ACCOUNTING THEORY FOR DETERMINING THE AMOUNT OF COMPENSATION FOR WAR DAMAGE TO SHARES OWNED BY ALLIED NATIONALS UNDER POST-WAR INFLATIONARY CONDITION IN JAPAN

By ICHIRO KATANO

Professor of Accounting

I. *The Problem*

When the Pacific War broke out on December 7, 1941, Japanese Government attached and administered property in Japan owned by the Allied Powers and their nationals according to the provisions of the Enemy Property Custody Law (Law No. 99 of 1941), enforecd on December 22, 1941. The war ended with the defeat of Japan in August, 1945, and, in accordance with the Peace Treaty of San Francisco, effective April 28, 1952, the Japanese Government was charged with the duty of returning the Allies' property which had been in Japan during the war (from December 7, 1941 to September 2, 1945), and with the duty of compensating for such property in cases where it existed in Japan when the war began and could not be returned or had suffered injury or damage.

As to compensation, it was provided that those who were to be compensated should be treated on no less advantageous terms than those stipulated by the Allied Powers Property Compensation Law (Law No. 264 of 1951). (Peace Treaty, Article 15(a))

The fundamental principles concerning indemnity for damages stipulated by the above Compensation Law are as follows:

(a) Eligibility for Compensation

Property which is eligible for compensation is limited to that which existed in Japan at the outbreak of the war (December 7, 1941) and which suffered damage directly due to the war for such reasons as "acts of hostility" and "wartime special measures" (Compensation Law, Art. 3, 4,).

(b) Amount of Compensation

As a general rule, the amount of compensation is the sum of money required at the time of compensation to restore the property to its status as of the time the war began. However, damage arising from causes other than those mentioned in the foregoing paragraph (for instance, natural disaster) is to be excluded.

According to these priniples, tangible assets such as buildings, ships, cargoes, goods and personal effects, shares and claims, and intangible assets such as patents were included as property for which compensation must be made.

The inclusion of shares as property eligible for compensation raises important problems from the viewpoint of accounting. Though a small number of shares was owned by Allied nationals as individuals, the value of shares owned by corporations of the Allied Powers as long-term imvestment in Japanese corporations at the outbreak of war was enormous. Compensation for war damage to the latter shares involves important problems which have never been treated in the accounting literature of any country.

These problems can be summarized as follows:

> From before the outbreak of war between two nations, A and B, until the present time, when the war is over and diplomatic relations between them have been restored, a company in A and a company in B have existed. During this period, the company in A has owned shares of the company in B for the purpose of long-term investment. With the defeated nation having a post-war inflation, what are the theory and the method to be used in determining the amount of damage to those shares as a result of the war and in determining the amount of compensation for that damage?

The gist of the results of my study of about one year on this subject is given below. However, it should be noted that my opinion expressed here has no immediate connection with the problem of whether the method of measurement and the actual amount of compensation for damage to shares which the Japanese Government has been negotiating with the governments of the Allied Powers over the past several years and which will be paid upon final decision in the near future are entirely fair or not. How the amount of compensation for war damage will actually be determined is, after all, a problem to be finally solved by political negotiation between the Japanese Government and the governments of the Allied Powers in accordance with the provisions of the "Allied Powers Property Compensation Law", or by the decision of the International Court of Arbitration. I simply experss my opinion on the theory and method of measuring the amount of compensation from the viewpoint of accounting, in compliance with the request of the authorities of the Japanese Government.

II. *The Viewpoint of the "Allied Powers Property Compensation Law" as to Compensation for War Damage to Shares Owned by Allied Nationals*

First, I should like to view the focal point of the provisions in the "Allied Powers Property Compensation Law" (hereinafter referred to as "Compensation Law") as to the method of measuring the amount of war damage to the shares owned by Allied nationals and the means of indemnifying the amount of this damage.

A. Provisions of the Compensation Law as the method of computing the amount of war damage to shares

The procedure for computing the amount of compensation for war damage to shares owned by Allied nationals given in the Compensation Law is composed of the following three parts.

(1) First, in cases where property which was in Japan when the war broke out and which was owned by Japanese corporations, whose shareholders included Allied nationals, suffered damage through direct acts of hostility during the war or wartime special measures and the like, a sum of money required at the time of compensation to restore the property

to its status as of the time of the commencement of war, shall be computed.

(Compensation Law, Art. 4∼10)

This amount shall be computed in conforming with the following provisions concerning calculation procedure ((a)∼(h)).

