'Bricks without straw'? The evidential basis for theories in accounting history

A J Arnold and S McCartney

Department of Accounting, Finance and Management

University of Essex

Correspondence to: A J Arnold, Department of Accounting, Finance and Management, University of Essex, Wivenhoe House, Colchester, Essex CO4 3SQ

Tel: (01206) 872730 **Fax**: (01206) 873429 **E-mail**: arna@essex.ac.uk

January 2001

'Bricks without straw'?
The evidential basis for theories in accounting history

Abstract

The paper argues that the division between 'old' and 'new' accounting historians, whether marked by polemical exchanges or declarations of mutual respect, is a substantially false dichotomy that serves to mask the real problem facing accounting history, its newness as a sub-discipline in comparison with other areas of history.

Consequently, whereas other histories can generally look to an underlying and rigorously grounded body of data and evidence to support the construction of competing theories, the evidential base in accounting history rarely supports an informed debate.

The paper examines the quality of the support for widely-held views on the accounting practices of the early railway companies, as an exemplar of the quality of the support for existing theories in accounting history and as an area of central importance to a pervasively 'Whig' view of 'progress', of a steady move forward, in nineteenth century accounting history.

'Bricks without straw'?
The evidential basis for theories in accounting history

It is nearly a decade since the 'new' accounting history was 'announced' (Miller *et al.*, 1991). This period has been marked by an outpouring of accounting history research, written from both 'new' and 'old' perspectives, accompanied by much bitter polemic between the partisans of the two camps.

The debate between the schools of accounting history has been wide-ranging but a major theme, and the one that is of particular interest for this paper, has been the approach to the evidential base that underlies this historical writing.

The 'new' historians have typically disparaged the 'old' historians for a narrow focus on the (assumed) evolution of the technical practices of accounting, divorced from any social context, and so implicitly supporting rather than challenging the status quo. Thus the traditionalist has been described pejoratively as someone who:

> … at worst sets out on a "treasure hunt" merely to establish the oldest, the earliest, the strangest, at best views the past entirely from the perspective of the present (Carnegie and Napier, 1996, p. 8).

In the view of the traditionalists however, 'new historians have approached historical records with insufficient rigor and reverence' (Fleischman and Radcliffe, 2000, p. 37). In the words of one polemicist, they:

> … outline speculative arguments… disdain the importance of confirming evidence… Their omission or suppression of primary source materials prevents the reader from empirically assessing the veracity of the authors' interpretations… (Tyson, 1995, p. 29).

More recently, antagonistic exchanges have tended to be superseded by calls for diversity, tolerance, and mutual understanding (see, for example, Chua, 1998; Fleischman and Radcliffe, 2000), although the philosophical differences remain.

The division between 'old' and 'new' accounting historians, whether marked by polemical exchanges or declarations of mutual respect, is however something of a false dichotomy which serves to mask the real problems facing accounting history.

The 'explosion in the academic literature of accounting history' (Carnegie and Napier, 1996, p. 7) is a very recent phenomenon. Napier (1998) suggests that two events in particular 'kick-started' this expansion; the report of the American Accounting Association's Committee on Accounting History in 1970 and the founding of AOS by Anthony Hopwood in 1975. Accounting history is very much a new sub-discipline when compared to many areas of the social sciences, such as economic or political history. As a consequence, whereas, for example, economic history has an underlying and rigorously grounded body of data and evidence which generally supports the construction of competing theories, and subsequent debate and (sometimes) vilification, the evidential base in accounting history, although in some cases able to support an informed debate (e.g. concerning the Hoskin-Macve thesis on the genesis of managerialism), in most areas lacks data or evidence beyond the merely anecdotal.

Clearly, papers identifying historical facts that do not lead to theories (antiquarianism) have little value in the academic world, but all manner of challenging and critical theorisations require a substantial evidential base. If we look to other branches of history, typically at a later stage in their evolutionary cycle, the important debates and alternative theorisations (e.g. concerning the origins of the First World or the extent of changes in real wages in pre-industrial England) can take for granted a substantial body of basic data, even if they wish to challenge its meaning or methodological soundness, or indeed to produce new sources which shed fresh light on question in dispute. In so new an area as accounting history this (largely) cannot happen, because the underlying evidential base is simply not there. Existing theories, whatever their ideological slant, are often based on incomplete, fragmentary, or anecdotal evidence and can be frighteningly tenuous, by the standards of more mature areas of history.

