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A POSITIVE STUDY ON VIEWS UPON THE ACCOUNTING RULE OF COMMERCIAL LAW IN JAPAN

by
Yoshio Aida

Foreword

It has been, for the past ten years, my method of study upon accounting theory, through analysis of actual practices of corporate accounting, to re-examine the theory, scrutinize legal systems, and further to appreciate business' way of disposition. The present study, a survey, makes a link in the chain of such study. It is intended to survey views and practices in the business world on a number of problems of the so-called financial accounting, particularly in connection with the amended Commerce Law and accompanied rule for accounting calculation.

The object of the survey comprises 1,025 companies listed in the securities markets in Japan. We mailed enquête at the end of August, 1963, and received answers from 381 companies by November 15 of the same year, the due closing day. The rate of answers is 37 per cent.

Below I shall summarily report the result and make some examination upon the business' views and underlying problems.

(Questionnaire) Inquiry on Accounting

(Please select and mark your views on the following questions, or insert remarks where necessary.)

I. On the Accounting Rule (attached to the Commerce Law)*

- 1) Enactment of such rule is-
 - a. Necessary (approving)
 - b. To be left to other regulations such as Regulations for Financial Statements (oppositing)**
 - c. Necessary, but to be conformed to Rule for Financial Statements (conditional approval)
 - d. Other (your view

* Rule concerning Balance Sheet and Income Statements of Joint Stock Company, proclaimed on March 30, 1963. In the below abridged as Calculation Rule.

** Rule for Financial Statements, based on the Security Exchange Act.

- 2) By the Rule, valuation over cost is not admitted. Upon this-
a. It is proper. b. To be admitted, unless not over current price. c. Other (Your view) d. Your experience of revaluation (Yes, No.)
- 3) The principle of consistency is not clearly indicated in the Rule.
a. It is inevitable as a matter of legislation since smaller companies are concerned too. b. The principle ought to be made clear. c. The principle is acknowledged in the necessary Note about changes in accounting disposition. d. Other (Your view)
- 4) Treasury-stock is to be shown as liquid assets, by the Rule.
a. It is proper. b. It is to be shown as deduction from capital. c. Other (Your view)
- 5) Subsidiary company is defined as stockholding of over 50 per cent.
a. It is proper. b. It ought to be connection company with stockholding of 10 per cent and over. c. It ought to be governing company with stockholding of 25 per cent and over, like tax law. d. Other (Your view)
- 6) Long-term prepaid expense is included into fixed assets.
a. It is proper. b. It ought to be included in deferred account. c. Other (Your view)
- 7) "Allowance" section is independently set up.
a. It is proper. b. Not necessary. c. Other (Your view)
- 8) Corporate tax for current term is counted as tax allowance; hence it is made an expense of the current term.
a. It is proper. b. Corporate tax ought to be an item of profit disposition. c. Other (Your view)
- 9) All-inclusive theory is adopted, and drawn-out profit may be included into special income item.
a. All-inclusive theory is proper. b. Current performance theory is proper. c. Other (Your view)
- 10) Individual items of "capital" are not shown.
a. It is proper. b. Common stock and preferred stock are to be separately shown. c. Other (Your view)
- 11) In legal reserves are included profit reserve, capital reserve and revaluation surplus.
a. It is proper. b. Profit and capital ought to be distinguished. c. Other (Your view)

II. On Valuation of Inventory

- 1) Method of valuation

a. Acquisition price method	Product () Goods in process ()
b. Lower-cost or market method	Semi-products () Materials
	Commodity ()

 1. Fifo
 2. Moving average method
 3. Periodic average method
 4. Unit method
 5. Lifo
 6. Retail Inventory method
 7. Last purchase price method
 (Please show, for instance, as 1-b, or 2-a.)
- 2) Which ones of attendant expenses do you include into cost?

- a. Charge for purchase b. Freight and cartage inward c. Customs duty
- d. Expenses for office work of purchase, inspection and repair
- e. Expenses for package f. Expense for storage
- g. Other ()
- 3) Valuation loss is counted for in the following cases,
 - a. Wear & tear b. Missing c. Obsolescence d. Quality worsening
 - e. Decrease in current price f. Other ()
- 4) The meaning of current price for valuation
 - a. Disposable price b. a minus profit c. b minus after cost
 - d. Replacement price e. Other ()
- III. On Depreciation
 - 1) Method of depreciation (Please show by sorts of assets)
 - a. Fixed rate method b. Straight line method c. Output proportion method
 - d. Other ()
 - 2) Change of depreciation method
 - a. Year b. Reason
 - 3) Decision of useful life
 - a. By regulation of tax law b. Shorter than tax law c. Longer than tax law
 - 4) On special depreciation
 - a. Perform as tax law b. Perform below tax law c. Not perform
 - 5) On extraordinary depreciation
 - a. Perform or not b. If performed, sort of assets and reason

I. On the Calculation Rule (attached to the Commerce Law)

1) The first question relates to the adequacy of enacting such rule. The result of the survey is as follows.

a. It is necessary (supporting)	21 companies
b. It ought to be left to other regulations such as Financial Statements Rule (opposing)	26 companies
c. It is necessary, but ought to be conformed to Financial Statements Rule(conditional supporting)	314 companies
d. Others	14 companies
No remarks	6 companies
Total	381 companies

Thus the opinion (c) is overwhelmingly majority holds the Accounting Rule necessary, but conformity with the Financial Statesments Rule must be considered. In addition almost all of "other" views stress adjustment with tax law and special regulations, for instance, regulation for electrical enterprises. It must be noted the surveyed companies are those with respective capital amounts of more than 100 thousand yen, and hence subject to the Security Exchange Act.

