

# THE TWO TYPES OF LEGAL COMPANY-ACCOUNTING IN ITS EARLY DAYS

—German Type and English Type—

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## 1. Introduction

It is well known that the early commercial codes of Germany and Japan had balance sheet provisions, with particular reference to the valuation of assets (*Bilanzbewertung*) and the ability to be assets (*Bilanzfähigkeit*), from the standpoint of creditors' protection. The valuation of assets was to be based on its true value (*wahrer Wert*), namely, disposal value (*Veräußerungswert*), and only the objects that have such value were permitted to be assets on the balance sheet (=the ability to be assets). Thus, it was thought that the protection of creditors was complete when a limited (share) company had such amount of net assets, valued on the disposal basis, as equal to the legal capital of the company.

By and by, however, in Japan after Germany, the balance sheet provisions began to be, so to speak, soft. As to fixed assets, the valuation at cost (less depreciation) came to be permitted, even when the current value was lower than the cost. On the other hand, organization (and such like) expenses came to have the ability to be assets. Thus, nowadays finally, the Japanese Commercial Code (*Shōhō*) and the German Law on Limited (Share) Companies (*Aktiengesetz*), as to the valuation of all assets, place emphasis on the cost basis. And especially in the Japanese Commercial Code, it is permitted that a good many kinds of so-called deferred charges come to be assets on the balance sheet.

It is generally said that these new balance sheet provisions are based on the doctrine of shareholders' protection. However, it appears that the following two main problems are still unsolved. The one is the problem of creditors' protection under the new provisions. The commercial code, as it is apparent, has never abandoned the doctrine of creditors' protection. Then it must be asked how the creditors' protection operates under the new provisions. Indeed, a good many explanations have ever been done about this problem, but, in our opinion, there is not yet an adequately persuasive explanation.

The other is the problem of shareholders' protection under the new balance sheet provisions. Also in this case, it appears that there is not a definite explanation about the relationship between the shareholders' protection and the new provisions.

As a step in approaching these problems,<sup>1</sup> we shall pay attention to the following fact. In England, about the same time when in Germany the early company-accounting pro-

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<sup>1</sup> In this treatise, the emphasis will be laid on the former problem.

visions were established, there existed a very interesting legal company-accounting system. This English company-accounting system, in many points, presented a striking contrast to the German one. Thereupon, we are going to compare the two types of early legal company-accounting—so to speak, German Type and English Type—, especially having relation with their backgrounds.

## *2. The Balance Sheet Provisions in the General German Commercial Code as of 1870*

### *—The German Type of Legal Company-Accounting—*

In the year 1870, the General German Commercial Code of 1861 (*Allgemeines Deutsches Handelsgesetzbuch*) met the amendment about limited (share) companies (*Aktienrechtsnovelle*). Thus, the German Commercial Code as of 1870 had the following provisions relative to the limited companies accounting:<sup>2</sup>

Art. 31<sup>3</sup>—At the preparation of the inventory and balance sheet, the collective properties and credits must be set down at the value, which ought to be ascribed to them at the date of the preparation. But, doubtful credits must be set down at their probable values; the unrecoverables must be written off.

Art. 239a<sup>4</sup>—For the preparation of the balance sheet, the following provisions are observed;

- (1) The securities that have a market quotation may not be valued higher than at the market value, which they have at the date of the preparation of the balance sheet:
- (2) The costs of organization and administration must not be set down among the assets, but must appear at their whole amount as expenses in the annual account:
- (3) The amount of the legal capital and of the reserve fund or renovation fund, that is possibly prescribed in the articles of association, must be set down among the liabilities:
- (4) The profit or loss appearing upon the balancing of the collective assets and liabilities must be expressly stated at the foot of the balance sheet.

It is apparent that from the above-mentioned provisions we can describe the following features, which will show a type of legal company-accounting, namely, in our words, the German type.

1. Profit (or loss) is calculated on a balance sheet by deducting, basically, the legal capital from the net assets.
2. The valuation of assets on the balance sheet is based on the “value to be ascribed” or “ascribable value (*beizulegender Wert*).”

<sup>2</sup> Cf. K. Barth, *Die Entwicklung des deutschen Bilanzrechts*, Bd. I (*Handelsrechtlich*), Stuttgart, 1953. E.J. Schuster, *The German Commercial Code*, London, 1911.

<sup>3</sup> In Chapter IV (*Mercantile Books of Account*), Book I (*Mercantile Trade*).

<sup>4</sup> In Chapter III (*Limited (Share) Companies*), Book II (*Mercantile Associations*).