(a) (Principles of Compensation)

"If the property owned in Japan by the Allied Powers or their nationals on December 7, 1941 has suffered damage as a result of the war, the Japanese Government shall compensate for such damage. (Compensation Law, Art. 3. par. 1)

(b) (Scope of Damage and Location of Property)

1 The damage suffered as a result of the war mentioned in paragraph 1 of the preceding article (Article 3) shall be the damage listed in the following items:

(i) Damage caused by acts of hostility on the part of Japan or of any of the states which were at war or in a state of belligerency with Japan;

(ii) Demage caused by the war-time special measures or other measures of the Japanese Government and its agencies;

(iii) Damage on account of lack of due care on the part of the administrator or possessor of the property concerned;

(iv) Damage suffered owing to the inability of an Allied national to have the property insured in Japan on account of the war;

(v) Damage suffered while in use of the Occupation Forces owing to lack of due care on the part of the Occupation Forces or the inability of an Allied national to insure property.

2 The cargo or baggage which has been loaded on board the Japanese ships navigating the high seas at the time of the commencement of the war and which was unloaded in Japan shall be regarded as property which was in Japan at the time of the commencement of the war. (Compensation Law, Art. 4.)

(c) (Damage to Tangible Property)

1 The amount of damage to restituted tangible property shall be a sum of money required at the time of compensation (meaning here and hereinafter the time of payment of compensation by the Japanese Government in accordance with the provisions of Article 16 paragraph 1 or 4) for the restoration of such property as of the time of restitution to its status as of the time of the commencement of the war, in so far as the damages mentioned in paragraph 1 of the preceding article are concerned; provided that, if such property has been repaired by government expenditure after its restitution, its status upon repair shall be regarded as its status as of the time of restitution.

2 The amount of damage to tangible property which is incapable of restitution on account of its loss, substantial destruction, or its location being unknown, shall be a sum of money required at the time of compensation for the purchase in Japan of property of similar condition and value, in so far as the damages mentioned in paragraph 1 of the preceding article are concerned.

3 The amount of damage to tangible property other than that falling under the preceding two paragraphs shall be a sum of money required at the time of compensation for the restoration of such property as of the time of the coming-into-force of the Peace Treaty to its status as of the time of the commencement of the war, in so

far as the damages mentioned in paragraph 1 of the preceding article are concerned. (Compensation Law, Art. 5)

(d) (Damage to Use and to Lease of Immovable Property)

The amount of damage to the superficies, perpetual tenant-right, servitude, or lease of immovable property, which is incapable of restitution on account of the loss or substantial alteration of the objects of such rights shall be a sum of money required at the time of compensation for the acquisition of the rights of the same substance as such rights in Japan. (Compensation Law, Art. 6)

(e) (Damage to Debts)

1 The amount of damage to pecuniary debts shall be a sum of money equivalent to the amount of the debts transferred or liquidated by the war-time special measures.

2 The amount of damage to debts in cases where mortgage, pledge, lien, or priority, has been extinguished by the war-time special measures or in case where the object of these rights has been lost or destroyed as a result of the war shall be a sum of money equivalent to the amount due to the creditor which has been defaulted on account of the extinction of such right or loss or destruction of such object.

(Compensation Law, Art. 7)

(f) (Damage to Public Loans, etc.)

1 The amount of damage to those public loans, debentures, bonds issued under special laws by juridical persons, or public loans or debentures issued by foreign states or by foreign juridical persons (hereinafter referred to as "the public loans, etc.") which have been subjected to the war-time special measures and have not been restituted and for which the time of their redemption has arrived before the time of compensation shall be the total of the amount of the principal and the amount of the interest coupons which accompanied such public loans, etc.

2 The amount of damage to those public loans, etc. whose time of redemption has not arrived by the time of compensation and which are incapable of restitution shall be the total of their current price as of the time of compensation and the amount of the interest coupons up to the time of compensation.

(Compensation Law, Art. 8)

(g) (Damage to Industrial Property Rights)

1 The amount of damage to a patent which has had the exclusive license established (meaning here and hereinafter the right of persons who have received the license of exclusive use in accordance with the provisions of Article 5 of the old Industrial Property Rights War-time Law (Law No. 21 of 1917)) shall be a sum of money equivalent to the patent working fee payable in cases where the exclusive licensee has worked the patent during the term of the patent, deducted by a sum of money equivalent to patent fee payable to the Japanese Government, unless the Allied owner has waived rights to patant working fee and damages for the said term in accordance with the provisions of Article 5 of the Order for Post-war Disposition of Industrial Property Rights Owned by Allied Nationals (Cabinet Order No. 309 of 1949) as amended.

