

HISTORICAL SIGNIFICANCE OF ACCOUNTING FOR CHANGING MONEY VALUE*

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I. '*Money Illusion*'

Some thirty-five years ago, in 1928, Irving Fisher, an economist, wrote,

We simply take it for granted that "a dollar is a dollar" —that "a franc is a franc," that all money is stable, just as centuries ago, before Copernicus, people took it for granted that this earth was stationary, that there was really such a fact as a sunrise or a sunset. We know now that sunrise and sunset are illusions produced by the rotation of the earth around its axis, and yet we still speak of, and even think of, the sun as rising and setting.

We need a somewhat similar change of ideas in thinking about money.

(The Money Illusion, 1928 p. 4.)

The idea cited above seems to have attained greater importance, now that the price levels in most of the principal capitalism countries have been ceaselessly rising since the end of World War II. It is quite natural that the Fisher's suggestion should be accepted in business accounting, for it uses money as a unit of measurement.

A perspective of what have been, and what are to be done by enterprises in the face of changing money value is the subject of this lecture.

II. *How has Business Accounting based on the historical cost been developed?*

History of accounting evolution could be roughly divided into three stages.

The first stage began when double entry bookkeeping was invented towards the fourteenth century in Italy, where merchants were accumulating commercial capital. It is a feature of double entry bookkeeping that the accounts can clarify the process of charging and discharging accountability, and simultaneously distinguish between invested capital and earnings.

Clarifying accountability and determining income are the most fundamental functions of business accounting. Double entry bookkeeping came to be built up as a device to accomplish integrally the above two functions on the basis of the acquisition cost of goods. Then, it took no more than several centuries that this device spread all over the world.

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Here, we must pay special attention to the quite important fact mentioned below. In later years, especially in the twentieth century, large scale business enterprises have remarkably developed. With the advent of these big businesses the income determination has become so complicated that the accountants' interest has been strongly focused on the problem of profit measurement, which, in general, has caused most accounting literatures to give minor consideration to the notion that the essential task of double entry bookkeeping is to account for the stewardship. It seems that this fact mislead the general public to a false understanding as to what role accounting plays and what position it occupies in the present economic society. To the economic world, the emergence of double entry bookkeeping was significant, because the most effective way of clarifying accountability, which is logically required under the private ownership of property, was established through the device of the account system with asset and equity sides. As is said, "Scenery is lost on the keen sportsman", today's accountants, rather than some past historians and scientists, show less insight into what is just pointed out above. For example, Goethe said as early as the end of the eighteenth century, "Double entry bookkeeping is one of the most elaborate inventions that have ever been made. Every scrupulous head of the family should maintain double entry bookkeeping in his own economy." (J. W. Goethe, *Wilhelm Meisters Lehrjahre*, 1795) Then, about ninety years later, Karl Marx stated, "Bookkeeping, as the control and ideal synthesis of the process (of production—added), becomes the more necessary the more the process assumes a social scale and loses its purely individual character. It is therefore more necessary in capitalistic production than in the scattered production of handicraft and peasant economy, more necessary in collective production than in capitalistic production. (Karl Marx, *Capital*, Vol. 2, Moscow, 1957, p. 135)

The second stage in the history of accounting evolution began when the practices of financial reporting were instituted in Britain in the nineteenth century. At that time in Britain, the laissez-faire policy and violent business cycles caused investors to suffer terrible losses from intentional bankruptcies of fraudulent bubble companies. Therefore, for the purpose of protecting their interests, the practice of making the company publish their financial reports audited by independent professional accountants was instituted. In hundred years or more that followed, this practice has become spread throughout the principal capitalism countries of the world.

After the first and the second stages of functional evolution of accounting, the third stage began in the United States at the opening of the twentieth century. It is, in short, when the area called managerial accounting was developed. With the progress of American industries towards mass production for the vast market, a new accounting function as a means to administrative control in large scale businesses was recognized fully, and specialized accounting devices, such as budgetary control, standard costing, financial analysis and internal audit attained a rapid growth.

Thus, the modern business accounting has been established as an organic integration of financial accounting and managerial accounting, both of which are founded on the ground of double entry bookkeeping.