Further, it was then understood that the "ascribable value" meant disposal value.<sup>5</sup>

3. The costs of organization can not be assets on the balance sheet.

4. There are not any provisions about a profit and loss account (or statement).

5. There are not any provisions about the form (or construction) of the balance sheet.

Among the aboves, to tell the truth, the first three matters by themselves already show the whole figure of the German type of legal company-accounting. Therefore the remaining two matters (4 and 5) may be seen as the results of the German type. But these two matters will be useful, afterwards, to compare with the other type of legal company-accounting.

Under the German type, the amount of assets on the balance sheet is most important. Moreover, in this case, the emphasis is laid rather on the total amount than on the every amount of assets. It is because of this that the provisions as to the form (or construction) of the balance sheet do not exist. The total amount of assets is equivalent to the same amount of cash, because the assets' valuation is based on the disposal value and the objects that have no such value can not be placed on the balance sheet.

Next, the pure liabilities, namely not including the legal capital and the reserve fund by the articles of association (if any), are placed on the opposite side of the balance sheet. The difference between the two sides that is called as net assets means the amount that will remain after the complete payment of all liabilities at the time.

Then, the legal capital is placed on the same side of the balance sheet as the liabilities. Further, if the articles of association provide a reserve fund (and the like), indeed it will be treated in the same way as the legal capital. But, in this case, companies generally are not compelled by law to provide a reserve fund. Therefore, we can say that the part of net assets remaining after the deduction of the legal capital is, basically, profit. The profit may be distributed in the shape of dividends and others, so that the legal capital on the balance sheet works as, so to speak, the dam that protects the same amount of net assets as the legal capital from distribution. Hence, the legal capital is also called as nominal capital, on which the creditors of the company rely. This is the German type of legal company-accounting.

### 3. *The First Schedule of The Regulation of Railways Act, 1868*

#### —*The English Type of Legal Company-Accounting*—

The accounting system that was provided in the First Schedule of The Regulation of Railways Act, 1868, is in fact nothing less than what is called Double-Account System. This accounting system, which would be the first systematical legal company-accounting in England, was soon applied over to gas works<sup>6</sup> and further to electric lighting companies.<sup>7</sup>

<sup>5</sup> Cf. The case of R.O.H.G., 1873. H.V.Simon, *Die Bilanzen der Aktiengesellschaften und Kommanditgesellschaften auf Aktien*, Berlin & Leipzig, 1886, pp. 150-151.

Therefore the Item 1 of the Art. 239a is not inconsistent with the Art. 31. (Cf. H. Thöl, *Das Handelsrecht*, Bd. I, 6. Aufl., Leipzig, 1879, p. 501. W. Endemann (Hrsg.), *Handbuch des Deutschen Handels-, See-, und Wechselrechts*, Bd. I, Leipzig, 1881, p. 245).

<sup>6</sup> The Gas Works Clauses Act, 1871.

<sup>7</sup> The Electric Lighting Act, 1882.

Moreover, it appears that the basic thought of profit calculation in this accounting system has relation to a series of cases which is characteristic of English company law.<sup>8</sup> Thus, the accounting system in the First Schedule of The Regulation of Railways Act, 1868, may be seen as a basis of the subsequent legal company-accounting in England. The provisions, namely, forms of account which are relevant to our subject in the First Schedule are shown at the end (appendix) of this treatise.<sup>9</sup>

The accounts or statements shown there are not the whole of what should be prepared under The Regulation of Railways Act, 1868. But, they are adequate to point out the following features, that will show a type of legal company-accounting, namely, so to speak, the English type.

1. A balance sheet in the traditional sense is divided into two accounts. The one is the (Receipts and Expenditure on) Capital Account, and the other is the General Balance Sheet. The former relates to so-called fixed capital, and the latter does to so-called floating capital. Further, for each of them the detailed form (or construction) of account is provided.

2. Profit or loss is calculated on the Revenue Account and Net Revenue Account. By the way, the Revenue Account links to the Net Revenue Account, and the Net Revenue Account does to the General Balance Sheet.

3. The loss or depreciation of fixed capital (fixed assets) is not made good out of revenue. But, the expenditure for the maintenance and renewal of fixed assets is charged to the Revenue Account. Therefore, the original costs of fixed assets remain forever on the Capital Account.

4. Organization expenses are treated as a part of capital expenditure, and so placed forever on the Capital Account.

5. The Capital Account may be seen as a pure statement of money-inflow and outflow; inflows on the credit side and outflows on the debit side.

It is most important in the English type to divide so-called capital (including both assets and liabilities) of a company into two parts; fixed capital and floating one. This division of capital does not merely result in the division of balance sheet, but also has a great influence upon profit calculation. Fixed capital is excluded entirely from calculating profit. It must be because of this that the loss or depreciation of fixed capital (fixed assets) is ignored and organization expenses as a part of fixed capital (see the Form No. 5) remain forever on the Capital Account. Profit calculation, therefore, relates only to floating capital. It is apparent from, besides this, the above-mentioned forms of the Revenue and Net Revenue Accounts that Revenue Expenditure means the decrease of floating capital (floating assets), and Revenue Receipts do the increase of it. Here we can completely understand why the (maintenance and) renewal expenditure of fixed assets is charged in the full amount to the Revenue Account. Precisely, the (maintenance and) renewal expenditure reduces floating capital (floating assets) like other revenue expenditures.

