to justify his view to deduct even loss from revenue lie in such an idea of the maintenance of capital, and this point must be specially noted in the case of loss treated by him, as it constitutes a very important issue when viewed from the way he argues.

It may, indeed, be true that the maintenance of capital as mentioned above is a matter of the utmost importance, which may be called a supreme task for business administrations, and that it is certainly a "practical necessity", but it can not be accepted straightforwardly that such a "practical necessity" is the reason why even the loss in question should be deducted from revenue and why the capital should naturally be maintained by such a disposal. Substantially speaking from the matter-of-fact aspect, it is impossible to maintain capital as it is, or rather there is in truth no such guarantee in reality. As far as a business is operated by using capital, the entrepreneur is always exposed to some kind of hazard. Therefore, he sometimes fails to make any profit, and in the worst case he loses even his capital itself—he naturally can not be entirely free from being driven into circumstances under which capital comes to be forfeited (or is lacked). Yet, speaking from the aspect of business management, such risks are all presupposed or expected from the very beginning. And the forfeited portion of the principal under such circumstances, which means none other than the loss in question, should naturally be shared and disposed of, if viewed from the primary nature of such a loss, on the sole responsibility of the capitalist (or enterprise) himself, who originally operates a business at his own risk. Consequently, it necessarily follows that it is evidently inappropriate to dispose of a loss of this kind as if it were an ordinary kind of expense, thus shifting such a loss to other people by charging it to revenue.

Substantially speaking, *the forfeiture of capital* (*deficiency of principal*) caused in the course of business management should naturally be grasped and disposed of as such. It should be not reasonable at all, at least primarily speaking, to maintain that even such a forfeiture of capital should be deducted from revenue in income determination based on the above-mentioned idea of the maintenance of capital[14]. The importance of this point can not be too much emphasized when our consideration is given to the fact the interests of numerous other interested groups might be unduly injured on the one hand, as a result of the foregoing reason through *the overstatement of expense* and particularly through *the understatement of profit* arising therefrom, even if it might become possible for the capitalist (or enterprise) to maintain his capital by the method of deducting even the above-mentioned loss from revenue in income determination on the other.

Be the matter as it may, the way of thinking of regarding loss as expense (that which is conceived in the broad sense), as described in the above, is nothing but a manifestation of the capitalistic way of thinking to try ordinarily to make the extent of expense as large as possible (and correspondingly to make what can be obtainable as profit as small as possible), which has already been treated frequently by some people, but what we can not overlook in this connection from our point of view is the fact that expert accountants (scholars) are in the habit of following such a capitalistic way of thinking as their own view in accounting, without giving sufficient critical consideration to the theoretical or practical problems involved therein, and it can fairly be said that such views as held in accounting in this case are in truth nothing other than good examples, which, at least objectively straight-forwardly as it were, speak for the capitalistic way of thinking just mentioned above, or rather the interests of capitalists themselves. And it is necessary

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14) It can be said that the meaning of capital-maintenance as mentioned in the above is also often erroneously interpreted greatly according to the way of thinking based on the common views held in accounting. For example, also under circumstances where ¥2,000,000 out of ¥10,000,000 which has been in use as principal (capital) is lost by fire, the capital to be maintained is ordinarily thought to be the above-mentioned ¥10,000,000 and it is considered that this is the capital to be recovered, too.

However, the capital to be maintained in this case should, properly speaking, be nothing else but ¥8,000,000. The ¥2,000,000 which was lost has already been extinguished as value, and consequently the existing capital (principal) should be regarded as that portion which has been decreased by that much amount. At the same time this means, if seen from the stand point of investors, that the above ¥2,000,000 is the forfeiture of their own capital (principal) by that much amount.

Moreover, if it is right to think in such a way, since what exists in reality as capital after the fire is after all only the remaining ¥8,000,000, it must be considered that there exists nothing else as capital to be maintained in this case except the ¥8,000,000. The very concept, such as the maintenance of the value which was extinguished, is substantially beyond conceivability. The same should naturally be held true with the case of recovery of value. Furthermore, if it is desired to maintain the original ¥10,000,000 in the same amount as it was before in the foregoing example, it should be done either by re-investing profit or by newly investing some capital, and either of these two methods can in fact accomplish the above purpose.

In other words, the term capital-maintenance, strictly speaking, should be interpreted in the way described in the above and it is not until such a conception is formed that the meaning of such a term could be understood correctly.

here again to point out that this matter is one which we can not overlook.