The fundamental principle supporting the whole structure of this business accounting is the periodic measurement of income through ascertaining the revenue and corresponding expense periodically on the three basic assumptions, namely, that business enterprise is an entity independent of and separate from its owners, that business enterprise is a going concern having continuity of life, and that the value of money as a measurement unit is stable. (These assumptions are called in technical terms as accounting conventions.) The measurement of expenses

mentioned above is made characteristically through the method of periodic apportionment of acquisition cost on the basis of services accrued in each period. This is the reason why today's method of measuring business income is termed income determination on acquisition cost basis or that on historical cost basis.

The direct motive of development of the income accounting system mentioned above was the discovery of a new method of periodical expense determination called "depreciation" of machinery and equipment which had been increasing weight in the asset composition of business ever since the industrial revolution in the later eighteenth or early nineteenth century. And, by extending the device of depreciation, the so-called modern dynamic accounting was established. In relation to this, it should not be overlooked that the structure of this dynamic accounting is built up on the ground of traditional double entry bookkeeping, accordingly that the function of clarifying accountability, indigenous to double entry bookkeeping, serves as the foundation for it. That is to say, the role played by historical cost in the structure of dynamic accounting is not only to be the basis of value apportionment when measuring periodic expenses, but also to be the means of objectively clarifying the process of charge and discharge of accountability for the whole aspects of business activities.

This is a much important point for the exact understanding of the role of historical cost in today's business accounting.

III. *How was Business Accounting based on the historical cost damaged by inflation?*

Since the opening of the twentieth century, stormy inflations have already challenged twice the functional validity of traditional business accounting on the assumption of stable money value. The functional defects disclosed in historical cost basis accounting may be summarized in the following two aspects. The first is that it becomes difficult or in worse case utterly impossible to perform such income measurement as will secure the capital maintenance which is vitally essential to the continuity and expansion of business.

The second is that the informative function performed by accounting becomes withered or in worse case entirely paralyzed.

Concerning the first aspect, that is, the defect of the function of income measurement, somewhat detailed explanations may be added as follows. In the time of inflation, prices are pushed upward continuously. Therefore, revenue is measured in terms of inflated sales prices, while cost of goods sold is measured in historical cost, and as the result of it the more furiously the prices rise, the larger the periodic income is shown. In consequence, original invested capital can be recovered nominally, and substantial money value of invested capital is not ensured in traditional accounting. In short, inflationary spiral drives in ineffectiveness or collapse the function of measuring the periodic income which, even if disposed of outside the business, would not impair its substantial capital.

What harm will be brought forth in the presence of this defect? Japanese businesses experienced this bitterly in the inflationary course shortly after World War II. At that time, profits swelled up in the periodic income accounting because of the prices shooting up. Since the purchasing power of invested capital, as a rule, was not recovered even if the profits thus boosted would have been retained intact, it goes without saying that in case of the heavy

burden of inflationary taxes, working funds fell short to maintain the level of business activities. In order to meet the shortage of fund, they could not but have recourse to debts, because it was then too much for stockholders to subscribe the additional issue of capital stock. It surely lives in the memories of today's top managers, the working executives at that time, that businesses got into debts after debts which could barely satisfy the want of working funds for incessantly rising wages and inflated raw materials. Even today, more than fifteen years after the ceasing of the vicious inflation, there remains in the financial affairs of many businesses the vestige of serious damages caused by the policy of borrowing fund in those days. It is fresh in our memory that the World Bank, when asked for the extension of credit by certain internationally large corporation of Japan, required as the necessary prerequisite to the granting, the improvement of the disadvantageous equity composition, that is, to make better the state of unduly large proportion of liabilities in comparison with capital.

What was just stated is the situation that the capital maintenance of business is not secured by the periodic income accounting based on historical cost.

Now, explanations may be given to the second defect already pointed out. This defect in informative function is a natural result of the injured measurement function. The figures in the position statement or income statement are nothing more than the mixture of various acquisition prices at different money values, that is, in a figurative way, the conglomeration of quantities measured in terms of metres, yards and so on. Lacking in comparability, they do not reflect the realities of business activities. To put it in more practical manner, if we compare the production cost for this month with that for the last month, we can hardly exercise judgement as to the productive efficiency; the comparison of the rate of earnings on capital for the period with that for the preceding one conveys no information as to the earning power of capital; further, no significant conclusion may be derived from the comparison of these figures or rates between companies.