Now we find that, under the English type of legal company-accounting, profit (net

<sup>8</sup> The so-called Lee v. Neuchatel series of cases. Among them, the case of Verner v. General Commercial Co., (1894) 2Ch. 268, will be most relevant; "... the shortest way of expressing the distinction ... is to say that fixed capital may be sunk and lost, and yet that the excess of current receipts over current payments may be divided, but that floating or circulating capital must be kept up, ..."

<sup>9</sup> Cf. W.C. Glen, *Shelford's Law of Railways*, 4th ed., vol. I, London, 1869, pp. 396-416.

revenue) or loss means the net increase or decrease of floating capital (floating assets, or strictly speaking, net floating assets). If so, profit or loss could be determined on the General Balance Sheet, too. In this case, profit would be a balance of the General Balance Sheet, and so the item that means profit would lie at the end of the General Balance Sheet. While, the above mentioned General Balance Sheet sets forth the relevant item (that is, "Net Revenue Account, Balance at Credit thereof, as per Account No. 10") *in the middle* of other ones. Therefore, we can not find out the intention to determine profit on the General Balance Sheet. This seems to be because of the order of the Revenue and Net Revenue Accounts and the General Balance Sheet. The Revenue and Net Revenue Accounts that have determined profit come before the General Balance Sheet. Therefore it would not be necessary to calculate profit again on the General Balance Sheet.

Here we encounter the problem of the order of the accounts; Capital Account, Revenue and Net Revenue Accounts and General Balance Sheet. Why do these accounts arrange like this? Why does the Capital Account come first of all and the General Balance Sheet come after all the others? It appears that the accounts' order has reference to the main objective of the accounting system.

Under The Regulation of Railways Act, 1868, every incorporated company shall give a printed copy of every statement, "on application, to every person who holds any ordinary or preference share or stock in the company, or any mortgage, debenture, or debenture stock of the company; and every such person may at all reasonable times, without fee or charge, persue the original in the possession of the company."<sup>10</sup> Thus, under the accounting system, all the statements are directed to the investors (including debenture-holders) of the company. Investors or contributors, in general, will want to know, above all, how the contributed money was used. In this case, there will be necessity to prepare some kinds of money-inflow and outflow statements. From this point of view, the order of the above-mentioned accounts may be understood. First of all, we may easily understand the first position of the Capital Account.<sup>11</sup>

The Capital Account is precisely a kind of money-inflow and outflow statement, which states the money-inflow, namely, receipts that are created by share capital and fixed liabilities and the money-outflow, namely, expenditures that are directed to the construction of the company.<sup>12</sup> Further, we can understand the detailed form of the Capital Account,<sup>13</sup> thereby the sources of money-inflow and the purposes of money-outflow will be shown. The Revenue and Net Revenue Accounts may be seen as another statement of money-inflow and outflow. These accounts are, roughly speaking, the statements of money-inflow and outflow relative to floating capital (that may be a part of the invested or contributed capital) in the last period; that is, money-inflow on the credit side and money-

<sup>10</sup> The Art. 3 of The Regulation of Railways Act, 1868.

<sup>11</sup> Further, the precedent three accounts (No. 1, 2 and 3), that are not mentioned above, are about the creation of share capital and fixed liabilities.

<sup>12</sup> Therefore, the following Decksee's exposition seems to exactly fit the Capital Account:

"The object of the Double-Account System would appear to be to direct special attention to the importance of keeping a strict account of the expenditure of moneys obtained by the creation of Fixed Liabilities; that is to say, from the issue of Capital to Shareholders or Debenture-holders." (L.R. Dicksee, *Advanced Accounting*, 6th ed., London, 1921, p. 159.)

By the way, it appears that the money-outflow concept has a bearing on the historical cost basis of assets' valuation in the recent commercial codes of Japan and Germany.

<sup>13</sup> And the Details of Capital Expenditure for Half Year (No. 5).

outflow on the debit side. On the other hand, the General Balance Sheet, which relates also to floating capital, may not be seen as a statement of money-inflow and outflow, but rather as a statement of the *results* of these. Therefore, if the investors of a company have an interest, above all, in money-inflow and outflow, it will be necessary for the Revenue and Net Revenue Accounts to precede the General Balance Sheet.

Strictly speaking, the Revenue and Net Revenue Accounts are not, for the following two reasons, pure statements of money-inflow and outflow relative to floating capital in the last period.