Among "other" views, we can find some that are opposed to the Accounting Rule on the grounds that it might fall into supplying materials for "company scamp". Let us consider, in relation to this point, the reason for the

"necessity" of the Rule. Primarily the Rule has been devised in order to overcome the difficulties arising from the fact that hitherto concrete contents of accounting statements, to be prepared pursuant to the Commerce Law, have not been set forth, that must serve various purposes such as general meeting, publication, auditor's use, or company's own sake. Due to the lack of clear definition of the terminology, forms, and contents of accounting items, often disputes have arisen in the explanation toward stockholders, creditors or other interested groups. The new enactment could afford standard to the effect that companies will be exempted from the duty to make more detailed explanation than this, while interested persons will have the right to require explanation so far. In this sense the Rule must be useful rather to restrain company scamp.

One point with regard to this Rule is disputed, whether it is compulsory or arbitrary, due to the fact that it was proclaimed as an ordinance of the Attorney General's Office. Mr. Mizuta of the Regulating Office says the Rule is mere instructive regulation, not compulsory, and hence a violation will make no reason for ineffectiveness or cancellation of agreement, nor punishment to director and responsibility for damage compensation. On the contrary Mr. Ajimura of the same Office discusses, mainly in connection with the prescribed presentation of treasury-stock in accounting, that it is not mere instructive regulation, with possible result of punishment or director's responsibility. In any way it binds practical business, regardless of its legal nature.

On the other hand, as mentioned above, companies with capital of more than 100 thousand yen are subject to the Statements Rule based on Security Exchange Act. Possibly the more detailed is the Accounting Rule the larger may be the discrepancies between the two regulations. This may have resulted in the overwhelming majority of the view that asserts conformity between the two. However the significance of the Accounting Rule must be recognized at least in view of the fact that the Statements Rule does not always regulate the contents of financial statements for publication, and that more than 90 per cent of joint stock companies are of capital amount of less than 100 thousand yen and are not under the Statements Rule.

2) The second question relates to the principle of "acquisition cost", taken in the text of the Commerce Law (Article 285-2-3 etc.); namely, valuation over cost is not admitted. On this point, the result;

a. It is proper	271 companies
b. To be admitted, unless not over current price	91 companies
c. Others	14 companies
No remarks	5 companies
Total	381 companies
d. Experience of upper-appreciation	
Yes	34 companies
No	274 companies
No remarks	73 companies
Total	381 companies

As seen in the figures, the cost principle has gained the majority, 71 per cent. This suggests the penetration of the so-called "cost principles" in modern accounting theory. While the customary standpoint of the Commerce Law has been "under-market price" principle, for the sake of protection for creditors, in the business circle valuation not exceeding current price is supported by 24 per cent. Other opinions include: "Securities, temporarily held, are to be valued at current prices," "Distinction must be made by sorts of assets,"; "as to fixed assets, appreciation up to current price is to be approved in case of loss of cover": "Valuation up to cost is admissible".

In the second point, by experience in the past, it is clarified that most of companies, 72 per cent, have held cost-principle (no appreciation), while 9 per cent have performed valuating. It may be seen, by contrasting the results of two questions, that valuation up to current price is recognized even by those companies that in practice have not performed valuating. Again, it is interesting to note that most of those companies that have performed valuating approve count-up of valuation profit. Here a fault lies in the fact that often valuation profit is counted up by those companies that cannot in the real count up enough profit, for the sake of profit policy. This makes the reason for cost principle.

Next we shall observe a problem shown in the "other" opinion, that whether count-up of valuation profit is possible or not, from the standpoint of the revised Commerce Law. As mentioned above, the new Law takes acquisition cost as principle; forcibly requires valuation at current price, in case of a sharp drop in current price to a degree that recovery seems impossible; and at the same time exceptionally recognizes "cost-or-market-which-ever-lower" principle. Hence it is possible to suppose that the Law does not primarily take the count-up of valuation profit into consideration. Conforming to such view, in other words, that the Law has abandoned current price principle, the Accounting Rule has revised former current price principle for temporarily owned securities, replaced it by acquisition cost principle, and at the same time eliminated securities valuation profit from the non-business income item. In so far valuation profit seems impossible.

On the other hand, the view, that count-up of valuation profit is admissible under the revised Law, is founded on the following grounds. (1) If, after a devaluation loss is counted up as to liquid assets under the Article 285-2-1 of the Law by supposition that recovery will be impossible, unexpected rise of current price has occurred, the count-up of valuation profit up to cost will be possible. (2) When under the Article 285-2-2 of the Law lower-cost or market principle is applied, and after a valuation at lower-than-cost market price is made, if the market price has risen, a valuation profit up to the cost may be possible. (3) When, under the Article 285-3-2 of the Law, after a devaluation on fixed assets by unexpected loss is counted up, the market price has risen, or (4) in the case of valuation on stocks and bonds under the Article 285-5 and-6 of the Law, count-up of valuation profit may be possible.

Truly it seems possible in these cases to perform upper-appreciation, so far as a matter of juristic interpretation is concerned. However, it must be

noted, these cases are rather exceptional. The valuation profits referred to therein have a meaning quite different from that to be properly implied in the current price principle; their nature is revision of loss or profit in preceding terms. Therefore they may be treated, not as proper valuation profit, but, if the amount is relatively large as the item of profit surplus increase, and if it is small as the item of miscellaneous profit, and, as the amount of upper-appreciation up to cost is generally small, it seems unnecessary to provide an independent, special item of valuation profit.