B MINORITY VIEWS—THEORY OF EXPENSE IN THE NARROW SENSE

I

The common views with respect to loss in accounting are the theory of expense in the broad sense (the theory of loss=deduction from revenue) as already discussed before, which holds in the broad sense that even loss is to be deducted in principle from revenue. However, there are in fact not a few different opinions in accounting as well, though only held by the minority, against such common views as already mentioned. All these minority views, being different from the aforementioned common views, can be regarded as opinions held in opposition to the common views in that the minority views maintain that loss should not be regarded as expense (particularly that which is conceived in the broad sense) to be deducted from revenue. For the reasons that loss is excluded from expense in the broad sense and expense which is to be deducted from revenue is after all grasped as expense in the narrow sense, this type of opinion can be called *the theory of expense in the narrow sense.*

However, in the case of this theory of expense in the narrow sense, too, what is grasped as loss (items of loss) is not always conceived in the same way by advocates of this theory. Generally speaking, in this connection nothing more is done than to list some illustrations which can be regarded as loss, and when viewed more comprehensively, we can not say that sufficient clarification has been made as to what should be included therein, particularly as to individual items, and I shall have to say that also in the case of this theory of expense in the narrow sense this point will give rise to disputes to begin with. Besides, again in this theory of expense in the narrow sense we can see that there are the following differences in what are claimed to be the items from which the loss in question may be deducted: (1) profit=earned surplus of the current fiscal year concerned (hereafter whenever the word profit is simply used, it means the profit of the current fiscal year concerned) and (2) earned surplus in the past, capital surplus and capital stock which mean capital as principal, particulary periodical principal (see the aforementioned reference about it) in addition to (1). In other words, if seen from the viewpoint of the items from which the loss in question may be deducted just mentioned above, the former has it simply as profit=earned surplus of the current fiscal year concerned, while the latter has it as capital=principal in addition to profit. Putting it more concretely, in the former case loss is regarded as being disposed of by the distribution of profit, while in the latter case loss is regarded as being disposed of not only in such a way but also by offsetting it to capital=principal. Furthermore, this point must again be specially noted as it comprises an important difference of opinion among advocates of the theory of expense in the narrow sense[15)16)].

But, let it be as it is, viewed from the foregoing discussion, the ways of thinking in the above-mentioned (1) and (2), we may as well further call respectively (1) the theory of disposing of loss by the distribution of profit and (2) the theory of offsetting loss to profit and capital: or, in a simpler way (1) *the theory of loss=deduction from profit* and (2) *the theory of loss=deduction from profit and capital.* Furthermore, since what is meant by deducttion from profit in the latter case is in short the way to dispose of loss by offsetting loss to profit, it may also be called *the theory of offsetting loss to profit and capital.*

But, adding a further explanation to the two foregoing theories, when the deduction is made as maintained by the theory of loss=deduction from profit, there may be no difficulty as far as the loss can be disposed of by profit (that of the current fiscal year), but under the circumstance where such a disposal can not be made, as far as the advocates of this theory deny to regard loss in question as expense, there naturally can not be any other way for its disposal than deduction from capital=principal (earned surplus in the past, capital surplus and capital stock) or carrying the loss over to the following fiscal year as it is. But it is evident that this last method, substantially speaking, can not be accepted even by advocates of above-mentioned theory because of the nature of loss itself. Consequently, if viewed from the above viewpoint, the theory of loss=deduction from profit should be by all means looked upon as unacceptable, and so it naturally follows that what is acceptable to us, as far as the way of conceiving loss and the resulting way of disposing it is concerned, should be the theory of offsetting loss to profit and capital (what is meant by capital=principal in this case must be understood to include all of the earned surplus in the past, capital surplus and capital stock).

Needless to say, this theory of offsetting loss to profit and capital as can be seen from the descriptions mentioned above includes at the same time the theory of losss=deduction from profit in it. Consequently, whenever the theory of offsetting loss to profit and capital is referred to hereinafter, it is used in the sense explained above.

But, although I may speak of the thoery of offsetting loss to profit and capital, it must be kept in mind that this theory also involves some debatable points in it,

15) Those points that are given above with respect to the theory of expense in the narrow sense are taken from the works published by the authors listed below. (However, some are not listed.)