First, these Accounts do not include all of the relevant money-inflow and outflow. The money-inflow and outflow relative to a short-term loan are not included therein. Secondly, the Revenue and Net Revenue Accounts and the General Balance Sheet deal with more than money, even in its wide sense, as it is apparent from the above-mentioned forms. For example, "General Stores—Stock of Materials on hand" lies on the General Balance Sheet, therefore the consumed part of these materials necessarily comes on the debit side of the Revenue Account (see the Form No. 9 and 12).

It seems that these phenomena are not fully explained from the viewpoint of investors, namely, on the theory of money-inflow and outflow statements (and a statement of the results of these), because, from the viewpoint, it would be natural to bring the materials' expenditure in the full amount to the debit side of the Revenue Account in the period when the expenditure occurs. Therefore, another viewpoint or theory will be necessary to explain these phenomena, and it will be mentioned later.

At any rate, it must be essential in the English type that, on one hand, some kinds of money-inflow and outflow statements prevail, and on the other hand, profit or loss is calculated only with reference to floating capital.

#### 4. *Bankrupt Law in Germany and England*

From the above, it has come to be apparent that the two types of legal company-accounting, namely, the German type and English type presented a striking contrast. Then, we are going to study into the causes.

It is well known that law on limited (share) companies generally has, above all, the purpose of creditors' protection. But the concrete thoughts or ways of creditors' protection are not always the same among countries, because bankrupt laws, that will be the most important ground upon which the concrete thoughts or ways of creditors' protection lie, may differ among some countries. Now, let us investigate the bankrupt laws in Germany and England in those days, particularly with reference to bankrupt causes of a company.

In those days, Germany (Prussia) had the Bankruptcy Code of 1855 (Die Konkurs-Ordnung vom 8. Mai 1855), which was modified and supplied by the act of 1869. The Bankruptcy Code had the following provisions as to the bankrupt causes of a limited (share) company:<sup>14</sup>

Art. 281—As to the assets of a limited (share) company, which aims at business or trading enterprise, the bankruptcy shall be adjudicated;

<sup>14</sup> Cf. Die Konkurs-Ordnung vom 8. Mai 1855 abgeändert und ergänzt durch das Gesetz vom 12. März 1869, Berlin, 1869.

(1) when, according to the balance sheet presented to the local administration, the liabilities of the company exceed the assets of it:

(2) when the company has suspended its payment. . . . . (The rest is omitted)

. . . . .

From the provisions, it is apparent that there were two bankrupt causes as to a limited (share) company, namely, so-called overindebtedness (*Überschuldung*) and suspension of payment (*Zahlungseinstellung*).

Further, in the General German Commercial Code of 1861, we can see the following provision:

Art. 240 (Sec. 3)—When it proves that the assets of the company cover no more the liabilities, the directors (of the company) must give notice thereof to the court for the purpose of the adjudication in bankruptcy.

We can understand here that so-called overindebtedness occupies the important position as a bankrupt cause in Germany.

In England of those days, The Companies Act, 1862, provided the “Winding up by Court”, in which the case corresponding to the bankruptcy of a company was included, as follows:<sup>15</sup>

Art. 79—A company under this Act may be wound up by the Court as hereinafter defined, under the following circumstances; (that is to say),

(1) Whenever the company has passed a special resolution requiring the company to be wound up by the Court:

(2) Whenever the company does not commence its business within a year from its incorporation, or suspends its business for the space of a whole year:

(3) Whenever the members are reduced in number to less than seven:

(4) *Whenever the company is unable to pay its debts:*

(5) Whenever the Court is of opinion that it is just and equitable that the company should be wound up.

Among the above five sections, the fourth is the matter relevant to the subject. According to that provision, whenever a company is unable to pay its debts, the company may be wound up by court. Therefore, this is equivalent to the bankrupt cause of inability to pay. Further, in this Act, the circumstances in which the inability to pay shall be deemed were provided as follows:

Art. 80—A company under this Act shall be deemed to be unable to pay its debts;

(1) Whenever a creditor by assignment or otherwise to whom the company is indebted at law or in equity in a sum exceeding fifty pounds then due, has served on the company, by leaving the same at their registered office, a demand under his hand requiring the company to pay the sum so due, and the company has for the space of three weeks succeeding the service of such demand neglected to pay such sum, or to secure or compound for the same to the reasonable satisfaction of the creditor:

(2) Whenever, in England and Ireland, execution or other process issued on a judgement, decree, or order obtained in any court in favour of any creditor, at law or in equity, at any proceeding instituted by such creditor against the company, is re-

<sup>15</sup> Cf. G. A. R. Fitzgerald, *Thring's Law & Practice of Joint Stock and other Companies*, 4th. ed., London, 1880, pp. 213-217.

turned unsatisfied in whole or in part:

(3) Whenever, in Scotland, the induciæ of a charge for payment on an extract decree, or an extract registered bond, or an extract registered protest have expired without payment being made:

(4) Whenever it is proved to the satisfaction of the Court that the company is unable to pay its debts.