This has serious consequences for both 'old' and 'new' accounting history. The 'old' is damned, not (only) by its inadequate theorisation but by its own chosen criterion, that proper history is firmly grounded in evidence acquired from archival sources. The 'new' is damned inasmuch as it often seeks to reinterpret already existing evidence (see Merino, 1998, p. 607) and rely on already published material (e.g. the Bryer 'railway swindle' thesis), which frequently leads to the enthusiastic construction of bricks without straw.

This paper has two objectives.

Firstly it aims to evidence the foregoing assertions by a micro-level examination of an important issue in accounting history, about which there is a widely held and apparently solid consensus, one that embraces both 'old' and 'new' accounting history. This is the view in the literature that the published accounts of early British railway companies were subject to pervasive manipulation by their directors, in order to exaggerate reported profit figures and justify higher dividends. The importance of early railway accounting to the history of corporate financial reporting would in itself justify this review of the literature. However, in this paper it can also serve as an exemplar of the quality of the support for existing theories in accounting history.

Secondly, the paper tries to show that the pervasively 'Whig' view of nineteenth century accounting history, what Merino calls the 'implicit assumption of a steady move forward (progress) that may mask the conflicts inherent in a free enterprise system)' (1998, p. 606), insofar as it relies on the alleged deficiencies of early railway reporting practices, rests upon perilously little and is ripe for re-examination.

In the next two sections of the paper, a relevant literature is defined and the evidence that it looks to, whether by way of original or earlier materials that it references, has been outlined. The fourth (and the main) section of the paper identifies the specific assertions made within the relevant literature about the accounting practices of early railway companies, the evidence provided in each case, and provides an explanatory comment, where this seemed likely to be helpful. The final section of the paper provides some overall conclusions.

The relevant literature

A thorough search of the accounting and economic history literature was conducted for discussions and identifications of alleged accounting manipulations by early UK railway companies, i.e. in the period to 1850.[1] In order to keep the paper of manageable size, it does not include references to papers that comment on the variability of depreciation practice (e.g. Brief, 1966; Edwards, 1986),[2] on the regulatory arrangements governing the railways (e.g. Parker, 1990), on the desirability of greater presentational uniformity (e.g. Parker, 1990) or on the efficacy of the audit processes of the time (e.g. Pollins, 1957; Chandler et al. 1993; Jones, 1995). A paper that *opposes* earlier suggestions that an (important) early railway paid dividends out of capital (Pollins, 1952b) has also been excluded.
The various discussions and assertions are contained in a core, relevant literature of sixteen articles and books, published in the period 1952-97, consisting of (in chronological order):

Pollins (1952a), Edey and Panitpakdi (1956), Pollins (1956; see also Pollins (1969)), Clapham (1964), Brief (1965), Broadbridge (1970), Lee G A (1975), Lee T A (1979), Watts (1979), Lee T A (1982), Glynn (1984; see also Glynn (1994)), Edwards (1985), Edwards (1989), Bryer (1991), Jones and Aiken (1995), Simmons and Biddle (1997).

Evidence, references to early materials and (later) citation

In the historical literature generally, from the 1970s, and more recently in the accounting history literature, there have been important debates about historical methodologies and objectives. Part of this debate has concerned 'evidence', the nature of the distinction between primary and secondary evidence and its relationship to issues concerning the existence or non-existence of 'factual' history.

There have been polar claims that important areas of history are capable of objective or 'factual' evidencing and, alternatively, that all sources are merely 'texts that reconfigure reality' without significant qualitative variation but few historians seem to believe the first proposition (except at a very simple or basic level) or to readily accept the second as credible. Instead, 'many historians would characterise their work as the metamorphosis of evidence into a coherent and probable picture' and thus seem to approach 'evidence' in a quasi-judicial manner whereby, in the light of its perceived reliability, it is able to shed light on an essentially contested reality, itself shaped by the issue under investigation and which is always likely to change as new evidence is obtained (see the discussion in Fleischman *et al.*, 1996, circa p. 62).