16) In the latter cases mentioned above there are, as far as capital=principal is concerned, some cases where some advocates are taking up only the earned surplus which composes only one part of capital=principal. But, similarly in such a case, as far as the chargeable items of loss are concerned, for the reason that not only the profit of the current fiscal year concerned but also capital=principal (periodical capital=principal), though at least partially, are taken up as items of deduction, I am of the opinion that such a view belongs to the one in the latter case.

as explained in the foregoing discussion. Nevertheless, generally speaking, the way of thinking by which this theory holds that at least the loss in question is not regarded as expense which is to be deducted from revenue, but is regarded to be deducted from profit or from profit and capital=principal, that is, the opinion that loss should be disposed of by offsetting it to these items, must be taken as an important characteristic of this theory which clearly distinguishes itself from the common view. Now, then, with the above-mentioned points in mind the present writer is going to further discuss the above-mentioned theory of offsetting loss to profit and capital (theory of expense in the narrow sense) in detail, taking up the views held by some leading advocates of this theory.

II

To begin with, it is not so unusual these days in the U.S.A. itself frequently to hear of the theory of expense in the narrow sense, particularly the theory of offsetting loss to profit and capital described above as a different view (minority view), also in objection to the American view with respect to expense (that in the broad sense which is conceived to involve even loss) which was discussed before. As main advocates of such minority view in U. S. A. we can list W.A. Paton, A.C. Littleton, S. Gilman, J.A. Mauriello and M. Backer, etc.[17)18)].

But, among all these advocates W.A. Paton is particularly noteworthy. Therefore, I will specially discuss his view here. In reality he adequately deserves to be

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17) Paton, W.A., book cited next. Gilman, S., *ibid.*, p. 83; Paton, W.A. and Littleton, A.C., *An Introduction to Corporate Accounting Standards*, 1940, pp. 95–96 and p. 104; Mauriello, J.A., *Intermediate Accounting*, 1950, pp. 549–553; Backer, M., Determination and Measurement of Business Income by Accountants, in Backer, M. (ed.), *Handbook of Modern Accounting Theory*, 1953, p. 210.

18) However, as can be seen from the foregoing discussions, what has been asserted by these advocates is not always of a similar contention. Also, the same will hold ture in the case of other advocates to be taken up later. And this point must be noted here again with special attention.

Besides, with reference to the views of advocates to be further taken up, under the circumstances where the decreased portion of assets (capital) caused merely by the decline of the market price is regarded as loss (at least that which comes under the concept of such loss), that portion which may be caused by the fluctuations of money value (as to the fluctuations of money value, not a few debatable points are involved in what is advocated by the common views and for that reason there is the necessity of stricter confirmation, but for the time being it will simply be called the fluctuations of money value in this way), primarily speaking, (though no remark is made separately,) should naturally be excluded from that which is regarded as the loss mentioned above. The reason is because this portion influenced by the fluctuations of money value (if that which is concerned with asset=capital corresponding to the profit of the current fiscal year is excluded for the time being) is concerned primarily with capital=principal, but that portion merely raises a problem only in the form of nominal adjustment with respect to capital=principal and so it is something completely different from what is to be grasped under the concept of loss which we are taking up as an open question.

called a prominent advocate who has emphasised, since as early as the days when his "*Principles of Accounting*", co. ed. by R.A. Stevenson was published in 1918, that loss and expense (in the narrow sense) which are chargeable to revenue should be treated in a different way for the reason that these two items are originally different from each other and who has made it clear that loss should be deducted from *equities* (either capital or income: see footnote 21 to be referred to below about this point)[19]. And I think that such a view of his with respect to loss is best expressed in the following quotation from his "*Essentials of Accounting*", lst ed., 1938. "From a strictly technical point of view a loss may be defined *as any deduction from equities (either capital or income) resulting from the expiration of some asset value for which no compensatory values are acquired.* Thus *loss* is in sharp contrast with *expense.* Expense is the cost of revenue; it measures the consumption of resources which is made good (at least in part) from the proceeds of sales. A loss measures an expiration for which there is no return. ..."[20][21]

Yet, it appears that the way he looks upon loss in such a manner was partially changed afterward, which seems to have become clearer of late. The revised points may be pointed out as follows: the loss in question is further classified into two categories of "deduction from revenue" which means *expense to be deducted from revenue* (in this connection it may be added that this is what usually happens in business and what is quoted by him as an example is labour service which may bring forth little or nothing to revenue, or a deduction like damages inflicted on goods which are returned by a customer due to careless packing) and "deductions which can not be viewed as revenue charges". And he further maintains, by calling the latter "true losses"[22] that only this kind of loss should be deducted from equities as suggested by the expression "deductions which can not be viewed as revenue

19) Paton, W.A. and Stevenson, R.A., *Principles of Accounting*, 1918, p.44 and p. 109.