These are the brief outlines of the harmful effects of changing money value on business accounting.

IV. *How was Business Accounting adjusted when inflation ceased?*

As you may see now, the sharp decline in the value of money deprives historical cost accounting of its functional validity, but accountants have not been successful in finding out any acceptable accounting method which could effectively take the place of conventional one from the practical as well as theoretical point of view. When the value of money restored its stability, therefore, it becomes urgent necessity to clear away the perplexities into which conventional accounting had fallen in the inflationary process, thus to reconstruct it on the foundation of the new stable value of money. The practical steps taken thereon were either of the following two ways.

(a) The first is to revalue on the basis of stable money value the business assets in terms of current replacement cost, with the amount of net worth being newly determined, thus starting afresh the accounting based on acquisition cost. (This is called 'fresh start accounting'.)

Examples of this are seen in the accounting reconstruction in Germany in accordance with the Ordinance over Gold Balance Sheet (Die Verordnung über Goldbilanzen) of November 30, 1923; the accounting arrangement in West Germany subject to the Statute on the Opening

Balance Sheet in German Mark and on the New Determination of Capital (Gesetz über die Eröffnungsbilanz in Deutschen Mark und die Kapitalneufestsetzung) of June 21, 1948. Both of these were based on the method of starting afresh the accounting based on acquisition cost with the abolishment of the old one.

(b) Another procedure taken is to adjust the book-values of assets to current value, with the capital being adjusted by the difference between the old book-values and new adjusted costs of assets, thus continuing the accounting heretofore adhered to.

To illustrate, fixed asset revaluation taken in France as a tax administration in 1930, revalorization taken as a tax administration in France three times, in 1945, 1948 and 1950, according to the Government Ordinance re Method of Revising Balance Sheet and Taxation of 1945, and the somewhat same kind of fixed asset revaluation taken in Japan three times from 1950 to 1955 in accordance with the Assets Revaluation Law (Shisan Sai-hyōka Hō) were all based on the method of adjusting the book values of fixed assets to current money value, making the whole items on a position statement reflect it, thus maintaining the accounting really based on acquisition cost.

From the viewpoint of accounting structure, it deserves special emphasis that the method followed by the pre-war Germany and the post-war West Germany as the counterplan for arranging accounting confusion when inflations calmed down, differs fundamentally from the one followed by France and Japan. In the former, the new accounting has no structural connection whatever with the old accounting, while the structural feature of the latter is the consistent maintenance of accounting on acquisition cost basis during and after inflation throughout.

V. *How could Accounting for changing Money Value be constructed?*

I have summarized thus far what difficulties the conventional accounting fell into when it confronted with vicious inflations, and what measures were taken for the arrangement of them when the inflationary storm settled down.

The citation from Irving Fisher at the outset of this lecture, expressed several years after the settlement of the vicious inflation raging in Europe for some five years since the end of World War I, has been proved true in many countries through the trend of currencies thereafter. Even in the United States and Britain, where the value of money has been fairly stable compared with that in Japan, France and Italy, serious interests of accountants have been directed to the steady upward trend of price-levels for some twenty years since the end of World War II, and numerous research studies have come into the world. In 1961, the Accounting Principles Board of the American Institute of Certified Public Accountants came to the position, "The assumption in accounting that fluctuations in the value of the dollar may be ignored is unrealistic." Though the above citation is very short, we could not exaggerate its importance to accounting practices. For, it purports that today's conventional accounting practices on the assumption of stable money value should be now re-examined, just as is suggested by Irving Fisher's saying, "We need a somewhat similar change of ideas in thinking about money."

Then, in case of fluctuating money value, what structural change should be brought in the conventional accounting?

According to my view, only a half part, not the whole of the functions performed by the conventional accounting becomes weakened or broken down when the value of money is unstable. This point is not clearly recognized in the studies that have ever been done in many countries. That is, in my opinion, the primary reason why the past approaches departed from the right course. The following is the explanation of it.