Issues concerning evidence are clearly important and a large number of historical enquiries are, directly or indirectly, concerned with the qualitative aspects of 'evidence'. It has been claimed that, in history generally, a great deal of 'evidence gathering' has been carried out and that attention is moving towards increasingly 'interpretive' approaches although, in the comparatively recent field of 'accounting history', the amount of evidence that has been gathered to date is very modest, which can lead to the deriving of conclusions from very slender evidential bases.

Evidence comes in a variety of forms, which can be analysed in a number of ways; because of our interest in the way that certain practices can operate within a given academic literature set, we have chosen within this paper to dichotomise 'evidence' into 'references' (to original or early materials) and 'citation' (of contributions within the current literature).

In both cases, the evidence quoted is intended to convey the substance of a given situation at tolerable length, although there are dangers within this process that we believe have received insufficient attention to date, whereby a set of essentially tenuous beliefs can become an established, conventional wisdom. Towards such an end, evidence can be misrepresented in two ways; firstly because the initial evidence may be less relevant or conclusive than it appears and, secondly, because its subsequent citation and re-citation without that 'attitude of scepticism' that characterises all critical research (Merino, 1998, p. 603) can lend an entirely spurious, additional credibility that itself operates to entrench existing beliefs.

The assertions in the relevant literature (as above) are thus based upon both *references* to original materials and sources (whether archival or textual) and *citations* of other contributions within the core literature. The former, which by definition provide the evidential basis for the entire set of assertions within the literature, were found to have been derived from:

a) archival papers of the time; Lancashire and Yorkshire Railway (4 instances)
b) contemporary government papers; the Report of the House of Lords (Monteagle) Select Committee of 1849 (9)
c) contemporary journals or newspapers; Economist, 1848 (2); Railway Times, 1841 and 1843 (2); Times, 1850 (1)
d) contemporary textual sources; Smith, 1848 (3)
e) later journals or newspapers; Accountant, 1885 (1); Times, 1866 (1)
f) later textual sources; Adams, 1886 (2); Tomlinson, 1915 (1); Jackman, 1916 (1); Wang, 1918 (1); Lambert, 1934 (3); Evans, 1936 (1); Pollins, 1952b (1); Peacock, 1988-89 (1).

As can be seen, contemporary sources (i.e. up to 1850) provided sixty per cent of the referenced support for assertions in the relevant literature. The Monteagle Report was by far the most important single source, providing twenty-five per cent of all references.

The various assertions of accounting malpractice

Our analysis of the relevant literature of sixteen articles and books, as above, has again been confined to statements or allegations made about manipulative accounting practices and hence does not include other statements made in those papers on the variability of depreciation practice (e.g. Pollins, 1956, p. 348; Brief, 1965, p. 17; Bryer, 1991, p. 449), on the nature of the financial instruments of the time (e.g. Bryer, 1991, p. 446) or on the supposedly confused state of some published accounts (e.g. Pollins, 1952a, p. 401). Further, generalised assertions within this literature, where the comments made were clearly of an introductory or concluding nature have not been included. Instead, the analysis has looked to the core areas of the papers concerned where the assertions were generally defined with greater precision and where their supporting evidence was identified.

Each of the comments or assertions (shown inset and in italics and identified as A1, A2 etc for the convenience of later discussion) have been set out below, accompanied by its detailed reference (identified as E1, E2 etc, also in parenthesis) and a discussion of the quality of the evidence concerned.

Pollins (1952a)

> **A1 (p. 401)***...frauds and scandals relating to railway accounts were made known in the late 1840s, when almost every railway company had its accounts examined by some sort of committee of inquiry ...[fn] "...accounts have been cooked by the Directors." [Economist, 1848, p. 825;* ***EV1****].*

The page reference in the Economist is concerned entirely with Parliamentary Debates (on sugar duties etc) and has nothing to say about railways. The remainder of the issue of the Economist concerned (22 July 1848) was searched, but nothing could be found that was relevant. Further, Committees of Inquiry were typically set up by shareholders when the company was providing unsatisfactory returns and their incidence (which Pollins does not evidence) does not provide a reliable indication of the existence of 'frauds and scandals'. A notable exception to this concerned the Committees of Inquiry of four companies previously chaired by George Hudson, including the Eastern Counties Railway, set up in 1849.