20) Paton, W.A., *Essentials of Accounting*, lst ed., 1938, pp.105–106.

21) It is viewed that the loss taken up above is to be chargeable, when it is disposed of, to the equities of the stockholders or proprietors until they are exhausted, and then afterward to other equities (evidently these appear to mean borrowed capital = liabilities), and in this case the order of deduction of the said loss from the former equities which is normally considered is stated in a similar manner generally advocated with respect to the disposition of deficit as follows: (1) current income, (2) undivided profits or surplus, and (3) original investment or capital (Paton, *ibid.*, p.106).

Also, in the above case the following items, for example, are listed among various items of losses which are regarded by him to be deducted from equities: an unrecoverable embezzlement by an employee, extraordinary damage to buldings, equipment, and other assets as a result of storms, fire, accident, etc., and not fully covered by insurance, shrinkage in the market value of securities, and decline in value of inventories either as a result of damage and like factors or of falling prices, and so forth (Paton, *ibid.*, p.106).

22) The term "true loss" is, in truth, used in the previously quoted *Essentials of Accounting* (1st ed.), but the word in that work is only simply used to a limited extent and no argument is further asserted, at least in the above-mentioned form (Paton, *ibid.*, p.106).

charges", and losses that are regarded as belonging to "true losses" by him in this case, for example, are loss of uninsured property by fire, realised loss on sale of property, valuation loss due to "cost or market whichever is lower" in inventories, etc. (However, it appears that the above-mentioned way of treating he mentions with respect to those items held to be "true losses" by him is not always consistently held.)[23]

However, even though we can see some changes in his contention such as referred to in the above, he after all makes it clear that what are usually regarded as losses (at least principal ones among them, particularly the "true losses" which are designated by him) should be deducted not from revenue but from equities, as can be seen from what has been stated in the above. Consequently, as far as it is viewed from such a standpoint, it will naturally lead to the conclusion that his view with respect to loss can be looked upon as an anti-common view and moreover that his view still belongs to the thoery of offsetting loss to profit and capital which is supported by the present writer. And in this sense I must conclude that the aforementioned view of his does have an important meaning which should by no means be overlooked from our viewpoint.

III

With reference to the concept of loss in accounting in this country also, the American view=the theory of expense in the broad sense as already mentioned before are commonly supported as popular view. But also under such circumstance in this country, it is true that another group of advocates stand for the theory of expense in the narrow sense, particularly the theory of offsetting loss to profit and capital. And as advocates of this type Wasaburo Kimura (Professor of Aichi-Gakuin University), Katsuzo Baba (Professor of Seinan-Gakuin University) may be listed, including a number of other scholars[24].

Particularly the view held by Katsuzo Baba can be looked upon as one representative type of theory of offsetting loss to profit and capital in such situation of this country[25]. Of course it is not directly concerned with loss (in general). What he treats in his case is concerned exclusively with the problem with respect

23) Paton, W.A. and Paton, W.A., Jr., *Corporation Accounts and Statements*, 1955, pp.274–275, p.334ff.

24) cf. Kimura, W., book cited next. Baba, K., book cited next. Nakanishi, T., *Theory of Business Expense*, 1936, pp.48–49, Nabeshima, T., Expense, in Furukawa, E., & Takamiya, S. (ed.), *Fundamental Concepts of the Business Administration*, 1959, p.97; Ota, T., *Accounting*, New ed., 1959, p.156–160; Hayashi, K., *Theory of Income Determination*, Revised & Supplemented ed., 1950, pp. 35–36; Tanihata, H., Cost Allocation of Fixed Assets, in Yamashita, K. (ed.), *Theory of Income Determination*, 1959, pp.199–201, etc.

25) What is going to be further described below as an opinion held by Katsuzo Baba is taken from chapter 1 of his *Theory of Depreciation* (Revised and Supplemented ed.), 1951, unless otherwise indicated.

to the depreciation of fixed assets. But it must be said at the same time that this problem has an immediate bearing on the loss in question, and moreover that it has an important meaning for us.