3) The third question concerns the principle of consistency. As to the lack of clear indication of this principle in the Accounting Rule:

a. It is inevitable as a matter of legislation	33 companies
b. Consistency ought to be made clear	86 companies
c. Consistency is acknowledged in the Rule	245 companies
d. Others	10 companies
No remarks	7 companies
Total	381 companies

By the survey, the leading view is (c), interpreting that the principle is recognized in the Rule, occupying 64 per cent. The second rank view advocates more clear presentation of the principle. "Other" opinions are: "It is a problem requiring juristic treatment, and, needless to say, must be observed." "The Rule must be adjusted to the principle." "The requirement of consistency has not been softened of course, for the sake of truthfulness."

Indeed it is a question how the principle is accepted by the new Commerce Law and Accounting Rule. By 64 per cent of the business circle it is taken that the principle is recognized by the Law. However the view of the official is rather negative as shown below. There are three explanations about this problem.

The first is negative standpoint by the official. For example Secretary Ueda of the Regulating office discusses: "The necessity of consistency is problematic....It is right to see that the Commerce Law does not make it coercive....The principle is not adopted as a principle, because it might be a too far carrying of the thing, in view of the present conditions of economy, not to permit any change of valuation method."

The second explanation is that, though if not perfect the principle is recognized in the Law. Professor Kurosawa says: "We could not speak of the principle in the Law in its strict sense, but it is implied imperfectly."

The third explanation is positive affirmation. For instance, Mr. Kawai says: "In view of the principle of truthness adopted in the Law, the consistency is indispensable as its premise.....In addition, the principle is born from the duty of careful management and loyalty in accounting required to directors."

Two opposite views are to be borne, it seems, from the provision in the Accounting Rule, by which changing of the method of valuation and depreciation, are made items of footnote of financial statements. The one is that the footnote is required from the standpoint that consistency is essential.

The other is that, while the principle of consistency does not allow any change of accounting method without due reason, the new Rule admits changes, possibly even without due reason, to be freely performed only by adding it in footnote. Hitherto the meaning of "due reason" has not been always made clear, but in the Rule it is evidently stated (Article 8). Our survey has revealed that generally consistency is perceived as a requirement based on the Commerce Law. This is too rigid an interpretation. It is not to be taken so rigidly as a problem of juristic norm. Of course, if the change is to be made completely freely, there is no reason for footnote. It may be properly said that the Commerce Law esteems consistency, it does not coerce it. In this respect it would be better to make footnotes include not only facts of changes but also their reasons, and, as regards big enterprise, their effects upon profit.

4) The fourth question relates to the rule that "treasury-stock" is to be shown in liquid assets.

a. It is proper	290 companies
b. It is to be shown as deduction from capital	65 companies
c. Others	19 companies
No remarks	7 companies
Total	381 companies

The opinion that supports the system to insert treasury-stock in liquid assets occupies 76 per cent, while that approves capital-deduction, customarily insisted upon as an accounting principle, accounts for less than 20 per cent. In "other" opinions are included: "No need to insert so long as lawful"; "It may be included in other item since the holding may be temporary"; "It ought to be decided by motives of holding"; "When the stock has market ability, count-up in assets ought to be recognized; if no market ability, capital-deduction is to be adopted"; "No need to insert"; "Footnote is proper"; "To insert specifically in liquid assets, only in case of holding longer than a certain limit"; "It ought to be allowed to indicate as securities samely as other companys' stocks". Within these opinions we can find two contradictory sides of treasury-stock, namely, the assets character, or security character of treasury-stock and the capital character, or equity character of stock itself. The majority opinion recognizes its character as assets, as it is recognizable in the Commerce Law. This reflects the speciality that, under our law, acquisition of treasury-stock is an exceptional case.

5) The fifth question is the definition of subsidiary company in the Rule, that takes stock holding of over 50 per cent as its condition.

a. It is proper	272 companies
b. It ought to be connection company with stockholding of 10 per cent and over	25 companies
c. It ought to be connection company with stockholding of 25 per cent and over	33 companies
d. Others	43 companies
No remarks	8 companies
Total	381 companies

In this question a noteworthy result is the numerous number of "other" opinions. It tells the difficulty of absorbing new concept, subsidiary company, into law. Major views among "others" are three. "It is not to be decided merely by stockholding"; "Substantial and close business connection ought to be weighted"; "Uniformity within the Rule, tax law and other regulations must be considered". Still others; "Subsidiary relationship is to be recognized in every case of holding of over 50 per cent, and to be judged by business relations in the case of holding of over 10 per cent"; "It is appropriate if adjusted to the Financial Statements Rule"; "It ought to be left to discretion of each enterprise"; "30 per cent is proper". Thus the complexity of the problem is reflected.

Now, a concept of "related company" is involved in the Financial Statements Rule, that takes two conditions for it; stockholding relation of 10 per cent and over subordinate relation in major business. On the other hand tax law has a concept of business-governing-stock, that means holding of 25 per cent and over. Hence adjustment between three concepts is wanted. By the recent revision of the Financial Statements Rule the concept of a related company has been widened so as to include even if business relation is not close; every case of holding of over 50 per cent samely with the subsidiary company in the Accounting Rule (Article 8).

In any event, by the survey the opinion that holds the definition in the Rule as appropriate is overwhelmingly numerous, occupying 71 per cent. We can see here a conformity with the concept held by American Securities and Exchange Committee, namely holding of over 50 per cent and consolidated statements. The present concept of subsidiary company might lead to the problem of consolidated statements. In the new Commerce Law it is thought too hasty to adopt consolidated statements, not without reason. But as regards the Financial Statements Rule it is advisable to take up the preparation for such statements. The above mentioned adjustment might be possible only through them, because most of the companies under the Financial Statements Rule are bigger enterprises that would find the necessity of consolidated statements earlier and more concretely than smaller companies subject to the Accounting Rule.