Edey and Panitpakdi (1956)

> **A2 (p. 361)** *Railway accounts could be uninformative (Select Committee on Audit of Railway Accounts, Third Report, p. iv;* ***EV2****).*

The comment is extremely modest in its scope ('could' rather than 'were', for example). The Third Report of the Monteagle Committee (p. iv) draws attention to Section 121 of the Companies Clauses Consolidation Act (CCCA) of 1845 under which '...the Company are expressly prohibited from making any Dividend by which their Capital Stock shall in any degree be reduced......... and, unfortunately, the Evidence proves that in several instances it has been altogether disregarded, and that the Accounts of Railway Companies, and the proceedings of the Auditors, afford no security that a principle so essential to the very existence, as well as the profitable management, of Railways shall be invariably enforced', but itself provides no further elaboration or referencing to any specific evidence.

Pollins (1956)

> **A3 (p. 340)** *One commentator wrote of the important Lancashire and Yorkshire Railway, "No one can examine the capital accounts with any degree of attention without being impressed and - were it not for the declarations of the Chairman to the contrary - being convinced that this company paid all dividends out of capital." This was not an isolated case (A Smith, 1848, p. 49;* ***EV3***).

Pollin's assertion appears in a section headed 'the distinction between capital and revenue' and looks to Smith, who based his views solely on published accounts and provides no supporting evidence, beyond some (anything but conclusive) details of the greatly increased expenditures of the Lancashire and Yorkshire and his own comment that 'everything connected with its affairs is most deplorable'. In fact, as Broadbridge (see A 16 below) shows, the circumstances at the Lancashire and Yorkshire in 1848 were far more complex than Smith recognises (although he deserves credit for a well-placed scepticism about the likely pay-off from the railway investment opportunities of the time).

> **A4 (p. 334)** *In 1850, the Times referred to the financial affairs of the Caledonian Railway Company in these terms, "The Caledonian Railway Company, the work neither of lawyers, nor of old women, nor spendthrifts, but of shrewd middle-aged mercantile men, is just such a tangle as one might dream of after supping on lobster salad and champagne" (Times, 30 September 1850, p. 4;* **EV4**).

This is part of a lengthy discussion by the Times on the railway's relationship with other lines on which it had made guarantees under leasing arrangements and on which it now faced a 'long list of lawsuits' that sought to restrict the company's spendings; collectively, these lawsuits were ' intended to prohibit the Caledonian Company from doing anything and everything'. It also comments on the railway's difficult strategic position, 'with competitors running on each side of it from

England, and cutting off the traffic of both coasts, with the Edinburgh and Glasgow almost master of the populous districts, the Caledonian has a hard battle to fight'.

The quote, although entirely accurate in itself, and supposedly representative of the kind of comments 'constantly made throughout the nineteenth century about railway finance and accounts' is used to support the important assertion that 'railway accounts' were deliberately framed to mislead the user but is itself entirely deceptive as the confusion that the Times discusses was in the company's legal affairs and strategic position; the firm's *accounts* are not mentioned at all.

> **A5 (p. 334)** *This kind of comment* [i.e. A4 above] *was constantly made throughout the nineteenth century about railway finance and accounts (for some further references, see Pollins,1952a, pp. 400-1*).

The reference is to assertion A1 (see above).

> **A6 (p. 340)** *The flexibility in the treatment of items of expenditure naturally lent itself to fraudulent management. The most notorious case was that of the Eastern Counties Railway which, between 1845 and 1848 (when George Hudson was Chairman) paid out in dividends some £115,000 more than the "accounts in their books stated they had earned", by the conscious transfer of items from revenue to capital account...this was in addition to some £200,000 "improperly charged to capital" (Select Committee on Audit 1849, Appendix A, p. 362, reprinted in BPP 1849 X (366);* ***EV5****).*

The Report of the Eastern Counties Committee of Investigation (The Cash Committee), together with accountants reports was included as an appendix to the Report of the (Monteagle) Select Committee on Audit, and fully evidences the improper dividend payments and fraudulent accounting practices of George Hudson, who as Chairman controlled the Eastern Counties Railway from October 1845 to February 1849. It does not, however, provide any evidence in support of the related assertion that this was merely the most notorious of a number of similar, if less marked, instances.