2 The amount of damage to a patent which has been cancelled or transferred by the war-time special measures or without free consent of the Allied national concerned shall be a sum of money equivalent to the patent working fee payable by the person who has worked it during the term for which it shall have continued, deducted by

a sum of money equivalent to the patent fee payble to the Japanese Government during such term, unless the Allied owner has waived rights to patent working fee and damages for the said term in accordance with the provisions of Article 5 of the Order for Post-war Disposition of Industrial Property Rights Owned by Allied Nationals as amended.

3 The amount of damage to a patent which has become extinct on account of the non-payment of the patent fee or the expiration of its term ot continuation shall be a sum of money equivalent to the patent working fee payable by a person who has worked it during the term for which it would have continued if the patent fee had been paid or if the extension of its term of continuation had been applied for, deducted by a sum of money equivalent to the patent fee payable to the Japanese Government during such term, unless the Allied owner has waived rights to patent working fee and damages for the said term in accordance with the provisions of Article 5 of the Order for Post-war Disposition of Industrial Property Rights Owned by Allied Nationals as amended.

4 In the case of the preceding three paragraphs, the patent working fee payable by a person who has worked the patent shall be calculated on the basis of the method of calculation of the working fee stipulated in the working contract existing at the time of the commencement of the war in case such working contract existed, or on the basis of the working fee stipulated in a working contract for a patent analogous to the patent concerned existing at the time of the commencement of the war in case there was no working contract for the patent concerned.

5 If stipulation has been made in working contract mentioned in the preceding paragraph for the obligation to be performed by the patentee to the working-licensee or for the benefit receivable by the working-licensee from the patentee, the loss suffered by the person working the patent on account of the default of such obligation or the impossibility to receive such benefit during the term provided for in paragraphs 1 to 3 inclusive may be taken into consideration in calculating the patent working fee payable by such persons.

6 The provisions of paragraph 2 to the preceding paragraph inclusive shall apply *mutatis mutandis* to utility models and designs.

(Compensation Law, Art. 9)

(h) (Damage to Trade Marks)

The amount of damage to a trade mark which has become extinct on account of the cancellation by the war-time special measures or the expiration of its term of continuation shall be the total of a sum of money equivalent to the benefit obtained through its use by the person who has used it and a sum of money equivalent to the cost required at the time of compensation for the restoration of its good-will as at the time of the commencement of the war. (Compensation Law, Art. 10)

(**2**) Secondly, the following sums of money which arose after the commencement of war until the time of compensation shall be deducted, as partial compensation, from "the amount of damage to the property as a result of the war" provided for by the above (**1**). The remaining amount shall be "the amount of damage to the company".

(Compensation Law, Art. 12.)

(a) If, in cases special loss or final loss has occurred to the company in accordance with the Enterprise Reconstruction and Reorganization Law (Law No. 40 of 1946) as amended or the Financial Institution and Reorganization Law (Law No. 39 of 1946) as amended, such loss has been made up by writing off liabilities, the amount of such writing-off of pre-war liabilities other than the capital:

(b) If, in cases where a company has increased its capital to make up the loss suffered as a result of the war, its capital has been replenished with the capital increase through the payment by its shareholders other than Allied nationals, the sum of such replenishment;

(c) If, the current market value of the property owned by a company at the time of compensation, but not owned by the company at the commencement of the war, exceeds the acquisition cost of the property, the sum of such excess.

(**3**) "The amount of damage to shares" shall be the "amount of damage to the company" provided for in (**2**) above multiplied by the ratio of the amount of the paid-up shares of the company which were owned by the Allied national at the time of the commencement of war to the amount of paid-up shares of the company concerned at the time of outbreak of war. (Compensation Law, Art. 11.)

B. Provision of the Compensation Law regarding Compensation Means

The amount of compensation payable shall be "the amount of damage to the shares" computed in accordance with the method in A above less the amount equivalent to the debt for which the claimant of compensation is liable. As to the means of payment, the Compensation Law says that "the compensation payable shall be paid in Japan in *yen*" (Compensation Law, Art. 17.)

Thus, the provisions of the Compensation Law with regard to the method of computing the amount of damage and compensation means for war damage to shares owned by Allied national are substantially not different from those concerning war damage to other tangible assets or to intangible assets.