6) The sixth question relates to the count-up of long-term prepaid expense into fixed assets.

a. It is proper	135 companies
b. It ought to be included in deferred account	232 companies
c. Others	8 companies
No remarks	6 companies
Total	381 companies

"Other" opinions are: "Both (a) and (b) are appropriate, but conformity with the Financial Statements Rule is necessary"; "Fixed assets is proper, but a special item, other than intangible fixed assets, should be set up"; "It ought to be put into deferred accounts, so as to be free from dividend limitation"; "To put it into liquid assets is to be admitted too".

A noticeable point in the result, in contrast to the preceding two questions, is that the view that supports the regulation is only 35 per cent, while that approves customary opinion, to include it in deferred account, occupies as many as 61 per cent.

While such criticism is not out of expectation, why has the Accounting Rule prescribed the inclusion of long-term prepaid expense in fixed assets? An official explanation is that; "Since deferred assets is a kind of fictitious assets,....it is reasonable to distinguish long-term prepaid expense from deferred assets." "Its character has been perceived, as a right of claim for service, a pure real assets, to be distinguished from deferred assets." In other words, long-term prepaid expense is considered as assets, because it has exchangeability to money or value owing to its character as credit. In opposition to this argument, Professor Kurosawa supports the standpoint of the Accounting Rule, saying: "It is never intangible fixed assets..... This sort of problem must not be settled uniformly with juristic strictness."

On the other hand, by tax law many deferred account items are admitted, for instance, contribution for public establishments. In order to carry through the standpoint of the Commerce Law, adjustment to the Financial Statements Rule as well as tax law is necessary. To speak of the standpoint of the Commerce Law, it should not stick to the view that grasps the essence of assets merely by convertibility; it should fully esteem customary accounting practice, if only for its cost principle. Of course the homogeneity between fixed assets and deferred accounts from the viewpoint of accounting theory is not the problem here. The problematic point is that only long-term prepaid expense is taken up as fixed assets.

7) The seventh question concerns the accounting item, "allowance", independently set forth by the Accounting Rule.

a. It is proper	300 companies
b. Not necessary	68 companies
c. Others	12 companies
No remarks	1 company
Total	381 companies

"Other" opinions are: "The allowance in the Commerce Law is ambiguous. It is a thing done by halves"; "It is to be divided into debit nature items and profit nature items"; "It ought to be classified into three parts, by natures, namely valuation, debit and profit"; "Allowance of valuation is needless"; "The meaning of allowance is not clear." These opinions show the problem underlying in the nature of allowance in the Commerce Law itself.

By the way, among the business circle an absolute majority of 79 per cent approves the provisions in the Commerce Law and Accounting Rule. Why is it? It is to be noted that many sorts of reserves, that the Commerce Law prescribes, are taken into consideration here. These are reserves for price change, for water shortage, for export loss and so on, that are allowed loss treatment under tax law. Since the customary accounting theory recognizes only two categories of allowance, namely that of valuation nature and debit

nature, the above mentioned special sorts of allowance are generally taken as profit-reserve items. However, the character of profit-reserve item, before profit disposition, is also obscure. Hence it seems favorable for clear presentation, to set forth Allowance Section, including those allowances that have the loss-nature of tax law but not the nature of valuation nor debit, as the third group of allowance. Such reasoning is underlying the views shown in the survey. It may be a possible solution for corporate accounting to group and distinguish these reserves or allowances that are of profit nature but not yet so disposed. The standpoint of the Commerce Law can be understood as the like.

It is questionable, however, that the allowance in the new Commerce Law holds really such contents. It is seen in the process of drawing the Law; in the first tentative plan only conditional liabilities such as retirement allowance were included; by the second plan allowances for specific sorts of outlays were added; in the final plan reserves for loss were added while conditional liabilities were excluded. Herein lie the grounds for criticism against the nature of allowance in the Commerce Law. In this sense, it may be justified to see that into the viewpoint of the Commerce Law the "originalism" is not fully taken.

The reason why the independent item of allowance is supported by the business circle seemingly lies, as observed above, in the consideration upon tax regulation and the intention to increase clearness by including only those after profit disposition in profit reserve. This may mean, on the other hand, a widening of the concept of allowance in the Commerce Law, being derived from respecting the standpoint of tax law. As the result there have been left many problems to be solved from the viewpoint of accounting theory.

8) The eighth question. By the Accounting Rule current-term sum of corporation tax (and the like) is counted up in tax allowance, and hence presented as current term expense. The question is whether this treatment is reasonable or not.

a. It is proper	207 companies
b. Corporation tax ought to be profit disposition	150 companies
c. Others	19 companies
No remarks	5 companies
Total	381 companies

"Other" opinions are: "Before-tax profit is to be shown, putting corporation tax aside"; "It is questionable since tax is estimation"; "Profit before tax is to be additionally shown"; "Enterprising tax and residence tax should be also shown"; "The loss-nature is to be recognized in tax law also"; "Allowance is based on estimation and hence inaccurate".

By the customary practice in our country, the treatment of corporation tax (& etc.) makes a part of profit disposition. Then, why has the Commerce Law prescribed to treat it as expense? Firstly, it is argued, since tax allowance is to be regarded as liability with unspecified amount, it ought to be counted in the item of liability, because of its nature as liability. Secondly,

profit after deduction of corporation tax should be shown, because it presents profit disposable as dividend, from the standpoint of the Law that profit must be disposed for the interest of stockholders, and, corporation tax is to be shown as the last item of non-business expenses. Thus it is generally understood.

