

An Inquiry into the Non-Classification of Gains and Losses as Accounting Elements

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Abstract: Accounting elements are the basic classification of accounting objects and the foundation for establishing the system of accounting recognition, measurement, recording, and reporting. They directly determine the completeness and relevance of accounting information. China's *Accounting Standards for Business Enterprises – Basic Standards* have established six accounting elements: assets, liabilities, owner's equity, revenue, expenses, and profit. Gains and losses are not included as independent accounting elements; instead, they are separately classified under owner's equity and profit for accounting and disclosure. This treatment differs from international accounting standards and has triggered many controversies in practice. Based on the core theories of accounting elements and combined with China's accounting standards, this paper explores the historical background, practical reasons, and dilemmas of not treating gains and losses as independent accounting elements, compares the differences between Chinese and foreign standards, and puts forward targeted optimization suggestions to provide references for improving China's accounting standards.

Keywords: Gains; Losses; Accounting elements; Accounting standards; Quality of accounting information

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1. Introduction

With the development of China's market economy, enterprises' economic activities have become increasingly complex. Changes in economic benefits caused by non-routine activities such as asset disposal, fair value changes, and donations have become more frequent, which are the specific manifestations of gains and losses^[1-2]. Gains and losses directly affect enterprises' financial position and operating results. The rationality and standardization of their accounting treatment are crucial to the authenticity and relevance of accounting information.

Accounting elements are the foundation of accounting and a bridge connecting accounting theory and practice. China's current six-element accounting system has been implemented for many years, with gains and losses included in owner's equity and profit. Its rationality has always been controversial: some scholars believe that failing to grant independent status to gains and losses leads to an incomplete accounting

element system; others argue that existing elements can cover gains and losses, and setting separate elements will increase accounting complexity^[3]. Meanwhile, the differences between China's treatment and those of international accounting organizations such as IASB and FASB have brought obstacles to enterprises' cross-border operations and international financing. Therefore, it is of great theoretical and practical significance to explore the issues related to the non-classification of gains and losses as independent accounting elements.

2. Definition of relevant concepts and theoretical basis

2.1. Concepts and classification of gains and losses

According to China's *Accounting Standards for Business Enterprises – Basic Standards*, a gain is an inflow of economic benefits formed by an enterprise's non-routine operating activities, which can increase owner's equity and is unrelated to capital contributions by owners. A loss is an outflow of economic benefits incurred by an enterprise in non-routine activities, which will reduce owner's equity and is unrelated to profit distributions to owners^[4]. The non-routine nature, equity relevance, and economic benefit flow reflected in this definition constitute the core characteristics of gains and losses, and also lay the foundation for their classified accounting.

Gains and losses are mainly divided into two categories: first, those directly recognized in owner's equity, such as fair value changes of available-for-sale financial assets, which are recorded in capital reserves (other capital reserves) and presented in the balance sheet^[5]; second, those directly recognized in current profit, such as gains or losses on asset disposal and changes in fair value, which are presented in the income statement. The two categories follow different accounting paths and reflect different financial information.

2.2. Core theories of accounting elements

Accounting element theory is the core of accounting theory. Its classification must follow the principles of relevance, completeness, mutual exclusivity, and stability to provide a basis for accounting. The accounting element system is dynamically adjusted with the development of the economic environment and accounting theory. Traditional systems focus on routine operating activities, while the popularization of fair value measurement and the diversification of economic activities have highlighted the importance of gains and losses, putting forward new requirements for system improvement.

The mainstream accounting element theories are divided into the asset-liability view and the revenue-expense view: the former emphasizes assets and liabilities as the core, and gains and losses, as manifestations of changes in assets and liabilities, should be included in the element system; the latter emphasizes revenue and expenses as the core, and gains and losses, as profit adjustments, do not require separate elements. China's current standards integrate the two views and do not treat gains and losses as independent elements, which is consistent with the level of accounting practice at that time.

2.3. Theoretical feasibility of gains and losses as accounting elements

Gains and losses are feasible as independent accounting elements: first, their non-routine and incidental characteristics are clearly demarcated from existing elements, meeting the principle of mutual exclusivity; second, they can reflect the economic results of non-routine activities, meeting the principle of relevance and providing more comprehensive decision-making information for stakeholders; third, China's standards

have clearly stipulated their recognition, measurement and disclosure requirements, and mature accounting processes have been formed in practice, meeting the principle of measurability.

From the perspective of accounting information quality requirements, treating gains and losses as independent elements can improve the completeness and comparability of accounting information, avoid confusion with revenue and expenses, fully reflect enterprises' capital movements, and provide more reliable support for decision-making.