All of these circumstances (1, 2 and 3) are able to be called as suspension (or stoppage) of payment. Therefore, the inability to pay, which shall be deemed to be under these circumstances, means none other than so-called insolvency. Thus we can say that in England the bankrupt cause is only insolvency, that is to say, in England overindebtedness is not a bankrupt cause.

### 5. *The Relationship between the German Type and the Bankrupt Cause of Overindebtedness (Überschuldung)*

Then let us think about the relationship between the legal company-accounting types and the bankrupt causes. There must be some relationship between these, because on the one hand it is generally said that the law on limited (share) companies, which provides legal company-accounting, has the main purpose of creditors' protection, and on the other a basic thought of the creditors' protection in a country must depend on the bankrupt law, which provides bankrupt cause, in the country. We begin with the relationship between the German type of legal company-accounting and the bankrupt cause of overindebtedness (Überschuldung).

If a bankrupt law adopts the concept of overindebtedness as a bankrupt cause, the concept will necessarily join with the balance sheet institution of commercial code. The reason is that when the concept of overindebtedness becomes expected to give satisfactory results, it will be necessary in the first place to establish the institutional means of finding overindebtedness of a company. And in that case, if the balance sheet institution has been already put into operation in a commercial code or company code, it will be a matter of course to intend to use the institutional balance sheet as the means of finding overindebtedness. Well, the concept of overindebtedness depends on the comparison between the total amount of assets and that of liabilities of a company, therefore the concept easily becomes familiar with balance sheet.

Thus the concept of overindebtedness joins with the balance sheet institution of commercial code, then the provisions as to the valuation of assets and the ability to be assets will necessarily appear. Because the overindebtedness of a company is decided by the comparison between the debit side (assets) and the credit side (liabilities) of balance sheet, it will become necessary to provide the rules under which the balance sheet must be prepared, particularly the rules as to the valuation of assets and the ability to be assets. Without such provisions, the concept of overindebtedness will not be able to give satisfactory results less than the case in which the institutional means of finding overindebtedness, namely the institutional balance sheet, is not established. Even though the balance sheet is provided as the institutional means of finding overindebtedness, without the provisions as to the valuation of assets and the ability to be assets on the balance sheet, eventually



it will be difficult to use institutionally the balance sheet as the means of finding overindebtedness.

From here it will be already apparent what principles are needed as to the valuation of assets and the ability to be assets on the balance sheet. The valuation of assets is to be based on its true value, that is, disposal value, and only the objects that have such value have the ability to be assets, accordingly organization (and such like) expenses are not permitted to be assets on the balance sheet. These principles result from the rigid and exclusively present-oriented concept of overindebtedness,<sup>16</sup> which gives attention to whether or not a company could pay all its liabilities if the company were liquidated just at present. Now we must remember that these principles as to the assets' valuation and the ability to be assets are none other than some of the previously stated features of the German type of legal company-accounting.

Thus we have reasoned the relationship between the bankrupt cause of overindebtedness and the balance sheet provisions as to the valuation of assets and the ability to be assets, and there we have got the proposition which is schematized as follows; "The concept of overindebtedness as a bankrupt cause—→Joining with the balance sheet institution of commercial (or company) code—→The balance sheet provisions as to the assets' valuation and the ability to be assets." Now we can prove that the schematized proposition is in accordance with the historical facts in Germany.

In the first place, the concept of overindebtedness as a bankrupt cause existed already in the City Laws (Stadtrechte) before the 16th century in Germany<sup>17</sup> and further in the General Law (Gemeines Recht)<sup>18</sup> which prevailed all over Germany from the 16th to 19th century. Then, as previously mentioned, the concept of overindebtedness appears in the Prussian Bankruptcy Code of 1855. In the second place, although it was from the Prussian Limited (Share) Company Code of 1843 (Art. 24)<sup>19</sup> that the balance sheet institution came to appear clearly in Germany, this institution itself had already existed in the Spanish Commercial Code of 1829 (Art. 36) and the Dutch Commercial Code of 1838 (Art. 8), and these facts had been known to Germany.<sup>20</sup> In the third place, again the Prussian Limited (Share) Company Code of 1843 had the following provision:

Art. 26—When the assets of the company, according to the presented balance sheet, amount to no more so much that the assets can cover the liabilities, the court, to which the administration has to make notification thereof, must adjudicate *ex officio* the company to be bankrupt.

Thus the Prussian Code of 1843 early used the annual balance sheet as the means of

<sup>16</sup> Cf. E. Jaeger, *Die Konkursordnung auf der Grundlage des neuen Reichsrechts*, Berlin, 1902, p. 661.