As I said before, two roles are played by historical cost in business accounting; one is to clarify the process of charge and discharge of accountability, and the other to measure periodic net income. Even in the case of fluctuating money-value, the former function is preserved exactly the same as when money-value is in stable, while the latter function is influenced by the fluctuation. For, in order to account for the stewardship of business property it is strictly required for business accounting to cling to the historical facts throughout the areas of recording, calculating and reporting. Contrary to this, however, in the aspect of measuring periodic income in times of inflation, the decline or collapse in the measurement function of calculative unit causes the heterogeneity of accounting figures, which lessens, or in the worst case brings to naught, the significance of measurement and reporting.

For the full performance of the functions of business accounting even in case of changing money value, it is necessary to preserve, on the one hand, the accounting area based on historical cost for the sake of clarifying accountability, while on the other hand it is required to set up another area in which the heterogeneity among accounting figures is removed completely for the purpose of measuring and reporting income in terms of homogeneous figures.

Stabilized accounting is a systematic method to meet these requirements.

For the reason mentioned above, stabilized accounting is required to stand on organically co-ordinate terms with the accounting based on historical cost, and so it should be framed on the basis of stabilized cost. Accordingly, it is a logical inference that business accounting based on stabilized cost should be systematized as a secondary accounting area, the primary area being the accounting based on historical cost.

As to the relationship between the two areas, a detailed analysis will be attempted below.

Structure of Business Accounting under Cyclical Changes in the Value of Money

When money-value changes are cyclical, namely, when money-value finally turns back to a horizontal line and does not fluctuate in a long term, even if it sometimes rises or falls in a short term, in comparison with the amount of income determined by the accounting based on historical cost and the one determined by the stabilized accounting, the activity level of business being constant, the former shows increase or decrease as the value of money fluctuates, while the latter presents a smooth series. But if the whole span of one fluctuating cycle be taken, the aggregated amount of incomes earned therein will be the same in either accounting.

In the conventional accounting practices where no stabilized accounting is adopted, various countermeasures are taken for the purpose of dealing with the disturbing economic environment. For example, the last-in-last-out method of inventory pricing is admitted in the tax administration of Japan and the United States, and also the accelerated depreciation of fixed assets is allowed in Britain for tax purposes. The reason why the taxing agencies permit these procedures probably lies in the following logic, that is, the long term business income calculated through the adoption of these methods, consequently the total amount of taxes levied thereon too, is the same with the one which is calculated by applying the first-in-first-out method and normal depreciation, in so far as the cyclical type of money value changes is assumed. It may

also be said that only in case of moderate cyclical fluctuations the prevalent practices of smoothing periodic incomes, as secret surplus policy or other financial manipulations, could be effectively woven into the income accounting based on historical cost.

Thus, so far as money value changes follow the cyclical pattern, the same aggregate income results for the whole span of one cycle, whether income accounting for each period within the cycle is based on nominal historical cost or stabilized cost. So, in such case, we could do without the area of stabilized income accounting through the introduction of various devices to smooth periodical income calculated on the basis of historical cost.

Structure of Business Accounting under Non-Cyclical Changes in the Value of Money

In the situation where the values of money goes on declining without a halt, superior importance should be attached to the difference in the function of periodic income measurement between the accounting based on nominal historical cost and that based on stabilized cost, as well as to the theoretical significance of the organic relation between the above two accounting areas.

First of all, an intrinsic fault is found on the accounting based on nominal historical cost in its theoretical incomparability of figures between periods, so far as we premise the ever-declining pattern of money value changes. The fault in this case is far more serious as compared with the similar defect disclosed in case of cyclical changes in the value of money. For, the trouble caused by the latter is merely a relative matter restricted within the limit of one fluctuating cycle. But, the trouble caused by the former is of absolute gravity.

In our experience, the yen accounting of Japanese businesses gives a typical pattern of what is mentioned just above. There seems to be a well rooted public sense that the value of yen was fairly stable before World War II in comparison with that in the postwar days. Notwithstanding that, however, if we compare, every twenty years, the prewar days' financial reports of the companies whose inceptions date back to the early Meiji era (about the last decades of the nineteenth century), we can form no significant judgement therefrom.

Further, when the value of money shows a continuous downward trend for a long time, it is not too much to say that various financial manipulations could hardly be effective ways for smoothing periodic income on the long term, admitting their short term effects fettered with many limitations.