Now, upon discussing the above-mentioned depreciation of fixed assets, to begin with he divides it into "depreciation due to the transfer of value" and "depreciation due to mere forfeiture of value of fixed assets" and then he asserts that the former is depreciation caused by the transfer of value to goods produced and that the latter is mere "forfeiture of value" "due to influences arising outside an enterprise". What must be taken up here as a point in our discussion is particularly concerned with the latter case. Items which he thinks belong to this category are listed by him as follows: "Cases where some decline in the value of existing fixed assets may be brought forth by influences such as fluctuations of market prices of fixed assets, particularly the decline of their reproduction cost, appearance of inventions which can serve the same purpose better, natural calamities, other incidental causalities, etc." (From these examples given here what is meant by his "depreciation due to mere forfeiture of value of fixed assets" should be understandable in outline.) In the meanwhile, because he looks upon "depreciation due to mere forfeiture of value of fixed assets" in the above-mentioned manner, he holds the opinion that its disposal should be made not from revenue in income determination but from profit or capital in the balance sheet, thereupon we have an immediate concern with the loss at issue as an open question. That is, it is because, viewed from the fact that "depreciation due to mere forfeiture of value in fixed assets" in his case stated in the above is excluded from income determination and is regarded as to be deducted either from profit or capital in the above-mentioned way, it means, putting it in other words, nothing more than what we mean by loss[26].

There is a necessity to further discuss in detail his view as seen in the above. It is concerned with the way he includes "the decline of reproduction cost" of fixed assets and depreciation due to "appearance of inventions which can serve the same purpose better", i.e. so-called functional depreciation among "the depreciation due to the mere forfeiture of value of fixed assets" as already pointed out. Originally speaking, depreciation of this kind is normally divided, as one of its classifications, into that which is to be expected and that which is unexpected (or that which is non-incidental and that which is incidental), but about this classification he further states that neither of these two has any substantial dif-

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26) What is meant by "depreciation due to mere forfeiture of assets" which is used by him in the above is, according to his own explanation an idea based on "the depreciation caused by assets" ("vermögensbedingte Abschreibung") which is taken up by F.Schmidt (to be discussed later). I have to spare a detailed discussion of "depreciation due to mere forfeiture of assets" as asserted by K.Baba here but it can not be said that his opinion is not always similar in every respect to the above-mentioned "depreciation caused by assets" asserted by F.Schmidt.

ference between them if viewed from the viewpoint of functional depreciation, and also that not only unexpected depreciation in the latter case but also expected depreciation in the former case, whenever they are to be disposed of in accounting, should be deducted (at least theoretically) not from revenue in income determination but from profit or capital, in accordance with what was discussed in the above with respect to loss. Therefore, according to this opinion of his it naturally leads to the conclusion that, also *in a case when the useful life of fixed assets is to be determined*, as far as functional depreciation (even if expected) is involved, there would originally be no room for any consideration. At least, substantially speaking, there can not be any other way of thinking[27]. In the case of Wasaburo Kimura it is not only held that functional depreciation should be deducted from profit[28], but also that functional depreciation could not be a factor by which the useful life of fixed assets might be determined[29]. That is, this point in the latter case is also stated clearly in such manner. (But, what gives rise to an open question in his case is the point that the item from which functional depreciation is to be deducted is limited only to profit as seen in the above. But, in addition to it capital=principal should naturally also be considered. Of course the points just expressed in the above are in truth not necessarily concerned merely with his case.)

However, not only in the case of the popular views, but also in the case of those who stand for the theory of offsetting loss to profit and capital the problem of functional depreciation, generally speaking, has not been looked upon in the same way as considered by the two professors mentioned. Particularly so is the case concerned with expected depreciation. Putting it in a more general form, it is not too much to say that knowledge of "the depreciation due to mere forfeiture of value of fixed assets" asserted by Katsuzo Baba (functional depreciation comprising part of it) is ordinarily lacking to an extreme extent, as can be seen from what is contended by the popular views. In this sense, although there still remain some disputable points in the above-mentioned views held by the two professors with respect to "depreciation due to mere forfeiture of value of fixed assets", parti-

27) Of course, if viewed from the argument about the problem involved in the factor to determine the useful life of fixed assets, what is expected in functional depreciation is in fact not necessarily conceived in his case in the manner I described in the above. Rather it can be said, with respect to the functional depreciation at issue, if viewed from his statement given separately, that he is of the opinion that what is expected should taken into consideration, excluding only that which is unexpected, when the useful life of fixed assets is to be determined (Baba, K., Depreciation, in Iwata, I., & three others (ed.), *Handbood of Bookkeeping and Accounting*, 1952, p. 601.) However, from the above-mentioned view held by him, saying that there is substantially no difference between what is to be expected and what is unexpected as far as it is functional depreciation, I can not help pointing out that what he first argues is contradictory and inconsistent with what he maintains later.