<sup>17</sup> Cf. O. Stobbe, *Zur Geschichte des älteren deutschen Konkursprozesses*, Berlin, 1888, pp. 3, 12-17.

<sup>18</sup> Cf. J. Petersen & G. Kleinfeller, *Konkursordnung für das Deutsche Reich*, 4. Aufl., Lahr, 1900, p. 411.

<sup>19</sup> "Art. 24—The director (of a company) is in duty bound to keep the books required to the survey of the properties' condition, also to prepare a balance sheet of the company's properties within the first three months of every fiscal year and enter it in a book specified thereto. The balance sheet is to be presented to the administration, in which district the company has its place." Cf. N. Weinhagen, *Das Recht der Aktien-Gesellschaften nach dem Allgemeinen Deutschen Handelsgesetzbuche und dem Preussischen Gesetze vom 15. Februar 1864*, Köln, 1866, Anhang pp. 24-30.

<sup>20</sup> Cf. *Entwurf eines Handelsgesetzbuches für das Königreich Württemberg mit Motiven*, Stuttgart, 1839, Motive p. 53. *Entwurf eines allgemeinen Handelsgesetzbuches für Deutschland*, von der durch das Reichsministerium der Justiz niedergesetzten Commission, Frankfurt am Main, 1849, pp. 51-52. O. Borchardt, *Die geltenden Handelsgesetze des Erdballs*, Bd. III, Berlin, 1885, p. 676.

finding overindebtedness of the company. But the Prussian Code of 1843 had not yet the provisions as to the assets' valuation and the ability to be assets on the balance sheet. In the last place, it was from the General German Commercial Code of 1861 and its amendment of 1870 that the imperative provisions as to the assets' valuation and the ability to be assets came to appear. These provisions are none other than what we previously mentioned.

Thus the schematized *reasonable* proposition proves to be in accordance with the *historical* facts in Germany. Moreover, it will be favourable to the reasonable proposition that within my knowledge the countries adopting the bankrupt cause of overindebtedness have the provisions of assets' valuation in their commercial codes; the Austrian Commercial Code of 1863<sup>21</sup> (Art. 31,240), the Hungarian Commercial Code of 1875<sup>22</sup> (Art. 28, 187), the Bosnian and Herzegovinian Commercial Code of 1883<sup>23</sup> (Art. 30, 199), the Bulgarian Commercial Code of 1897<sup>24</sup> (Art. 35, 194) and the Japanese Commercial Code of 1899<sup>25</sup> (Art. 26, 174).

We have just understood the relationship between the bankrupt cause of overindebtedness and the balance sheet provisions as to the valuation of assets and the ability to be assets. From there we can easily understand the profit calculation of the German type, which is done on the balance sheet, by deducting, basically, the legal capital from the net assets. Under the bankrupt cause of overindebtedness and on the therefrom resulted balance sheet, the legal capital of a company necessarily comes to have the definite meaning; the legal capital is the cushion against overindebtedness, in other words, the money to spare after the payment of all liabilities. Therefore, strictly speaking, the maintenance of legal capital means that the assets available to pay liabilities must be maintained to the total amount of the liabilities and the legal capital. It is apparent that from there the profit calculation of the German type results.

Thus we have completely understood the relationship between the bankrupt cause of overindebtedness and the German type of legal company-accounting. It is not excessive to say that the concept of overindebtedness is the only cause for the German type, in other words, the concept of overindebtedness is the necessary and sufficient condition of the German type.

## 6. *The Relationship between the English Type and the Bankrupt Cause of Insolvency*

Next, we think about the relationship between the English type of legal company-accounting and the bankrupt cause of insolvency.

If the concept of insolvency is adopted as an only cause of bankruptcy, the bankrupt law will not *directly* need a (annual) balance sheet. The reason is that the concept of insolvency will not so positively join with a balance sheet as the concept of overindebted-

<sup>21</sup> Cf. O. Borchardt, *op. cit.*, pp. 819-898.

<sup>22</sup> Cf. O. Borchardt, *op. cit.*, pp. 929-1018.

<sup>23</sup> Cf. O. Borchardt, *op. cit.*, pp. 1041-1116.

<sup>24</sup> Cf. J. Kohler &c. (edit.), *Die Handelsgesetze des Erdballs*, Bd. VIII, Berlin, 1906, pp. 21-144.

<sup>25</sup> Cf. L. Lönnholm (transl.), *The Commercial Code of Japan*, Tokyo, 1899.

ness does. The insolvency can not be judged directly by a balance sheet, but by some concrete act or conduct of a debtor (company). Though, it must be excessive to say that the concept of insolvency never needs a balance sheet, because the balance sheet may be *indirectly* useful to the bankrupt cause of insolvency. The balance sheet may show the possibility of future insolvency. In this case, the state of floating capital, namely, the comparison between floating assets and floating liabilities must be a matter of primary concern.