> **A7 (p. 340)** *Some companies may even have paid dividends directly from moneys raised to defray capital expenditure; although it is difficult to find specific evidence of this*...[a footnote {No. 19} at this point says) '*This appears to have been the burden*

> *of the complaint against the Liverpool and Manchester Railway in the 1830's' (Pollins, 1952b;* ***EV6****).*

The 1952 Pollins paper analyses the finances of the Liverpool and Manchester Railway, including the issue of whether that railway paid dividends out of capital. It states (pp. 94-5) that 'contemporaries suggested that the sum of almost £450,000 paid out in dividends between 1830 and 1836 had been financed by money raised by borrowings and from shares issued during the same period. An examination, however, of the figures of net profit earned and the amount paid out in dividends shows instead that the railway made enough profit to pay its dividends; up to December 1836 the Company earned £463,970 12s. 6d. in net profit and paid out in dividends £442,504 7s. 6d', evidence that directly *conflicts* with assertion A7.

> **A8 (pp. 340-1)**...*some contemporary accounts seem to imply it* [i.e. A7]. *"So long as you have a capital account open, you have two sources of receipts, one a much larger source of receipt than the other; and I am afraid, that with the best intentions, even on the part of such a Board as the London and North-Western, they can hardly avoid occasionally a little tripping, in spite of themselves" (Select Committee on Audit, 1849, Q. 1110;* ***EV7****).*

Again the assertion is modest in its scope. The evidence of Mihill Slaughter, a member of the Stock Exchange, to the Monteagle Committee consisted of the section quoted above, preceded by his view that 'it is not only indispensably necessary that the capital account should be closed as soon as possible, [and].....that within two years, or thereabouts, after the opening of any great line...there would be no good ground for keeping open the account'. Slaughter's view is offered without supportive evidence. He also does not address the real issue of whether the capital account could be closed when line extensions (which were very common at the time) had been approved by Parliament. He also argues that the capital account must be closed to prevent directors from misusing it, although he does not state that such abuse had actually taken place. The point of the reference to the London and North-Western railway is that, in terms of financial reporting, they were very much regarded as a model company.

> **A9 (p 344)** *For example, in a discussion of the payment of dividends out of capital by the Durham & Sunderland Railway,*

> *the Railway Times in 1841 wrote: "We hope and believe that the practice of knowingly declaring fraudulent dividends is not common with Railway Managements. At the same time care must be taken that deception of a similar kind is not incurred through incaution, or from any other cause. The declaration of a dividend without making allowance for depreciation of stock, cannot in our opinion be regarded as other than fallacious. Some companies, we fear, are running out their perishable stock, thereby exhibiting an appearance of a low scale of expenditure, and a rate of dividend not warranted by the profit really made, and thus leaving a succeeding set of proprietors to make up from their income the replacing of exhausted stock" (Railway Times, 30 October 1841, p. 1142;* ***EV8***).

The editorial in the Railway Times on the practices of the Durham and Sunderland Railway offers its opinion on the shameworthy nature of such conduct, although providing little hard evidence on the practices of the company concerned. An earlier item of news (a copy of an article printed in the Northern Times) in the Railway Times (1841, p. 1114) had stated that 'the shareholders declared the dividend and at the meetings at which these dividends were declared, the Directors certainly recommended the declaration of a dividend, but at the same time openly avowed that there was not sufficient profit to pay a dividend but that they hoped the revenue in future years would more than compensate for the difference'.

The references evidence the company's attempt to pay dividends out of capital, but only with the knowledge of the shareholders. No evidence is provided on the practices of any other companies, the editorial merely stating its 'hope and belief that the practice of knowingly declaring fraudulent dividends is not common with Railway Managements' before covering itself in all possible directions by also stating that 'at the same time care must be taken that deception of a similar kind is not incurred through incaution, or from any other cause'.