28) Kimura, W., "On Substantial Nature of Depreciation: Three Categories of Depreciation", *Accounting* (*Kaikei*), Aug. 1958, p.7 and p. 11.

29) Kimura, W., *Theory of Depreciation*, New ed., 1965, p.99.

cularly functional depreciation, it must be concluded that those views deserve special attention.

IV

As to loss to be conceived in accounting, again in Germany where the German view which denies the concept of loss itself is accepted at least as one influential popular view, there undoubtedly exist some advocates who, without accepting the above-mentioned popular view, not only accept loss as such, but maintain that loss should be regarded as a decrease (forfeiture) of profit or capital=principal by denying the view of loss as expense in income determination, i.e. the theory of offsetting loss to profit and capital which is mentioned by the present writer. F. Schmidt, W. Mahlberg, H. Mohr, E. Hatheyer, etc. may be listed as advocates of this type[30)31)].

Among these advocates F. Schmidt particularly can be cited as a most influential advocate who, strongly objecting against regarding the loss in question as expense in income determination, stands for the theory of offsetting loss to profit and capital. Now, the point with which we are particularly concerned about his view is his concept with respect to the fluctuations of value which may be accrued (without the instrumentality of transactions) to assets in themselves in the form of the balance of accounts, which is based on his well-known theory of organic current cost. Referring to this point, he holds that, on the grounds that a business profit should originally be regarded as what is realised through transactions, the above-mentioned fluctuations of value have nothing to do with the field of income determination and what they mean is nothing but the mere adjusted increase or decrease of assets and consequently capital (particularly owned capital). Therefore, in his case fluctuations of this nature, viewed from the way they are disposed of by accounting procedures, are excluded from the field of income determination to be disposed of simply through the so-called adjustment of assets and capital on a balance sheet. As to the said fluctuations of value, in his case it is seen that the fluctuations of market price are principally discussed, but in addition the cases of forfeitures of various assets caused by, for example, theft, fire, flood, destruction

30) cf. Schmidt, F., book cited next; Mahlberg, W., book cited next; Mohr, H., *Bilanz und immaterielle Werte*, 1927, SS.120–121; Hatheyer, E., *Vom Wesen der Kosten*, 1931, S.17.

31) However, similarly in the case of the above-mentioned advocates the foregoing views (the theory of offsetting loss to profit and capital) held by them are not directly concerned with loss itself. The very problem with which they are directly concerned is that of, if expressed in very general terms, the so-called fluctuations of value (including the mere fluctuations of prices) which may be brought about to the balance of assets (capital) of an enterprise. However, the decline of value which is one phase of it originally included the loss in question at least as a main portion of it, and the point which may give rise to an open question here from the viewpoint of loss is, to tell the truth, concerned with such a decline of value.

due to war are also taken up[32]. Now, putting aside all cases of the increase of value for the time being, because of the concern with the problem in question, if our eyes are inclusively directed to the other cases of the decrease of value only (excluding that portion which is caused by the fluctuations of money value mentioned before), it may be safely concluded from that have been discussed that the above-mentioned decrease of value in his case can not after all be anything different from our interpretation of how loss should be conceived and disposed of.

Of course it can not be said that his above-mentioned way of thinking is entirely free from being inconsistent with respect to some important issues. For example, with reference to functional depreciation (particularly that which is due to so-called obsolescence) which is taken up here as a case of the decrease of value, he is entangled in a contradiction or confusion in thinking that functional depreciation has nothing to do with income determination on the one hand, while on the other he regards it as if it were an expense in income determination[33], the fact of which eloquently indicates the lack of consistency in his case.