Thus, the bankrupt concept of insolvency will not always need, so to speak, a *full* balance sheet, but will be satisfied with a *partial* balance sheet. In other words, the concept of insolvency will not necessarily take an interest in the whole of the so-called capital of a company, namely, fixed capital and floating one. The concept of insolvency will be primarily concerned about a part of the capital of a company, namely, floating capital.

From here, we may understand some phenomena of the English type of legal company-accounting. First of all, we may understand that the English type divides the so-called capital of a company into the two parts, namely, floating capital and fixed one. According to this, the balance sheet in the normal sense must be divided into the two accounts, namely, General Balance Sheet and Capital Account. Besides, from the above viewpoint, the emphasis is laid on the floating capital and the General Balance Sheet. Secondly, we may further explain the substance of floating capital. It seems that the substance of floating capital has its original reason in the bankrupt concept of insolvency. If so, floating capital (floating assets) will consist of, other than money in its wide sense, the objects that have the value to become money and yet are applicable, (at least nearly) in the normal course of business, to paying liabilities. Here, we may understand why the General Balance Sheet and the Revenue and Net Revenue Accounts deal with more than money in its wide sense; for example, the "General Stores—Stock of Materials on hand" on the General Balance Sheet. Thirdly, we may interpret the concept of profit or loss under the English type of legal company-accounting. It appears that the concept of profit or loss also has its grounds in the bankrupt concept of insolvency. For the bankrupt concept of insolvency, the net increase or decrease of floating capital will be a matter of primary concern. The reason is that the net increase of floating capital will be thought to raise the ability to pay liabilities and the net decrease will be thought to the contrary. This basic thought seems to form the concept of profit or loss under the English type. Lastly, from the above, we may easily understand why the Revenue and Net Revenue Accounts do not include all of the money-inflow and outflow relative to floating capital in the last period. Indeed, as previously mentioned, these Accounts may be seen as a kind of money-inflow and outflow statement, but the objective of these Accounts is finally to calculate profit or loss. Therefore, the money-inflow and outflow which relate indeed to floating capital but do not affect profit (or loss) are not included in the Revenue and Net Revenue Accounts.

We have explained some phenomena of the English type, which remained previously unexplained, by connecting with the bankrupt concept of insolvency. From the previous explanation and the just above, we will know that the English type of legal company accounting consists of the two directional elements; so to speak, investors-directed element and creditors- or insolvency-directed one. The former element determines the contents of the Capital Account and the order (or arrangement) of accounts or statements. The latter element determines the contents of the General Balance Sheet and the Revenue and

### Net Revenue Accounts.

Therefore, as to the relationship between the English type and the bankrupt cause of insolvency, we can finally say that the concept of insolvency is a cause for the English type, in other words, the concept of insolvency is the necessary but not the sufficient condition of the English type.

## 7. *Conclusion—Diversity in Legal Company-Accounting—*

We have seen hitherto the two types of legal company-accounting and their backgrounds. From there, we may conclude the following points.

(1) The difference in bankrupt cause yields the diversity in legal company-accounting.

The bankrupt concept of overindebtedness yields the German type of legal company-accounting. The bankrupt concept of insolvency makes it possible that the English type of legal company-accounting comes to be.

(2) In legal company-accounting, the doctrine of creditors' protection is superior to that of investors' protection.

The concrete thought or way of creditors' protection in a country depends on the bankrupt cause of the country. The German thought of creditors' protection, which depends on the bankrupt cause of overindebtedness, governs (or covers) all of the so-called capital of a company. There, the doctrine of investors' protection or the investors-directed element can not appear. On the other hand, the English thought of creditors' protection, which depends on the bankrupt cause of insolvency, does not govern all of the so-called capital of a company. There, the doctrine of investors' protection can appear on the ungoverned part of the so-called capital of a company. From here, we may also say as follows:

(3) The doctrine of investors' protection can appear only in the area which the doctrine of creditors' protection does not cover.

Last of all, we dare to induce the following:

(4) If a change, whether actualized or hidden, occurs in the bankrupt cause of a country, the legal company-accounting of the country will also change.

[APPENDIX]

First Schedule of The Regulation of Railways Act, 1868  
Forms of Account (Extract)

[No. 4.] *Dr.* RECEIPTS AND EXPENDITURE ON CAPITAL ACCOUNT. *Cr.*

	Amount	Amount	Total.		Amount	Amount	Total.
	Ex- pended to	Ex- pended during Half Year			Re- ceived to	Re- ceived during Half Year	
	£ s. d.	£ s. d.	£ s. d.		£ s. d.	£ s. d.	£ s. d.
To expenditure—				By receipts—			
On lines open for traffic (No. 5.) ..				Shares and stock, per account No. 2. .. ..			
On lines in course of construction (No. 5.) .. ..				Loans, per account No. 3. .. ..			
Working stock (No. 5.) .. ..				Debenture stock, per account No. 3. .. ..			
Subscriptions to other railways (No. 5.) .. ..				Sundries (in detail) .. ..			
Docks, steamboats, and other special items (No. 5.) ..							
„ Balance .. ..							