> **A10 (p. 334)** *See also a letter to the Railway Times, 23 September 1843, p. 1060: "I fear that deceptive Reports and deceptive balance-sheets are a growing evil" (**EV9**) .*

The letter was referenced in support of the statement that 'railway accounts were "so intricately framed that they are calculated either to conceal the truth, or to lead to erroneous conclusions". It concerns the practice of the Greenwich Railway in charging £3,000 of new carriages to capital account, causing the writer to 'indignantly ask [whether there were] no means of punishing such delinquencies as these [and to] fear that deceptive Reports and deceptive balance-sheets are a growing evil.' Charging the costs of carriages to capital might in some circumstances be unreasonable, but in general would not be. The letter provides no further clarification of the circumstances and seems merely to express a [rather wayward] personal opinion.

<u>Clapham (1964)</u>

> **A11 (p. 390)** *In 1841-2, with Robert Stephenson surveying and George Hudson working in committee or arranging--when necessary--to pay dividends out of capital, or to accept huge personal liabilities, to forward his plans...to secure the creation of a direct Darlington and Newcastle Junction...(Tomlinson,1915, p. 433;* ***EV10****).*

Tomlinson discusses Hudson's plan to set up the Newcastle and Darlington Junction Railway, backed by a consortium of existing railway companies. The plan was that '...the Newcastle and Darlington Junction Railway was to be made by a separate company...The capital to be raised was £500,000 in shares of £25 each. The money market being depressed at this time, it seemed very doubtful whether the shares would be taken by the public at large. George Hudson, however, had a plan for forming the proprietary which met with general approval when submitted to the representatives of the companies directly interested in the new railway on the 6th of September, 1841. It was briefly this: that interest at the rate of 6 per cent. should be paid to the shareholders out of capital while the line was being made, and that, from the time of the opening, a lease of the line should be taken by those companies for a term of ten years, they guaranteeing a rent equivalent to the interest at 6 per cent on a capital of £500,000' (p. 433).

Clearly, there was nothing covert about the payment of the dividends (out of capital), and no suggestion that Hudson was manipulating the accounts (of a company only in its line constructing phase and therefore not able to prepare operating accounts): it was part of the scheme whereby subscribers in the new company were guaranteed 6% pa for the period of construction (as a form of quasi interest on capital) and a further ten years (as quite explicit rent) by a number of existing railway companies.

Brief (1965)

> **A12 (p. 16)** *Other writers also disapproved the financial policies of railroads. Evans, referring to the practices in England before 1850, states that "questionable tactics on the part of management, unchecked by the courts which were reluctant to interfere in the internal affairs of a company, are to be suspected in some instances." He went on the say that "whether legal or not, both preferred and ordinary shareholders often received dividends out of capital" (Evans, 1936, p. 103, p. 119;* ***EV11****).*

The quotation appears in the context of Brief's discussion of replacement accounting (widely used on railways according to Brief) and how this leads to an understatement of capital consumption and an overstatement of profits. 'Questionable tactics' thus appears to refer to the accounting policies that justified the payment of dividends out of capital, a view supported by A13 (below).

Although the sections quoted are accurate, they are part of a discussion by Evans of the opposition to the issue of preference shares; thus the payment of preference dividends was ' by a road whose original line was not open', which although legal was often opposed by ordinary shareholders who feared prejudice to their interests' (pp. 102-3). The remarks by Evans thus do not relate to accounting misrepresentations, or the way that replacement accounting could understate capital consumption and overstate profits.

> **A13 (p. 16)** *The Accountant confirmed the opinion that many early English railroads neglected capital consumption, paid dividends out of capital, and went bankrupt (The Accountant, 27 June 1885, p. 8;* ***EV12****).*

The Accountant, No. 551 (27 June 1885) reported a lecture to the Manchester Accountants' Students' Society by S. Lewin, about the large number of railway companies floated during the Mania: '...the bulk of the projected lines were wanting in the first elements necessary to success...The public, however, had got the railway fever, and no matter how wild the scheme, credulous investors were found ready to pour their hard earned savings into the coffers of the promoters...Very frequently the capital subscribed...was swallowed up by promotion expenses, and only too often the poor shareholders saw the whole of their subscriptions lost for ever...It took some time to awaken the public to any sense of the real position of affairs...till, presently, a division of "profit" was only the precursor of a call of much larger amount, and the shareholder then began to discover, only too late, that the dividend he had received so gaily, was paid out of capital, and that the vaunted profits had been practically nil. In too many case the companies published no accounts, or, if they did, the accounts were presented in a manner too vague to be of any assistance or guide to the shareholder, and so were practically useless...Many of the projected companies had to go to the wall, their capital wholly lost, while the sounder concerns suffered in great degree from the fact of their shareholders being unable to meet the liabilities which attached to their shares'.