But in spite of all this, at least the gist of his thinking with respect to the decrease of value (particularly that which should be regarded as loss), which is excluded from income determination by him, could easily be read through from what has been discussed in the above and also at the same time it could probably be understood with ease that such a view is an opposing opinion to the German view with respect to loss, and that his view also belongs to the theory of offsetting loss to profit and capital (mentioned by myself), if viewed from the aspect of the loss in question.

Another opinion which I would like to take up here as one way of thinking which is similar to that of F. Schmidt is the view held by W. Mahlberg, which is concerned with accounting procedures to dispose of a certain kind of loss inflicted on machines. Upon presupposing a circumstance under which the value of a certain machine declined by 50% due to a new invention, he suggests the following four possible accounting procedures to dispose of such loss:

(1) The amount of the above 50% loss is immediately written off from the profit of the fiscal year concerned and thus the nominal capital value is maintained as it is.

(2) In accordance with Clause 261 of the German Commercial Code depreciation is made as it used to be in the past, and thus the nominal capital value is to be recovered during the remaining period of depreciation.

(3) The decreased amount is to be respectively disposed of by extraordinary depreciation out of (a) nominal capital, (b) open reserve, or (c) secret reserve, extending over any fiscal year.

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32) Schmidt, F., *Die organische Tageswertbilanz*, 3.Aufl., 1929, S.161.

33) cf. Schmidt, F., *a.a.O.*, S.85; and Baba, K., *Theory of Depreciation*, pp.10–11 and pp. 226–227.

(4) Leaving the book-value of equipment as it is, the annual amount of depreciation is to be cut down by 50%, based on the remaining actual value of equipment. However, in this case as soon as equipment is used up, the equipment account is to be cleared immediately.

However, of all the procedures suggested above, procedure (3) is suggested by him as the most adequate. Also, he further goes on to state that when the decreased amount (loss) in question comes to be so enormous that it exceeds the extent of increase or decrease of values caused by ordinary business cycles, business executives may possibly be obliged to adopt other procedures in the order:— (c) of (3), (b) of (3), (1) or (a) of (3), so that the difficulties which arise when such loss is to be disposed of can be minimized.[34]

Now, it can not be said that there is no objection to his way of taking up such a problem (according to my opinion his way of thinking which holds a negative view against the procedure suggested as (1) gives a concrete example), but similarly in his case also as in the others mentioned above he denies that decreased value caused by a new invention or the decreased value due to so-called obsolescence should be regarded as expense in income determination, and he rather thinks it adequate to regard such decreased value as mere decrease of capital=principal such as capital stock (nominal capital) or reserve (surplus). And it must be pointed out that from my viewpoint what is acceptable in his way of thinking lies in these points. Particularly as already pointed out, viewed from the fact that losses such as decreased value due to obsolescence (or functional depreciation if expressed by a more general term) are ordinarily regarded simply as expense in income determination, it can be said that his opinion described in the above should likewise deserve our special attention.

Now, as can be seen from all that has been discussed in this paper about the loss in question, even though the theory of expense in the broad sense, under which loss is regarded as expense which is to be deducted in principle in the broad sense from revenue, has been accepted far and wide as a common view on the one hand, while on the other those advocates who maintain that, on the grounds that the loss in question means decrease=forfeiture of profit (that of the current fiscal year concerned) or capital=principal (particularly periodical capital=principal), such loss should be disposed of by offsetting it to those items—in other words those who maintain the theory of expense in the narrow sense, particularly the theory of offsetting loss to profit and capital—are also not necessarily few in number. And it should be justifiable to say that these facts clearly show the fact that these advocates hold their negative opinions against the above-mentioned common views, and that particularly for that reason a problem of the utmost importance

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34) Mahlberg, W., *Der Tageswert in der Bilanz*, 1925, SS. 36–38.

has been aroused thereof.

Primarily, how to understand loss in accounting is, as mentioned at the beginning of this paper, a very serious problem. Nevertheless, we can not say that sufficient consideration has so far been given in detail with respect to the loss in question and particularly so in the case of the common views. Making it worse still, the view held therein is based on an undoubtedly erroneous understanding of loss. Be the matter as it may, it must be said that there are not a few problems still to be further examined and studied with respect to the way of thinking in maintaining the common views. This paper was prepared in trying to explain the abovementioned contentions of the present writer in general for the time being, as can be seen in the above by taking up my study on the grounds of the minority view of loss, i.e. the theory of expense in the narrow sense, thus making this paper an introductory part of my studies with respect to loss.