In my view, there is a fundamental accounting mistake in this view of compensation for damage to shares, in that shareholder's interests in the going concern, represented by shares, are considered in direct connection with the company's own possession of assets in the going concern, while the former is one thing and the latter is another. As a result, many contradictions arise.

III. *My View of Accounting for Compensation for War Damage to Shares*

Fundamentally, from the standpoint of accounting, my view concerning compensation for war damage to shares of Japanese corporations owned by Allied nationals at the outbreak of war is as follows:

First, I believe that the damage arising from the freezing of interests owned by Allied Powers' nationals who were shareholders of Japanese corporations (shareholders' interests) during the period ranging from the time of attachment of the shares when the war broke out to the time of restoration of the shares, in accordance with the Enemy Property Custody Law, must be compensated when the Treaty of Peace comes into effect.

Secondly, I think that, in expressing this damage in figures, it should be measured as the value of the shares, as such, representing shareholders' interests.

Thirdly, the intrinsic value of the shares is one thing and their market value is another. This is an especially important point concerning the problem which is apt to be overlooked.

Fourthly, compensation for war damage to shares should not be considered a problem of payment of the sums of money required to restore the physical assets of the Japanese company concerned which were damaged as a result of the war to their *status quo* before damage was incurred, as provided in the Compensation Law. Rather, it should be thought of as providing the economic means needed for restoring the volue of the shares which was lost during the period of the freezing of shareholders' interests.

Fifthly, in my opinion, calculation of the amount of war damage to shares without considering as an accounting element the fact that the value of the *yen* declined due to the inflation in Japan during the period of the freezing of shareholders' interests would be a mistake. That is, my view is that it is absolutely necessary to base such a calculation on the theory of "stabilized accounting."

These views will be explained in greater detail below.

IV. *Basic Method of Measuring the Amount of Damage to Shares*

Considering the subject theoretically, I shall assume, at first, that the value of the *yen* was stable and that a free economy existed.

Under these assumptions, I shall discuss measurement of amount of damage to shares arising out of shareholders' interests having been frozen for a given period. As described in Section III, the most important fact to be noted is that there is no direct accounting relation between the damage to shares owned by the shareholders of a going concern and the damage to the assets of the company which issued those shares. From this standpoint, it is proper to consider the war damage to shares as the loss in value of the shares incurred during the freezing from the outbreak of the war until the conclusion of the Treaty of Peace. Therefore, war damage to shares should be measured by comparing the value of the frozen shares at the time of freezing of shareholders' interests with their value when they were released.

Assuming a free economy and stable value of the currency, the two fundamental factors which determine the value of shares at any particular time are the shareholders' equity in the net assets of the company and the earning power of the company. The value based on the former factor may be called the value of the shareholders' equity; the value based on the latter may be called the capitalized value of the company's earning power. It should be noted that both are no more than intrinsic values of shares. On the other hand, the market price of shares is the combination of these two intrinsic values established through transactions in the market.

Measurement of the realizable value of shares of a particular company under a free economy should be based on the market price of those shares. If no market price exists, measurement should be made on the basis of the capitalized value of the earning power of the company, or shareholders' equity in net assets owned by the company, or a combination of the two. However, it is particularly to be noted that the value of shares measured on some other basis than market price is not the realizable value.

V. *Special Circumstances Under the Japanese War Economy Affecting Measurement of Damage to Shares*

Methods using any of the above three bases for measuring the value of shares presuppose a free economy and stable economic conditions. Thus, under the economic conditions existing in Japan before, during, and after World War II, a practically significant good result cannot be expected from methods directly applying any of these bases. The following three special circumstances are obstacles to adopting such methods to measure the amount of damage to shares.

The first special circumstance is the restrictions on company profit and dividends as a result of severe price regulation, which was the core of the economic controls adopted before World War II began and continued during the war. The second is the vicious inflation, which started slowly before the War and which became rampant when the war ended. The third is the forced revaluation of all fixed company assets at the end of this inflation and the following divisional transfers of the resulting revalustion reserves to capital.

Limitations of space of this paper prevent a thorough discussion of these three circumstances. However, the following conclusions can be drawn concerning the adequacy of methods using the three bases of measurement mentioned previously—market price of shares, capitalized value of earning power, and net assets—in measuring the value of shares at different dates, the beginning of the war in December, 1941 and the restoration of shares when the Treaty of Peace became effective in April, 1952.