[No. 5.] DETAILS OF CAPITAL EXPENDITURE FOR HALF YEAR ENDING 186 .

Lines open for traffic—	} [Showing, under separate heads, amount paid for land (purchase and compensation), construction of way and stations, including rails, chairs, sleepers, &c., engineering and surveying, law charges, parliamentary expenses, interest, commission, &c.]		
Particulars—			
Lines in course of construction—	}		
Particulars—			
Working stock—			
Particulars—showing each description of stock .. ..			
Subscriptions to other railways—			
Particulars—stating lines .. ..			
Docks, steamboats, and other special items—			
Particulars .. ..			
Total expenditure for half year, as per account No. 4. ..			

[No. 9.] <i>Dr.</i>		REVENUE ACCOUNT.		<i>Cr.</i>	
Half Year ended		£ s. d.	Half Year ended	£ s. d.	£ s. d.
	EXPENDITURE.				
	To Maintenance of Way, Works, and Stations .. ..		By Passengers ..		
	„ Locomotive Power ..		„ Parcels, Horses, Carriages, &c.		
	„ Carriage and Waggon Repairs ..		„ Mails ..		
	„ Traffic Expenses ..		„ Merchandise ..		
	„ General Charges ..		„ Live Stock ..		
	„ Law Charges ..		„ Minerals ..		
	„ Parliamentary Expenses ..		„ Special and Miscellaneous Receipts—		
	„ Compensation (Accidents and Losses) ..		<i>Such as Navigations, Steamboats, Rents, Transfer Fees, &amp;c.</i>		
	„ Rates and Taxes ..		<i>Details.</i>		
	„ Government Duty ..				
	„ Special and Miscellaneous Expenses (if any) ..				
	„ Balance carried to Net Revenue Account ..				
		£		£	

[No. 10.] <i>Dr.</i>		NET REVENUE ACCOUNT.		<i>Cr.</i>	
Half Year ended		£ s. d.	Half Year ended	£ s. d.	£ s. d.
	To Interest on Mortgage and Debenture Loans ..		By Balance brought from last Half Year's Account		
	„ Interest on Debenture Stock		„ Do. Revenue Account, No. 9 ..		
	„ Interest on Calls in Advance		„ Dividends on Shares in other Companies ..		
	„ Interest on Temporary Loans		„ Bankers and General Interest Account (if in Credit) ..		
	„ Interest on Lloyd's Bonds ..		„ Special and Miscellaneous Receipts (if any)		
	„ Interest on Banking Balances ..		<i>(Detail to be given.)</i>		
	„ General Interest Account (if in Debit) ..				
	„ Rents of Leased Lines, Guarantees, &c. ..				
	<i>Details</i> ..				
	„ Special and Miscellaneous Payments (if any) ..				
	<i>Details.</i>				
	„ Balance, being Payment available for Dividend ..				
		£		£	
	[See No. 13.]				



[No. 13.] *Dr.* GENERAL BALANCE SHEET. *Cr.*

	£ s. d.		£ s. d.
To Capital Account, Balance at Credit thereof, as per Account No. 4		By Cash at Bankers—Current Account .. .. .	
„ Net Revenue Account, Balance at Credit thereof, as per Account No. 10 .. .. .		„ Cash on Deposit at Interest ..	
„ Unpaid Dividends and Interest		„ Cash invested in Consols and Government Securities ..	
„ Guaranteed Dividends and Interest payable or accruing and provided for .. .. .		„ Cash invested in Shares of other Railway Companies not charged as Capital Expenditure ..	
„ Temporary Loans .. .. .		„ General Stores—Stock of Materials on hand .. .. .	
„ Lloyd's Bonds and other Obligations not included in Loan Capital Statement, No. 3 .. .. .		„ Traffic Accounts due to the Company .. .. .	
„ Balance due to Bankers .. .. .		„ Amounts due by other Companies .. .. .	
„ Debts due to other Companies ..		„ Do. do. Clearing House .. .. .	
„ Amount due to Clearing House ..		„ Do. do. Post Office ..	
„ Sundry Outstanding Accounts ..		„ Sundry Outstanding Accounts ..	
„ Fire Insurance Fund on Stations, Works, and Buildings .. .. .		„ Suspense Accounts (if any) to be enumerated .. .. .	
„ Insurance Fund on Steamboats ..		„ Special Items .. .. .	
„ Special Items .. .. .			
£		£	