However, as stated above, such treatment is contrary to the customary practice, and so several opposite views have been suggested. Representative ones of them are illustrated in the "Opinions upon the treatment in connection with enforcement of the Accounting Rule and Financial Statements Rule" presented by the Committee for Managerial Accounting (a committee for governments' subsidies to scientific research under the Ministry of Education). To summarize, main points of the critics are as follows: The practice to treat corporation tax as an item of profit disposition is generally established: Collection of corporation tax is compulsory, but it cannot afford grounds for affirming its nature as expense: it cannot be said that corporation tax is expense since the amount is settled by resolution of general meeting, where profit disposition is discussed.

However, it must be admitted, corporation tax is an inevitable liability so long as profit is counted up, distinct from other items of profit disposition, and, from the viewpoint of stockholders, it is to be deducted as expense. In this sense it is outside of the resolution by general meeting. Therefore, as a compromise of both views, it may be desirable to show both before-tax profit and corporation tax as well as after-tax profit, as seen in "other" opinions. Above illustrated views are also suggesting such device. And the revised Financial Statements Rule (Article 97) recognizes a system, either in income statements or surplus account statements, to show corporation tax in a form of deduction, and to show the amount after deduction as "after-tax current term net profit" (to speak more exactly, current term net profit after deduction of corporation tax allowance), or as after-tax undisposed profit surplus account. This is a proper treatment viewed from the system that accounts corporation tax as non-business expense.

9) The ninth question is "all-inclusive theory" vs. "current performance theory". The Accounting Rule takes the standpoint of all-inclusive theory and thereby includes "drawn-out profit" in the special income item. Is this reasonable?

a. All-inclusive theory is proper	201 companies
b. Current performance theory is proper	147 companies
c. Others	20 companies
No remarks	13 companies
Total	381 companies

"Other" opinions are: "All-inclusive theory is proper, but it is unreasonable to include drawn-out profit in income account"; "It must be harmonized with the Financial Statements Rule"; "Combined statements ought to be adopted"; "Theoretically current performance theory is proper, but all-inclusive concept is necessary in respect of the profit disposable as dividend

mentioned in the Commerce Law."

By the survey, supporters of all-inclusive theory, accounting for 53 per cent, exceeds those of current performance theory, 39 per cent. However, it must be observed, the supporters of all-inclusive theory are not always affirming the contents of the income account of the Commerce Law, since not a few of them hold that the drawn-out profit is not to be included, similarly as "other" opinions.

Nevertheless, the majority of all-inclusive theory seems to suggest the existing negative attitude toward the current performance theory, due to the perplexity of documentary works or the inaccurate contents of the non-current income item.

An interpretation upon this point of the Rule is that; "The rule broadly takes the standpoint of current performance theory.....At the same time it admits income statement and surplus account statement (although there is some difference between them) standing on the ground of current performance theory." It argues the law takes a compromise view; but this is problematic. The significance of the so-called compromise concept or combined statements is to be found, not in the mere distinguished presentation in one income statement, but in the exclusion of non-current items from the current net income. In so far the Rule is near, if not same, to all-inclusive theory, with only difference in presentation. If combined statements, as mentioned in Revised Accounting Principles, is intended, at least the item "current income" must be shown as "current net income".

In any event, the result that the current performance theory, that has appeared to have scarce support in the business, has obtained supporters of 39 per cent, while on the other side the all-inclusive theory has gained 53 per cent approval, suggests probable increase of compromise, combined statements in the future. This is grounded by the reasons that non-current items are relatively few and that easy understanding by outside persons is required. Also in the Financial Statements Rule (Article 100) combined statements is permitted. This is an appropriate amendment.

10) The tenth question: The break-down of "capital" is not required in the Commerce Law and Accounting Rule; How about this?

a. It is proper	272 companies
b. Commonstock and preferred stock are to be separately shown	96 companies
c. Others	9 companies
No remarks	4 companies
Total	381 companies

"Other" opinions are: "Separation of transferred capital is to be permitted"; "It is adequate in the present position of the matter. A reconsideration will be necessary in the future when special types of stock are increased"; "It is out of question so far as the present state in Japan is concerned".

As suggested in these opinions, the significance of answers cannot be

truly understood, without taking the underdeveloped security market in Japan into account. The predominance of the view "proper", occupying 71 per cent, has been supposedly derived from the particular situation that non-par value stock can be seen only with a few companies and that preferred stocks have been issued by only a little more than ten companies since the war end.

In the former accounting rule, the capital account was so regulated as to divide it not only by the sorts of common and preferred stocks, but also by par and non-par value stocks. In the new Rule distinction is required only with common and preferred stocks; the distinction between par and non-par value stocks is eliminated from the items to be shown in balance sheet (Rule on Balance Sheet, 4-3-A). Then the necessity of distinction between par and non-par value stocks must be reexamined. Primarily the contents of capital are to be shown in order to explain the contents of dividend to stockholders. In this sense there is no difference between par and non-par value stock. Hence distinguished presentation may be applied, at most, as regards common and preferred stocks.

In this respect, the proportion of (b) view, 25 per cent, seems to be too small. This may reflect the particularity in Japan that preferred stocks are few. The method prescribed in the Financial Statements Rule that puts these distinctions in "detailed capital statement" (Article 60, 61) is justifiable. However, in view of the fact that the Financial Statements Rule is primarily applied to big enterprises, it seems appropriate, from the standpoint of the Commerce Law, to make some device to present capital contents to some extent, to show interests of stockholders, as regards smaller companies.