A. Adequacy of the Method Using Market Price of Shares as a Basis for Measuring the Amount of Damage to Shares

The market price of shares is determined by the two factors—the earning power of the company concerned and the shareholder's equity in the net assets of the company. How these two factors, which are the intrinsic values of shares, affect the determination of the market price of shares, which is realizable value of shares, depends on social and economic conditions. That is, under conditions of a stable, free economy, the earning power of the company concerned is considered to be the most important of these two factors in determining the market price of shares. However, conditions in Japan during the war were quite different from those after the war, in regard to determination of prices of marketable shares.

The market price of shares during the war was influenced by regulation of company profits, restriction on dividends and the excess war profits tax, and was far removed from the market price under a free economy, where earning power plays a more active role in determining the prices of shares. Nevertheless, the main determining factor was still the prospective earnings of the company concerned. As for companies for which profits could not be anticipated, it was considered that the value of the shares reflected the value of the shareholders' equity in the net assets of the company concerned.

The market price of shares during the inflation after the war did not reflect the true earning power of the company, because an artificial dividend was paid on the basis of unreal profits arising from the decline in the value of the *yen*. After the inflation had ended and the value of the *yen* had become almost stable, companies were forced to revaluate their fixed assets three times. Since that time (Spring, 1954), the market price of shares has generally reflected earning power in that, with prices stable, the factors reflecting company earning power were largely operative.

At the same time, a market phenomenon peculiar to the postwar Japanese economy should be noted: the market price of shares has generally been influenced by issuing shares for the fixed revaluation reserves transferred to legal capital of the company concerned by a definite time, according to the "Law concerning Transfer of Revaluation Reserves to Capital" (1951) and the subsequent supplementary laws. From the standpoint of business accounting theory, these revaluation reserves were to be attributed to the equity of the shareholders existing at the time of the revaluation. Actually, however, the laws permitted companies to increase their capital partly by cash payment and partly by transfer of revaluation reserves to legal capital. This decisively influenced the market price of shares of the company each time an increase in capital was announced.

Thus, since the creation of fixed assets revaluation reserves, the market price of shares in Japan has been determined chiefly by both the partial realization of the value of shareholders' equity arising from the transfer of revaluation reserves to legal capital and the prospective earnings of the company.

It can be seen from the above that economic base for applying the method using market price of shares to measure the amount of damage to shares by comparing their value at the outbreak of the war with their value when they were released in spring of 1952, was completely destroyed by the post-war inflation. Therefore, this method is out of the question. Nevertheless, the market price of shares as such has significance as a means to convert the unrealized amount of damage to shares, measured by other basises, to the actual amount of cash compensation to be made.

B. Adequacy of the Method Using Capitalized Value of Earning Power as a Basis for Measuring the Amount of Damage to Shares

The method of calculation using the capitalized value of earning power as a basis to measure the amount of damage to shares is as follows:

Normal net profit of the company at the time of the freezing of shares ÷ rate of capitalization at the time of the freezing of shares ÷ total shares of the company at the time of the freezing of shares

= capital value per share in current prices at the time of the freezing of shares ....(a)

normal net profit of the company at the time of the restoration of shares ÷ rate of capitalization at the time of the restoration of shares ÷ total shares of the company at the time of the restoration of shares

= capital value per share in current prices at the time of the restoration of shares ....(b)

$$(\mathrm{a}) \times \left(\begin{array}{l} 1 + \text{rate of the rise in} \\ \text{general prices between} \\ \text{the time of the freezing} \\ \text{of shares and that of the} \\ \text{restoration of shares} \end{array}\right) = \begin{array}{l} \text{capital value per share} \\ \text{at the time of the freez-} \\ \text{ing of shares on the ba-} \\ \text{sis of prices current at} \\ \text{the time of the restora-} \\ \text{tion of shares} \end{array} \quad \cdots\cdots\cdots\cdots\cdots\cdots (\mathrm{c})$$

$$(\mathrm{c}) - (\mathrm{b}) = \begin{array}{l} \text{balance arising from the} \\ \text{comparison of capital} \\ \text{value at the time of the} \\ \text{freezing of shares with} \\ \text{that at the time of the} \\ \text{restoration of shares on} \\ \text{the basis of prices cur-} \\ \text{rent at the time of the} \\ \text{restoration of shares} \end{array} \quad \cdots\cdots\cdots\cdots\cdots\cdots\cdots\cdots\cdots\cdots\cdots\cdots (\mathrm{d})$$