3. Historical background and practical reasons for non-classification of gains and losses as accounting elements

3.1. Historical background

The construction of China's accounting element system began in the 1980s. The *Accounting Standards for Business Enterprises*, issued in 1992, established six accounting elements for the first time. Combined with the economic environment at that time, enterprises had few non-routine activities, and gains and losses were small in amount and limited in impact. Therefore, they were included in owner's equity and profit for accounting treatment, which was in line with the practical level at that time.

The 2006 revision of the standards clarified the concepts and classification of gains and losses, dividing them into those directly recognized in owner's equity and those directly recognized in current profit, but did not grant them independent element status. This revision aimed to promote convergence with international standards, take into account the stability of the accounting element system and the practical situation, and continue to use the six-element system.

Historically, this treatment is reasonable. However, with the development of the market economy and the complexity of enterprises' economic activities, the impact of gains and losses has intensified, and their limitations have become increasingly prominent, urgently requiring optimization.

3.2. Practical reasons

3.2.1. Demand for stability of the accounting element system

The six-element accounting system has been implemented for many years, forming a complete accounting process, and accountants, management, and regulators have all adapted to it. Adding gains and losses as independent elements would require major adjustments to standards and accounting methods, increasing complexity, reducing the comparability of accounting information, and affecting decision-making. Therefore, separate elements are not set to maintain system stability.

3.2.2. Constraint of the cost-benefit principle

Accounting must follow the cost-benefit principle. Adding independent elements requires setting separate accounting subjects and formulating recognition and measurement standards, increasing enterprises' accounting costs and regulatory costs. For a long time, gains and losses of Chinese enterprises have occurred infrequently and in small amounts, and the benefits of setting separate elements are insufficient to offset the costs, so they are included in existing elements.

3.2.3. Consideration of compatibility with existing accounting elements

Gains and losses are compatible with the existing six elements: gains and losses directly recognized in

owner's equity can be covered by the owner's equity element, and those directly recognized in current profit can be covered by the profit element, without omitting accounting information. At the same time, treating them as profit adjustments is in line with the accounting habits of Chinese enterprises, reducing operational difficulty.

4. Comparison of differences in the treatment of gains and losses between Chinese and foreign accounting standards

4.1. Treatment of the International Accounting Standards Board (IASB)

In *IAS 1 – Presentation of Financial Statements*, the International Accounting Standards Board (IASB) classifies accounting elements into five categories: assets, liabilities, equity, income, and expenses. Gains and losses are not listed as independent accounting elements; instead, they are separately classified under income and expenses for accounting and disclosure^[6]. The core of this treatment is the broad definition of income and expenses.

The IASB's definition of gains and losses is roughly the same as that of China's standards, but it pays more attention to the broad connotation of income and expenses. At the same time, it requires enterprises to separately present items related to gains and losses in the income statement to improve the transparency and relevance of accounting information. In April 2024, the IASB issued *IFRS 18 – Presentation and Disclosure*, which officially replaced the original IAS 1. By optimizing the presentation structure of the income statement, it further standardized the presentation and disclosure process of gains and losses and improved the comparability of accounting information, which also put forward new convergence requirements for China's accounting treatment of gains and losses.

4.2. Treatment of the Financial Accounting Standards Board (FASB)

In *Statement of Financial Accounting Concepts No. 6 – Elements of Financial Statements*, the Financial Accounting Standards Board (FASB) classifies accounting elements into ten categories, which clearly list gains and losses as independent accounting elements, parallel to revenue and expenses^[7]. The FASB's definition of gains and losses is basically the same as that of China, highlighting their two core characteristics of non-routine nature and equity relevance. Based on the asset-liability view, it requires enterprises to separately present gains and losses in the income statement and statement of comprehensive income to avoid confusion with revenue and expenses, thereby improving the comparability of accounting information.

4.3. Treatment of UK accounting standards

The UK's *Statement of Principles for Financial Reporting* classifies accounting elements into seven items, with gains and losses as independent elements and adopting broad definitions: gains include revenue, and losses include expenses, which is significantly different from China. It pays more attention to reflecting changes in owner's equity, but deviates from the conventional understanding of revenue and expenses, reflecting regional characteristics.

5. Practical dilemmas of non-classification of gains and losses as accounting elements

5.1. An incomplete accounting element system affects the completeness of accounting information

A complete accounting element system should cover both routine and non-routine activities. As changes

in economic benefits of non-routine activities, gains and losses are not treated as independent elements, resulting in an incomplete system that cannot fully reflect enterprises' financial position and operating results. With the development of the market economy, the amount and impact of gains and losses have increased. Some enterprises make up for routine losses through gains from asset disposal, leading to distorted profit indicators and misleading stakeholders' decision-making.