When a mild creeping inflation leaves behind long-continuing decline in the value of money, the characteristic feature generally seen in the accounting based on historical cost is that there appears a high level of earning power and a steady increase of liabilities.

If the decline in the value of money follows the pattern of galloping inflation, money can not serve as a calculative measure any more. In this case, the going concern accounting based on historical cost on the assumption of constant value of money comes to a deadlock. All we can do now is to wait for the lull of inflationary storm, and then to abolish the going concern accounting thus far maintained through not only the revaluation of business assets at the current money value but also the new determination of the amount of capital from the viewpoint of business reconstruction, thus to start anew another business accounting from that time on. This is so called "fresh start accounting" referred to before.

The following may be deduced from the discussions above: the achievements in accounting evolution which have been ever attained show that for the purpose of preserving effectively

in case of unstable money value the functions which were done in case of stable money value by the accounting based on historical cost on the assumption of constant money value, no methodology is more valid both in theory and practice than the establishment of the co-ordinate system between the accounting based on nominal historical cost and that based on stabilized cost.

The devices for this new mechanism of business accounting are still in the stage of tentative studies throughout the world, or at best, in the primitive stage of experiments by a few specialists. (References may be made to Ichiro Katano's "Accounting for Changing Money Value" ("Kaheikachi Hendo Kaikei"), Tokyo, 1962).

VI. *Should Business Accounting be based on the presumption of 'Unchangeable Money Value' or 'Changing Money Value'?*

Now let me cite again Irving Fisher's words; "We need a somewhat similar change of ideas in thinking about money." Thirty-five years' history since then has proved the truth of his saying, which is thought will hold true on future as well. Moreover, a quite important observation is made that the value of money will go on into the future along the path of creeping decline as an inevitable consequence of economic structure inherent in capitalism society.

This being the case, if today's business accounting on the basis of acquisition cost still insists on the "assumption of constant value of money", what will be the consequences? Or, to the contrary, if it stands on the "assumption of changing value of money" in the place of the above assumption, what will become of the future business accounting? My answers thereto are as follows.

In the former case, the business accounting on the basis of acquisition cost can not but resort to various financial manipulations mentioned earlier in order to deal with its structural contradictions. This is the only way left for its continuation as a social institution. Also, in theory, no support remains for its existence but one; the concept of "fresh start accounting".

In the latter case, namely, in the case of assuming the changing money value, it is logically required to set up the coordinate system between the accounting based on historical cost and that based on stabilized cost, as the preceding examinations showed.

In this view, I am convinced that the present day business accounting stands upon, or at least has come near, the forked road; whether to go assuming constant money value or changing one. And, if the choice must be made, the latter rather than the former is, in my opinion, the way open to the future business accounting in so far as it is thought unavoidably that the value of money in most capitalism countries will be still on the creeping decline in future as well.

VII. *Several accounting problems interpreted from the viewpoint of Accounting for Changing Money Value*

In concluding this lecture, some comments will be added to the several economic and accounting problems of our popular interest from the viewpoint of accounting for changing

money value.

(A) *On the Proposed Amendment of the Corporate Tax Law in Japan*

In today's Japan, the most important one of the problems of tax reformation which is with nation-wide interests is that concerning the amendment of the corporate tax law. In this relation, the reduction of the current heavy corporate tax burden is asserted in order to facilitate retaining earnings, on the ground that it is necessary to improve the disadvantageous equity composition of Japanese businesses, that is, to remedy their financial weakness of unduly large amount of liabilities in proportion to capital, as a fundamental measure to enhance their international competitive powers in the economic movement of the present day Japan toward the liberalization of foreign trade. To put it in more concrete way, the proposals for the amendment have been advanced in three directions: 'to lower the tax rates', 'to accelerate depreciation through shortening the service life of a fixed asset', and 'to take special measures of tax administration'.

From the viewpoint of accounting for changing money value, the most reasonable approach to this problem is, above all, to set up a basic rule that the part of paper profits in nominal income resulting from the value decline of yen—more properly, the part of false income—should be excluded from taxable income, and that this untaxable part should be retained in business as an undistributable "special reserve". The accounting treatment of this "special reserve" may be similar to that of the revaluation surplus, its preceding practical example in Japan after World War II.