There is also a fundamental obstacle to the application of this method of measuring damage to shares, because of the special circumstances of the war economy in Japan. Whether the amount of damage to shares measured by this method is correct depends upon the adequacy of computing the normal net profit of the company. Though company profits were generally normal when the war began in 1941, because the value of the *yen* was stabilized by the Government wartime price controls, nominal company profits at the time of the restoration of shares in 1952 contained an unreal element, as a result of the effect of the inflation over the past several years on the periodic income determination of the company. Surely, underdepreciation arising from not fully revaluating company fixed assets to its extent created unreal profit. Therefore, the amount of damage to shares cannot be correctly computed from nominal profits in accordance with accounting practice as shown in the above method of calculation, even though adjustment is made in the formula(c) by introducing the effect of the decline in value of the *yen*.

However, in cases where unreal profit arising from decline in the value of the *yen* can be completely eliminated in periodic income determination, by systematically applying "stabilized accounting" to company finance over the whole period ranging from the outbreak of the war until the restoration of shares, the method using capitalized value of earning power as a basis can be combined with the following "method using net assets as a basis" and effectively applied to the measurement of damage to shares.

C. Adequacy of the Method Using Net Assets as a Basis for Measuring the Amount of Damage to Shares

In the method using net assets as a basis, the amount of damage to shares during the period assets were frozen is measured by the difference between the real amount of equity value per share in net assets of the company at the time shares were frozen and that at the time shares were released, multiplied by the total number of frozen shares.

The following two points are apt to make application ot this method difficult.
First, as a matter of accounting technique, the amount of equity value per share at the time shares were frozen and that at the time shares were released must be compared in terms of current monetary value at the time shares were released, so the original costs of all the assets for the company on the two dates must be adjusted in accordance with an index

reflecting change in the value of the *yen* in reference to their years of acquisition. This task of adjustment is very difficult because of the lack of a generally accepted accounting procedure.

However, assuming that a company has a complete fixed assets ledger, this task of adjustment is practicable, in view of my experiment with it in regard to a Japanese machinery company, to which my own method was applied. This method is stated in detail in my another treatise to be published in the near future called "Accounting Procedure for Compensation for War Damage to Shares Owned by Allied Nationals under Post-War Inflationary Condition in Japan".

The other difficulty is that, because the shareholders' equity value measured by this method is no more than the book-value of shares calculated on the basis of the amount of assets and liabilities entered in the books of the company, the amount of damage to shares measured by the comparison of equity value is the amount of diminution in intrinsic value of the shares, not the amount of diminution in their realizable value.

The question is how to convert the amount of damage to shares in terms of intrinsic value to a cash or realizable value. This is the crux of this method. However, we can eliminate this difficulty, both theoretically and practically, by dividing the total amount of damage to shares measured on the equity value basis by equity value per share, then multiplying the number of shares thus determined by the market price per share.

In connection with my view in regard to the method using net assets as a basis to measure the amount of damage to shares, the reason why I adopt the assertion of measuring the shareholders' equity value in a going concern by the amount of net assets of the company at a particular time, a method which might be regarded as outdated in the current controversy on 'accounting entity', should be made clear.

The concept of equity in business accounting originally meant a claim on company assets from a legal point of view. Claims on company assets are divided into claims of creditors and claims of shareholders. The former are claims which creditors can collect by force of law when they fall due, regardless of the continuance of the company. The latter are claims for distribution of the remaining assets in case of liquidation of the company. The accounting concept of shareholders' equity is the expression of the value of the latter claims.

The problem in the present discussion of the shareholders' equity is to measure the shareholders' equity value attributed to shares from the standpoint of shareholders of a going concern, not to account for the standpoint of a going concern. In other words, the problem should be solved from the standpoint of the proprietor, not from the standpoint of the business entity. The distinction between the two should be kept clear. Recently, some academic accountants in Japan have asserted that the total equity in the assets of a going concern consists of three parts—creditors' equity, shareholders' equity and the equity of the business entity. That is, they think that total equity, except for creditors' equity, is divided into the shareholders' equity arising out of capital transactions between the shareholder and the business entity and the equity of the business entity composed of the remaining surplus (vid. the reports on "Capital Accounting" in the 18th Meeting of the Japan Accounting Association, 1959).