11) The eleventh question relates to the point that, in the Accounting Rule, profit reserve, capital reserve, reevaluation surplus and so on are included in "legal reserves".

a. It is proper	174 companies
b. Profit and capital ought to be distinguished	196 companies
c. Others	2 companies
No remarks	9 companies
Total	381 companies

Two peculiar points are seen in the answers to this question. First, "other" opinions are only two; "Arbitrary capital reserve ought to be set up", and "Both are proper". Second, supporters of (a) account for 46 per cent and those of (b) 52 per cent; a small majority of opponents.

The Rule prescribes that, "capital account must be divided into items of capital, legal reserve and surplus" (Article 34), and the concept of legal reserve is emphasized, consisting mainly of capital reserve and profit reserve. In other words, the legal reserve is founded on the nature of these two reserves, that these cannot be drawn out except for loss cover or transfer to capital; and on the viewpoint that these, distinct from surplus account, the third of capital account, is not disposable; in short, for the protection of stockholders.

On the side of accounting theory, however, the concept of capital surplus is well established, in which the distinction between capital and profit is

stressed. Following this line, in the amended Financial Statements Rule, capital surplus is divided into capital reserve, reevaluation surplus and other capital surplus (Article 63).

A problem lies in the explanation of "other" capital surplus, including contributions to construction cost, aids to construction, donation and so on. If internally reserved, these are put under arbitrary reserve, and in so far remain to be disposable. Here lies a fear that the distinction between capital and profit would be destroyed.

In this survey, the criticism against the rigid uniformity of the Accounting Rule has been advocated. The regulation of the Rule should be such one in which the concept of other surplus capital is well acknowledged, even though, as shown in the Rule, the priority of drawing-out capital surplus to profit reserve, for the sake of loss cover, is allowed.

II. On Valuation of Inventory

1) The first question is the methods of inventory valuation, by sorts of assets. The result of the survey is summarized in the following table. An analysis by industry groups may be necessary, which however has been left to another survey.

In the summary table only broad line of tendency is recognizable. The main points, and comparison with a former survey of about eight years ago, will be explained below.

a) Method of moving average cost is most commonly used as the whole. This may reflect a thinking that the result of this method shows reasonable result.

b) As to products, however, periodic average method is most numerous. As to goods in process, periodic average shows almost same number as moving average.

c) It has been accepted formerly that "lower of cost or market" method is most popularly used, due to conservatism of the business. But, by the survey it shows only 13 per cent as the whole. This is to be appreciated in connection with the fact, as it will be seen in the next question, that, by tax law, count-up of valuation loss is permitted also as to other methods.

d) As a general rule, unit method is rather exceptional, but it is relative as to goods in process and products. This is to be considered in view of the development of huge-machinery industry, heavy electrical equipment industry and so on.

e) Compared with the former survey, last-in first-out method is fewer and first-in first-out method is more. (The former was 6.2 per cent and the latter was 11.2 per cent in the former survey.) As grounds for this change, we could point out the recent trend of accounting theory that places weight upon the flow of goods, degree of inflation, unfavorable treatment for price fluctuation reserve in tax law, and speedy accounting works by mechanization.

f) Another speciality as compared with the former survey is the increase of periodic average method and a small decrease of moving average method.

Simple inference is dangerous since the covered companies are not the same, but the causes of such changes may be found in the popularized use of process-costing system following advancement of techniques, increased production volume, and expanded equipment.

Method of Inventory valuation

Item	Method	First-in first-out method	Moving average cost method	Period average cost method	Last-in first- out method	Unit cost method	Retail inven- tory method	Last purchase price method	Others	Total
Products	cost	29	80	83	9	34	20	6	1	262
	lower-cost or market	3	13	16	5	1	0	0	0	38
	total	32	93	99	14	35	20	6	1	300
Products in process	cost	27	78	74	9	54	7	8	1	258
	lower-cost or market	3	12	10	4	1	0	0	0	30
	total	30	90	84	13	55	7	8	1	288
Semi- products	cost	20	73	56	6	18	6	5	1	185
	lower-cost or market	3	11	6	4	1	0	0	0	25
	total	23	84	62	10	19	6	5	1	220
Material	cost	35	141	75	16	12	1	18	0	298
	lower-cost or market	1	17	15	8	2	0	1	0	44
	total	36	158	90	24	14	1	19	0	342
Goods	cost	23	59	31	5	20	7	21	1	167
	lower-cost or market	5	9	7	3	1	2	4	0	31
	total	28	68	38	8	21	9	25	1	198
Total	cost	134	431	319	45	138	41	58	4	1,170
	lower-cost or market	15	62	54	24	6	2	5	0	168
	total	149	493	373	69	144	43	63	4	1,338
%		11.1	36.8	27.9	5.2	10.8	3.2	4.7	0.3	100

2) The second question is the extent of "attendant expenses" of inventory that are counted up into cost.

a. Charges for purchase	275 companies
b. Freight and cartage inward	319 companies
c. Customs duty	265 companies
d. Expenses for office work of purchase inspection and repair	96 companies
e. Expense for package	129 companies
f. Expense for storage	104 companies
g. Others	14 companies

In "other" groups are included "that part of transfer expense required by tax law to calculate into cost"; "A part of paid-out interest"; "Marine insurance premium"; "Encouragement outlays to materials suppliers"; "Drying expense for materials purchased"; "Interest on notes payable"; "Freight outward"; "Interest on borrowings on trade bill"; "Usance charge for import bill"; "Charges for banking". Noteworthy is that interest is counted into cost by four companies.