Of course, as to the problem whether the Japanese business carries relatively heavier burden of corporate tax or not, no simple conclusion may be drawn directly from the mere comparison of our tax rates with those in other countries. But, if a compared country has a stable value of money and the same tax rates as Japan, the tax burden levied on the Japanese business is surely more severe by the amount of the tax on paper profits resulting from the chronic decline in the value of yen. The problem of adjusting the weak financial composition of equity of the Japanese business, however, never reaches a thorough settlement merely through mitigating the corporate tax burden. The very establishment of practices to retain the paper profit part of the nominal income in advance of any other retained earnings is of the prime necessity to the solution thereof. This should be the starting point of theory for the rationalization of income taxes in Japan.

(B) *On the "Goodwill" in the Business of High Earning Power*

When treating with the accounting of goodwill in monopolistic industries of high earning power in the prewar Japan, first-ranking department stores were often referred to as the typical examples of it. As for myself, I made an analytical survey, extending over several years about 1935, of the financial affairs of some topnotch department store. The results showed that the store had nearly the same amount of ever-outstanding balance of coupons sold with the average stock of merchandise (base-stock of inventories). Together with plant and equipment, the average stock of merchandise is in its nature a part of fixed assets, while the ever-presence of outstanding coupons (untaxable at that time) is equivalent of the existence of eternal source of working funds from the long term liabilities with no interest thereon.

Taking into consideration the chronic decline in the value of yen, it was clear that the substantial burden of the ever-present coupon liabilities without interest diminished in proportion

to the decline of the value of yen, on the other hand, the goods acquired for the funds from this long-term liabilities were turned over at sales prices steadily rising. This reasoning will, as you may easily see, explain that the gain on monetary items due to the decline of yen value, which might be imputed after all to the above financial structure of the department store, played quite significant role as an element of its high earning power.

On the accounting nature of goodwill, Sōtarō Takase, the professor emeritus of the Hitotsubashi University, advanced an ingenious theory connected with economic theory of monopoly (*The Study of Goodwill* ("Goodwill No Kenkyū"), Tokyo, 1933). The approach from the viewpoint of accounting for changing money value, however, will promise a new view different from the traditional one on the nature of goodwill.

(C) On the Improvement of Equity Composition of Japanese Businesses with Reference to the Credit Limitation Suggested by the World Bank

From the same point of view as we took up on the goodwill problem immediately before, clearer answers may be given as to how Japanese businesses have incurred the excessive liabilities in comparison with total equities, and how the position be remedied.

It is said that in recent American businesses the average ratio of capital to liabilities is seven to three, while in recent Japan it is three to seven. As a fiscal measure to strengthen these weak financial conditions of Japanese businesses, the Bureau of Banks of the Finance Department announced lately (September, 1963) what is called "the credit limitation suggested by the World Bank" which has offered a topic in the business world in Japan.

In the rapid inflation soon after World War II, Japanese businesses could not but resort to the enormous amount of borrowed funds from the Finance Corporation for Reconstruction (Fukkō Kinyū Kinko) or the like in order to reconstruct business in the ruinous confusion brought about by the defeat, which had a long-continuing impact on their finance. This may be what has given rise to their weak financial composition of equity immediately. But the fundamental cause thereof lies far deeper. In the economic environment where the value of money has been incessantly falling down ever since the Meiji era as the expression "tragic history of yen" suggests, it is the instinctive wisdom of Japanese businesses that they have protected their capital against impairment in the manner that they make up for such substantial capital outflows as taxes on and the dividends from the paper profits with the money value gain on the long-term liabilities. Similarly, we could not criticize those businesses as reckless, which actively followed the financial policy of getting into debts to raise a part of necessary funds for the expansion of productive capacity.

To such businesses we can not reasonably apply the methods of judging credit limitation, which have been developed in economic society of stable money value, for example, ratio analysis. It should be highly appreciated as good intention that the World Bank and the Finance Department made clear to the public what is sound financial position.

However, the reasonableness of the concrete judgement basis, which are supposedly presented by them, could not be assured if not supplemented with informations from accounting for changing money value.

So far as accounting based on historical cost is maintained conventionally, the credit limitation as suggested by the World Bank will not make a significant contribution to the improvement of financial composition of borrower's equity, unless, as I suggested earlier in relation to the reform of corporate taxation, an accounting as well as taxing rule is set up

"that the part of paper profit resulting from the value decline of yen, namely, the part of false income, should be excluded and retained from nominal income."