In my view, 'the equity of the business entity' stated above disolves itself into the claim of shareholders in case of disolution of the company, so it has no legal claim to the assets of the company in that case. According to advocates of 'the equity of the business entity', the reserves created by revaluating the fixed assets of a Japanese company after World War II are a consituent part of the equity of the business entity. However, even if revaluation of company assets had not been enforced, the amount which shareholders would obtain through disposal of the assets remaining, after fulfillment of obligations to creditors, at the time of the dissolution of the company, would be no different from the amount they would receive with the revaluation.

In my opinion, the most important meaning that equities in the assets of a going concern has in business accounting, is as follows. Though both the shareholders' equity and the creditors' equity are nothing but book-values measured by recorded costs in the ledger, the value of creditors' equity is a realizable value, while that of shareholders' equity is a non-realizable value. The book-value of assets, on the basis of which the value of shareholders' equity is measured, amounts to the balance of the original invested cost in the periodic calculation of a going concern and represents no present value.

Of the methods using the three bases described above—the market price of shares, the capitalized value of earning power, and the net assets—the one using net assets can be applied without either theoretical or technical obstacles in measuring the amount of war damage to shares. The framework of this method is summarized in the next section.

VI. *'Method of Calculation Using Net Assets on the Theory of Stabilized Accounting' as a Basis for Measuring the Amount of War Damage to Shares*

In attempting to measure the amount of war damage to shares and the amount of compensation for it under the abnormal economic surroundings during and after World War II the only method which is theoretically proper and technically practicable is that using net assets on the theory of stabilized accounting as a basis. Calculation by this method is briefly shown in the following formulations.

Formula I

$$\left\{\left(\begin{array}{l}\text{Original cost of real assets}\\ \text{at the time shares were}\\ \text{frozen in terms of current}\\ \text{money value at the time}\\ \text{shares were frozen}\end{array}\right) - \left.\begin{array}{l}\text{amount of diminution}\\ \text{due to obsolescence of}\\ \text{assets and to decided}\\ \text{market price fall at the}\\ \text{time shares were frozen}\end{array}\right) + \begin{array}{l}\text{amount of monetary}\\ \text{assets at the time}\\ \text{shares were frozen}\end{array} - \begin{array}{l}\text{amount of liabilities}\\ \text{at the time shares were}\\ \text{frozen}\end{array}\right\} \div \begin{array}{l}\text{total number of shares}\\ \text{of the company at the}\\ \text{time shares were frozen}\end{array} = \begin{array}{l}\text{amount of equity per}\\ \text{share at the time shares}\\ \text{were frozen in terms of}\\ \text{current money value}\\ \text{at the time share were}\\ \text{frozen}\end{array} \quad \cdots\cdots (a)$$

Formula II

$$(a) \times \begin{array}{l}\text{rate of change in}\\ \text{money value from the}\\ \text{time shares were frozen}\\ \text{up to the time shares}\\ \text{were restored}\end{array} = \begin{array}{l}\text{amount of equity per}\\ \text{share at the time}\\ \text{shares were frozen in}\\ \text{terms of current money}\\ \text{value at the time shares}\\ \text{were restored}\end{array} \quad \cdots\cdots (b)$$

Formula III

{(Original cost of real assets at the time shares were restored in terms of current money value at the time shares were restored − amount of diminution due to obsolescence of assets and to decided market price fall at the time shares were restored) + amount of monetary assets at the time shares were restored − amount of liabilities at the time shares were restored} ÷ total number of shares of the company at the time shares were restored = amount of equity per share at the time shares were restored in terms of current money value at the time shares were restored ....(c)

Formula IV

(b) − (c) = difference between the amount of equity per share at the time shares were frozen and that at the time shares were restored in terms of current money value at the time shares were restored ....(d)

Formula V

(d) × total number of frozen shares owned by Allied Powers' nationals at the time shares were frozen = amount of damage to total shares owned by Allied Powers' nationals whose shares were frozen, in terms of current money value at the time shares were restored ......(e)

Formula VI

(e) ÷ amount of equity per share in terms of current money value at the time shares were restored, viz., (c) = number of shares to be compensated at the time shares were restored ......(f)

Formula VII

number of shares to be compensated at the time share were restored, viz., (f) × market price of share at the time shares were restored = amount of damage to shares to be compensated, measured by realizable value at the time shares were restored ....(g)

The following are explanations of the accounting meaning contained in the above formulae.