Generally three ideas are thinkable about the extent of counting into cost. The first is matching expenses with revenues. The second is the idea of taking the factor of increased assets value into account. The third is calculation that pays regard to the factor of importance, in other words, economic idea of calculation. By the first idea cost nature is to be recognized on all the items above illustrated. From the practical standpoint the third idea may be emphasized.

A noticeable point shown in the result of survey is that the former three items, namely expense for purchase, freight inward and customs duty, are counted into cost by almost all companies that are holding inventory, while other items are being given cost nature only or half one third of companies. That the former three items are given cost treatment generally tells that these have nature as direct, outward expense, and respectively connected to corresponding purchased goods. On the contrary, the subsequent group of four items have nature of indirect, internal expense, and hence are connected to purchased assets through periodic matching. These are given cost nature from the viewpoint of importance and economic calculation. By tax law also, the idea of importance is esteemed, and if these are under 3 per cent of purchase price, they may not be included in cost.

There lies a problem in including in cost, so to speak, financing expenses such as interest on notes for purchasing, interest on usance bill and so on. There is some reason for including these in cost, from the principle of correspondence between expense and income. If the logic is to be extended, however, interest must be taken into consideration with regard to every asset. This makes a problem further to be studied.

3) The third question asks the cases of depletion loss, or valuation loss, by costing methods other than lower-cost or market method.

a. Wear & tear	257 companies
b. Missing	255 companies
c. Obsolescence	203 companies
d. Quality worsening	187 companies
e. Decrease in current price	77 companies
f. Others	8 companies

"Others" include: "Out-season goods"; "Damage"; "Valuation loss for unpopular goods"; "Only valuation loss"; "Price down hopeless of recovery".

A characteristic point in these illustrated cases for valuation loss or depletion loss is that, these are relatively numerous, in contrast to above mentioned scarce adoption of lower-cost or market method, reflecting conserv-

atism or healthiness of the business. As there are included enterprises with scarce amount of inventory, such as banks, the figures show that about 80 per cent of enterprises in general are counting these sorts of depletion loss or valuation loss.

The second peculiar point is that these cases can be classified into three groups with respective divergent senses and contents. The first group, including the foremost two, namely wear of tear and missing, are typical cases of material loss, and overwhelmingly numerous. These losses are concrete and quantitative; not valuation losses incurred at the time of settlement, but those to be counted as expense at each occurrence. The second group, obsolescence and quality worsening, belong, so to speak, to in-between position, because, although these are primarily depletion loss as economic depletion, these cases are scarce compared with the first group, and accompany the nature of valuation loss, in view of possible diversion of use of obsolete or worsened goods. The third Group of cases is (e), decreased current price, typical valuation loss. However this is a small number compared with the other two groups, reflecting the penetration of cost allocation thinking into the business.

Group 1st and 3rd must be clearly distinguished because, as seen from above analysis, the items in the first group ought to be counted up in each year of occurrence as natural expenses, while items in the third need not always be counted up, as future recovery may be expected. As for the second group problem lies in the way of valuation.

4) The fourth question is the meaning of "current price" for counting valuation loss.

a. Disposable price	217 companies
b. a minus profit	12 companies
c. b minus conversion cost and sales cost	20 companies
d. Replacement cost	47 companies
e. Others	18 companies

Among "others" are: "a minus sales cost"; "Standard cost"; "Retirement price"; "For assets, disposal price minus sales expense; for materials and the like, replacement cost". These are representative.

The overwhelming majority of "disposable price" in the survey may have been affected by the thinking of tax law. In its Ordinance 187, it is settled that goods that cannot be sold at normal price due to damage, dirtiness, shopwornness or lost shape can be valued at disposal price.

Strictly speaking, the disposal price must be net balance in hand, after deducting sales expense. And there are two kinds of disposal; one with proper quality of goods, and the other as scrap. The above mentioned phrase—"cannot be sold at normal price"—seems to suggest retirement price as scrap. This point waits further study.

"Replacement cost" is also relatively numerous. This seems to be current price in relation to the lower-cost or market method in tax law (Execution Order, article 20). As a problem in this regard, I want to point out excessive

uniformity in the concept of current price adopted in the lower-cost or market method of tax law.

III. On Depreciation

- 1) The first question is the methods of depreciation, by sorts of assets.
 - a. Fixed rate method
 1. Applying to all assets 36 companies
 2. Applying to tangible fixed assets 318 companies
 - Subtotal 354 companies
 - b. Straight line method
 1. Applying to all assets 26 companies
 2. Applying to intangible fixed assets 252 companies
 - Subtotal 278 companies
 - c. Output proportion method 22 companies
 - d. Replacement method 7 companies
 - No remarks 2 companies
 - Total 663 companies

The total number exceeds 381 companies, because some companies denote two or more methods. On company basis the sum up of Total (a), (b1), and No-remarks makes 382 companies. (Still one company is surplus; This is due to Nihon Koku Co. that divides tangible assets into airplane and others, respectively applying two methods.) The composition must be counted on company basis.

To take up tangible fixed assets, fixed rate method is adopted by 93 per cent of surveyed companies, telling widespread use in bigger enterprises in Japan. On the contrary, straight line method is employed by only 26 companies, 7 per cent. And, it is to be noted, most of these companies have only recently changed into it from fixed rate method, as it will be shown later.

As for intangible assets fixed rate method is relatively scarce. This may depend on the fact that cases of intangible assets were unexpectedly rare in the surveyed companies.