5.2. Blurred boundaries between gains/losses and revenue/expenses affect the comparability of accounting information

In practice, the accounting scope of gains/losses overlaps with that of revenue/expenses, with blurred boundaries^[8]. For example, investment income and asset impairment losses are mixed with revenue and expenses, respectively, and different enterprises have different treatments for the same type of gains and losses. In addition, the ambiguous definition of routine and non-routine activities further reduces the comparability of accounting information and increases operational difficulty.

5.3. Imperfect disclosure requirements affect the transparency of accounting information

China's accounting standards have relatively brief disclosure requirements for gains and losses, only reflecting their total amounts in the income statement and balance sheet, without detailed disclosure of key information such as specific composition and recognition basis, resulting in insufficient transparency of accounting information. At the same time, the standards do not require enterprises to disclose forecast information of gains and losses, making it impossible for stakeholders to obtain a predictive basis for future changes in enterprises' economic benefits, which is significantly different from the relevant requirements of international accounting standards, and is not conducive to scientific decision-making by stakeholders^[9].

5.4. Adverse impacts on enterprise business decision-making and supervision

The blurred boundaries between gains/losses and revenue/expenses prevent management from clearly distinguishing the results of routine and non-routine activities, making it difficult to formulate scientific decisions, and may even adjust profits and cover up losses by manipulating gains and losses^[10]. From the perspective of supervision, non-standard accounting and disclosure make it impossible for regulators to grasp the real situation of enterprises and conduct effective supervision. Financial fraud by some enterprises has damaged the market economic order.

6. Suggestions for optimizing the accounting treatment of gains and losses

6.1. Clarify the independent accounting element status of gains and losses

Combined with China's practical needs and drawing on international experience, on the basis of the existing six elements, gains and losses are added as independent elements, parallel to revenue and expenses. Their definitions, accounting scope, and methods are clarified to improve the accounting element system and fully reflect enterprises' capital movements.

To clarify the independent status, attention should be paid to: distinguishing the boundaries between gains/losses and revenue/expenses, emphasizing their core characteristics; unifying the accounting scope and including the two types of gains and losses into independent elements^[11]; formulating special recognition and measurement standards and standardizing accounting methods. At the same time, improve the definition

combined with the market transaction view to provide theoretical support for their independent status ^[2].

6.2. Standardize the recognition and measurement of gains and losses

Clarify the recognition conditions for gains and losses: economic benefits are likely to flow in or out, and the amount can be reliably measured, emphasizing the non-routine characteristics. Adopt matching measurement attributes according to different types, such as fair value measurement for gains and losses on asset disposal, historical cost measurement for donation gains and losses ^[13]. Clarify the conditions and disclosure requirements for changes in measurement methods to avoid profit manipulation.

6.3. Improve the disclosure requirements of gains and losses

Drawing on the advanced experience of international accounting standards, further refine the disclosure requirements for gains and losses: separately present the detailed items and corresponding amounts of gains and losses in the income statement; in the notes to financial statements, disclose in detail the recognition basis, measurement methods, change reasons of gains and losses and their impact on enterprises' financial position and operating results; for material gains and losses items, separately disclose detailed information such as occurrence time, specific amount and formation reasons. At the same time, require enterprises to supplement the disclosure of forecast information of gains and losses, and optimize the presentation format of the income statement in combination with the relevant requirements of IFRS 18 to promote the convergence of China's gains and losses disclosure system with international standards.

6.4. Strengthen the training of accountants and improve the practical operation level

Organize accountants to participate in professional training, systematically study the relevant standards and international trends of gains and losses, improve practical operation ability through case teaching, strengthen professional ethics education, put an end to financial fraud, and ensure the authenticity of accounting information ^[14].

7. Conclusion

Gains and losses are an important part of an enterprise's capital movements. China's non-classification of them as independent accounting elements is a choice based on historical economic environment and practical needs, which has certain rationality. However, with the development of the market economy, its limitations have become increasingly prominent, making it difficult to meet the needs of improving information quality and international convergence.

This paper concludes that: gains and losses have theoretical feasibility as independent accounting elements; the reasons why they have not become independent elements include system stability, cost-benefit, compatibility, theoretical limitations and vague essential cognition; there are obvious differences in the treatment of Chinese and foreign standards, which bring obstacles to enterprises' cross-border operations ^[15]; this treatment leads to incomplete element system, blurred boundaries and imperfect disclosure, affecting decision-making and supervision.

Disclosure statement

The author declares no conflict of interest.

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