The reference appears to suggest that the editorial staff of the Accountant held the view expressed, rather than a lecturer quoted therein. Moreover, Lewin's talk focused mainly on ' bubble' companies promoted during the Mania, many of which were fraudulent or speculative ventures that never actually constructed any railway lines or published accounts, rather than on companies that built, operated and accounted for functioning lines over a period of time.

<u>Broadbridge (1970)</u>

> **A14 (p. 38)** *Many nineteenth-century writers argued not merely that railway accounts were badly drawn up, incomplete and incomprehensible-as if that were not enough-but that they were rendered do deliberately by scheming boards of directors who wanted to hoodwink their proprietors. Charges were made that dividends were paid out of capital, that expenses which should have gone into revenue account were placed instead in capital account; that there was, in fact, fraud on a colossal scale...He* [Arthur Smith] *charged <u>every</u> company with misapplication of capital receipts. Smith tended to be rather violent, and it is unlikely that the chicanery was as all-embracing as he insisted (Smith, 1848, p. 7;* ***EV13****).*

Assertion A14 identified a number of nineteenth century writers, only one of whom (Arthur Smith) was writing about the period up to 1850. Although the author thinks that the claims of Smith, and other authors, were exaggerated, equally clearly he sees some substance to them. Smith (1848, p. 7) in fact comments (adversely) on the extent to which the railway companies of the time had 'borrowed, without any legal authority, millions on loan notes' but does not, in fact, refer to the *misapplication* of capital receipts at all.

> **A15 (p. 41)** *They* [the auditors of the Lancashire and Yorkshire Railway] *wrote to the directors on 8 November 1850 drawing attention to several-though not very large-items which, they thought, should have been charged to revenue and not to capital account. Samuel Swarbrick, of the Accountant's Office, gave a detailed reply...but (and this is ominous proof that the railway companies did indeed juggle with the accounts even at that late date) he told the Finance Committee that the Company's margin for dividends and interest was small, and cautioned the Board against charging all the items to revenue. In the event, it was ordered that some of the items were to be charged to revenue, some to capital account (Proceedings of the Finance Committee, 18 November 1850;* ***EV14****).*

The proceedings of the Lancashire and Yorkshire Finance Committee evidences assertion A15, that the company charged some expenses against capital but the practice concerned was at most occasional and the items involved were indeed 'not very large'.

> **A16 (p. 66)***...it seems certain that in 1848 some of the 'productive' loan capital* [i.e. loans raised to finance lines that were in operation] *was serviced from capital receipts...the figure of £34,000* [i.e. for loan interest in the revenue account] *for 1848 is extremely low, and in these years the opportunities for misapplying capital receipts were so numerous and the accounts so confused and inadequate (most probably deliberately so) that the verdict must go against the Company*; **EV15**).

The reference is to the Reports and Accounts of the Lancashire and Yorkshire Company. The assertions are probabilistic not categorical and concern circumstances that were extremely complex. Finally, the author also suggests that the payment from capital came about because of ‘confusion and the pressure of events' and despite the directors 'fairly honest attempts to be consistent and proper' (1970, p. 190). See also A3 above.

> **A17 (p. 73)**...*the later 1840s and early 1850s, when there was no doubt that some dividends had been paid out of capital, and after years in which the amount of capital flowing into the Company had been so great that there was much scope for mistakes or for deliberate misapplication (see the figures of receipts and expenditures on capital account in Table 10;* ***EV16****).*

The assertion 'there was no doubt that some dividends had been paid out of capital' by the Lancashire and Yorkshire is based upon a highly complex partitioning of the company's capital between "productive" and "unproductive" according to the state of completion of several different lines (see Broadbridge, 1970, pp. 66-7), circumstances that gave 'much scope for mistakes or for deliberate misapplication' (p. 73). The evidence appears to support the fact that payments were made out of capital from 1845-50 but does not indicate whether this was in error under complex circumstances, or deliberate.