(Explanation 1)

The fundamental idea in accounting on which this method of calculation is based is that of measuring the difference between the values per share on the two dates. In my opinion, we must hold to the "going concern" concept of accounting before, during and after inflation. Otherwise, if we use the "fresh start" concept of accounting, which determines the new capital of a business by establishing a new accounting after inflation separated from the past accounting—this is, I think, the traditional idea of the ultimate treatment of business accounting under inflation—, we could not resolve the problem without a theoretical contradiction.

(Explanation 2)

Because the shareholders' equity value in a going concern is measured on the basis of the book-values of assets and liabilities of the company at a particular time, the valuation basises for real assets at the two dates are both *original cost.*

(Explanation 3)

By deducting the amount of obsolescence of fixed assets and the decided market price fall of inventories from the original cost of real assets, I intend to measure the value of shareholder's equity on the basis of the original cost which approximately reflects actual economic value.

(Explanation 4)

The index of general purchasing power, not the specific index of particular assets or classes of assets, is adopted as the index of fluctuations in monetary value, to eliminate obstacles to comparison arising from changes in the value of the *yen* as a result of inflation in Japan.

(Explanation 5)

In this study, all shares which are equity units in computing the value of shareholders' equity are assumed to be homogeneous units. In fact, all units of shares of companies in Japan issuing shares which are eligible for compensation for damage are shares with a par value of 50 yen.

(Explanation 6)

In cases where shares used to measure the value amount of shareholders' equity are composed of new shares paid on account and old shares paid in full (such a case occurred under the system of issuing shares in accordance with the old Japanese Commercial Code before the Amended Code enforced in July, 1951), the amount of equity value is measured in proportion to the amount of paid-up capital.

(Explanation 7)

In measuring the value amount of shareholders' equity, all the shares of the company that exist at the time of measurement should be taken into account equally. In other words, the shares included in the calculation of shareholders' equity value at the time shares were restored are not only those which existed at the time shares were frozen, but also shares issued thereafter, when capital was increased, until the time shares were released. This is another point of importance apt to be missed.

(Explanation 8)

The figures computed as the amount of shareholders' equity value represent unrealizable value in the accounting records of the company concerned, not realizable value.

(Explanation 9)

Through dividing the total amount of damage to shares as shown by unrealizable value measured in terms of current money value at the time shares were restored by equity value per share in terms of current money value at the time shares were restored, the number of shares as total damage can be obtained.

(Explanation 10)

By multiplying the number of shares to be compensated derived from the above calculation by the market price of shares of the same description at the time shares were restored, the amount of damage to shares can be converted into the amount of damage in terms of realizable value at the time of the restoration of shares.

(Explanation 11)

The amount of compensation for damage to shares must be clearly distinguished from the accessory amount of compensation arising for reasons other than damage to shares. The period, during which damage to shares occurred, must be confined to the period when the exercise of the right of shareholders was suspended. Therefore, the amount of compensation for damage to shares should be caluclated at the time of the restoration of shares, and the amount of compensation arising for reasons other than damage to shares should be calculated separately for the period from the time shares were restored to the time the indemnity is paid.

It is fundamentally important that new shares acquired by Allied Powers' nationals as shareholders as a result of increase in capital after the restoration of shares are not to be included in measuring the amount of damage. The reason is this. The old shares and the new shares are equal as shareholders' claims to company assets. Since the equity value of the old shares is partially transferred without charge to new shares issued to the old shareholders after restoration of shares, the amount of quity value per share after the increase of capital is smaller than that before the increase of capital. In this case, the amount of damage to the shares owned by Allied Powers' nationals as shareholders at the time shares were frozen becomes unreasonably large.

(Explanation 12)

The accounting precedure for carrying out the above method of calculation will be discussed in my subsequent article, "Accounting Procedure for Determining the Amount of Compensation for War Damage to Shares Owned by Allied Nationals under Post-War Inflationary Condition in Japan", which is to be stated in the 'Hitotsubashi Ronsō' Vol. 45, No. 5, May 1961.

VII *Postscript*

This article was written in December, 1959. Actually, compensation for war damage to shares owned by Allied Powers' nationals was made according to the agreement between the Allied Powers' nationals concerned as claimants and the Japanese Government as claimee. That part of the claim for compensation, concerning which agreement was not reached, was to be determined upon deliberation with various countries in the International Court of Arbitration held in Tokyo. There were three judges as members of the property committee—a representative of the Allied Powers Governments concerned, a representative of the Japanese Government and a representative from the neutral powers. Deliberations began in May, 1960. By September, 1960 some of the cases were settled, the amounts of compensation having been decided through compromise, apart from the accounting views stated above.

(October, 1960.)