(D) *On the Function of Accounting as "International Economic Language"*

Heretofore, I have considered from the viewpoint of accounting for changing money value three aspects of the income measurement problem in Japan. Now, I will take up an international subject in relation to the reporting function of accounting.

In the eighth International Congress of Accountants held in New York in the autumn of 1962, the chairman at the discussion of the common theme "World Economic and Accounting" emphasized that attention should be given to the new function of accounting as "International Economic Language", an important role which accounting ought to play for the well-being of our free society. The session, however, was too short to enter into detailed discussion of the problem.

I am of opinion that the concrete substance of the function performed by accounting as international economic language is to encourage consolidatability, comparability and interchangeability of accounting figures of nations through the introduction of the uniform accounting reports. Then, if the future economic growth in most countries is accompanied inevitably by creeping inflation, the necessary condition for accounting to perform its function as international economic language is that the system of accounting for changing money value on the international stabilization basis is established as an institutional practice of accounting in each country.

(E) *On the Connection between Business Accounting and Social Accounting*

We may say that one of the most important methodological problems in the field of present day economic sciences is on the possibility of structural reconciliation or, so to speak, hand-shaking between the conventional business accounting and the social accounting which has been developed by recent economists.

If so far as business accounting adheres to the conventional assumption of constant money value, it can not be reconciled with social accounting, I think. For, the measurement in the former is based on historical cost, while that in the latter is based on current price within my knowledge on the subject, and, historical cost and current price are much contradictory concepts as would never be compatible with each other.

Soon after the lull of German inflation subsequent to World War I, Fritz Schmidt of Germany, although not from the viewpoint of social accounting but from that of capital maintenance of individual businesses, advocated a theory that the income statement and the position statement should be prepared systematically on the basis of current price. The theory is called "the organic theory of current price balance sheet (die organische Tageswertbilanztheorie)". Though this has attracted much interest of those who study the theory of capital maintenance, it appealed little to accounting practitioners. The reason for this is, in my opinion, that his theory shows structural departure from the concept of historical cost, and this very departure implies that his theory, as a theory of business accounting, has two basic defects. One of them is that in his theory the function of clarifying the accountability is lacking throughout the whole area of recording, calculating and reporting, thus the inherent requirement of private ownership of property being neglected. Another defect in his theory lies in his approach to

capital maintenance. In the short-term view, it is indeed required to maintain the business activity of production and sales in the same kind as well as on the same level as before through measuring expenses in terms of current price, therefore, some financial measures are necessary to meet this requirement, but this is not all. In the long-term view, business activity of a going concern can not but alter, adapting itself to the innovations in industrial engineering and to changes in the fashion of social living. For example, some ten years ago a famous Japanese shipbuilder was engaged literally in shipbuilding, but now, the title of the company remaining the same, half or more of its products are machines for use on land. And we see many similar cases. The nature of the capital of individual going concern, therefore, should be viewed as funds from investors free to use at the will of business, namely, a "free alternative fund". Consequently, by the maintenance of capital should be meant the maintenance of original purchasing power of this alternative fund. In case of stable money value, an assurance is given that the purchasing power of the alternative fund is maintained by the process of periodic income accounting based on historical cost.

From the viewpoint of individual business, the current-price theory, as typically advocated by Fritz Schmidt, offers significant suggestions in the area of financial policy, but, in general, the upholders of the theory of physical capital maintenance may well be censured for the superficial idea that current price should take the place of historical cost in the periodic income accounting which is to secure the maintenance of capital.

At present, I believe, the only path possible to reconcile business accounting to social accounting is to frame up business accounting as a co-ordinate system between the accounting based on historical cost and that based on stabilized cost on the assumption of changing money value. The most important methodological problem therein is to what extent we can approximate an index number measuring money value fluctuations to the ideal one.

To answer this question is beyond the ability of us, accountants. Unless both economists and statisticians lend their help and co-operate with us, no further advancement may be possible.

When the gap between the measurement basis of business accounting and that of social accounting is filled up, accounting will, I hope, duly arrive at the fourth stage in its long evolutionary history.