The application of output proportion method is mostly on mining right and other assets incident to mining, such as mine gallery, minefield, clay mine for cement and so on. Replacement method is used exclusively on replaceable assets of car transport and electric power enterprises. The rare and confined use of these two methods is supposedly derived from regulations of tax law.

I shall make some remarks upon the reason for the overwhelmingly numerous use of fixed rate method in Japan. There are two factors; advantages and reasonableness in profit calculation of a term, and tax regulations. The first point is that, by fixed rate method, distribution of cost becomes proper since the depreciation is large in the beginning years, corresponding to increasing repair cost in the later years; large depreciation at the beginning holds good balance with high efficiency; recovery of invested

capital is more speedy and hence advantageous for financial policy; large depreciation at the earlier period is theoretical in view of obsolescence. The second point regarding tax is that, when a newly established corporation does not report the depreciation method it will apply (this report is necessary by law), legally fixed rate method is to be applied to all assets except mining fixed assets, on which output proportion method is applied; and in our tax law regulations are rigid, as seen in the legal useful life, compared with American practice where arbitrary decision of life is admitted under standard life system.

2) The second question is recent changes in the depreciation methods adopted by companies.

a. Performed changes	30 companies	7.9%
b. No change	289 companies	75.9%
No remarks	62 companies	16.2%
Total	381 companies	100.0%

The ways of changes are:

a. From fixed rate method to straight line method	19 companies
b. From straight line method to fixed line method	11 companies

It is noteworthy that the changes during 1960-1963 were mostly those from fixed rate to straight line. This is to be considered taking the excessively huge amount of equipment investment after 1960 into account. For, while fixed rate method has advantages as mentioned above, it naturally brings about too heavy charge of depreciation immediately after the acquisition of assets. Then, the problem is the reasons for changes.

The major reasons for changes from fixed rate method to straight line method are: "Levelling of profit" (1961); "Due to increased charges by acquisition of huge assets" (1963); "Levelled profit in hotel industry" (1960); "For the principle of correspondence between cost and profit" (1962); "By agreement between enterprises"; "For healthy finance"; "For secured profit"; "Rapid increase in equipment investment" (1963); "For simplification of accounting" (1963).

For the changes from straight line to fixed rate: "Fullfilment of capital" (1961); "Speedy depreciation" (1961); "Consideration on factor of economic obsolescence"; "By geometrical increase of depletion" (1959); "For annexation". The mentioning of increasing depletion and obsolescence is partly related to the rigidity of legal useful life.

3) The third question concerns the decision of useful life.

a. By regulation of tax law	359 companies
b. Shorter than tax law regulation;	
by company's own way	13 companies
c. Longer than tax law regulation;	
by company's own way	1 company
No remarks	8 companies
Total	381 companies

The first noticeable point in the result is that, in 94 per cent of our enterprises, the useful lives settled by tax law are applied as they are. Herein problems are propounded about settled accounting results basis and uniform system of useful life.

The second point is that, in the cases of company's own way, almost all of them take shorter lives than tax law regulation. It tells that legal regulation is longer than actuals. This problem will be discussed in the later fifth question about special depreciation. The one company that exceptionally takes longer life than tax law is Nihon Kōkū Co.; for airplanes.

- 4) The fourth question is the "special" depreciation.
- | | |
|--------------------------|---------------|
| a. Perform as tax law | 250 companies |
| b. Perform below tax law | 48 companies |
| c. Not perform | 71 companies |
| d. Other | 1 company |
| No remarks | 11 companies |
| Total | 381 companies |
- ("Other" one company performs within the bounds of before-depreciation profit.)

By the survey 66 per cent of surveyed companies are performing special depreciation exactly after law, while 13 per cent below the law. The reason for the "below" may lie in political consideration due to insufficient profit, and reasonableness in current income accounting to avoid too heavy burden, most typically one third in the first year. Here is the problem of disposition of special depreciation in accounting system, and also the question whether the "adequate" depreciation mentioned in the Commerce Law involves special depreciation.

The reasons for "No" special depreciation are not clear. Perhaps they may be; lack of applicable assets; insufficient profit; or no need.

- 5) The fifth question is "extraordinary" depreciation.
- | | |
|------------|---------------|
| a. Perform | 55 companies |
| No perform | 298 companies |
| No remarks | 28 companies |
| Total | 381 companies |
- b. About 90 per cent of applied assets are machinery; buildings, ship equipment and cars account for only 10 per cent.
- c. The reasons are, for machinery, "economic obsolescence accompanied to technical innovation" as major reason, and "increased operation rate" and "adjustment of profit". As to building or ship equipment the reasons are: "insufficient depreciation in the past"; "wear and tear"; "removal"; "obsolescence"; "internal reserve of profit"; "damage and missing".

Thus we see the major object of extraordinary depreciation is machinery, and the reason is economic obsolescence due to technical innovation. This leads us to the problem of the legal useful life and arbitrary depreciation.

Another problem is that the extraordinary depreciation has been seemingly utilized as a means of rich internal reserve, so to speak politically, to meet "open" economy, as seen in the large amount of extraordinary depreciation by auto industry.*

Conclusion

In the above, we have reviewed the result of our survey concerning some facts of the actual accounting system in our country; the business' views upon the revised Commerce Law and the Accounting Rule, inventory valuation and method of depreciation. As for the implied problems of questions and answers, and their significance for accounting theory, I have mentioned at respective places. I am hoping my contribution to the theory may prove useful to my fellow students through this positive study.

* For more detailed discussion of this problem, see the writer; "Accounting Policy," 1963.