<u>Lee G A (1975)</u>

> **A18 (pp. 21-2)** *The main controversies in early railway accounting turned upon the computation of profits available for dividend...The burning issue was the division of fixed assets expenditure between capital and revenue...From laxity in classification it was no very long step (particularly for less-scrupulous directors during the boom years) to wilful manipulation of the accounts to justify inflated dividends.*

> **A19 (p. 22)**...*(as on the Eastern Counties Railway under George Hudson's management).*

> **A20 (p. 20)**...*the more nefarious practices of the pre-1850 period had been curbed* [by the 1850s/60s].

A19 is presented as an example of A18. The evidence for all three of these assertions consists of the author's footnote stating that he was 'deeply indebted to Mr. Pollins for the main material in this part of the paper'. No other sources are referenced.

Lee T A (1979)

> **A21 (p. 17)** I*n particular, there is evidence to suggest that railway company directors were manipulating reported profit and balance sheet data by the arbitrary treatment and classification of expenditure in order to stabilize dividend levels (Pollins, 1956, p. 354).*

The citation is to a page that contains the conclusion to Pollins (1956) paper and can be taken to being effectively to that paper as a whole.

Watts (1979)

> **A22 (pp. 22-3)** *the accounts* [of railway companies] *were heavily criticised as being 'incomplete and incomprehensible' and 'were rendered so deliberately by scheming boards of directors who wanted to hoodwink their proprietors' by paying dividends out of capital and charging expenses to capital (footnote: Broadbridge, 1970, p. 38).*

The evidence consists of the citation of Broadbridge (1970, p. 38). See A14 above.

> **A23 (p. 23) a***n example of this* [ie A21 above] *is given by Broadbridge (1970, p. 41). It appears that in 1850, the auditors of the Lancashire and Yorkshire Railway Company wrote to the directors stating that several items had been incorrectly charged to capital.*

The evidence consists of the citation of Broadbridge (1970, p. 41). See A15 above.

Lee T A (1982)

> **A24 (p. 81)** *Nevertheless, the stewardship-orientated railway accounting of the mid-1800s must be treated with a great deal of caution, for...there were no generally accepted standards of accounting available to ensure that published information had been properly measured (the main controversy of the time concerned the treatment of expenditure - what should be matched against sales revenues when determining periodic income, and what expenses should be treated as assets for balance sheet purposes*).

The evidence consists of the citation of Pollins (1956) paper in general, described in Lee's selected bibliography as 'a detailed study of the earliest practices'.

<u>Glynn (1984)</u>

> **A25 (p. 107)** *Many instances occurred of fraud on a grand scale...A more notorious character was George Hudson...Having succeeded to the chairmanship of several railway companies he was eventually unmasked as one who had doctored the books to improve balance sheets, had paid dividends out of capital (footnote: a full account of Hudson's life is given by Lambert, 1934;* ***EV17****).*

The reference is to the most widely quoted biography of George Hudson. It provides a considerable amount of evidence (if not referenced with any great precision) to support the assertion that George Hudson was 'unmasked as one who had doctored the books to improve balance sheets and paid dividends out of capital'. Lambert does ***not,*** however, provide any evidence in support of the assertion that 'many instances occurred of fraud on a grand scale'; instead he emphasises the extent to which Hudson was different from other railway entrepreneurs.[3]

> **A26 (pp. 108-9)** *the absence of prescription in the CCCA 1845 led* to...*a diversity of practice [and] in many instance led to charges of deliberate deception. Many nineteenth century writers argued that...directors...deliberately sought to distort presentation to investors.*

No evidence is provided to support the assertion.

<u>Edwards (1985)</u>

> **A27 (p. 26)** *Allegations of 'cooked accounts' were a common feature at shareholders' meetings held in the mid-1840s. According to Wang (1918, pp. 155-6) 'railway shareholders were so bewildered and mystified by cooked accounts, manipulated figures, partial statements, and delusive representations of railway property that they actually regarded the payment of dividend out of capital as a legitimate device'. Many examples of these manipulations are given by Pollins (1956);* ***EV18****.*

The evidence, in support of the assertion that 'allegations of "cooked accounts" were a common feature at shareholders' meetings held in the mid-1840s' consists of the citation of Pollins (1956) paper in general and a reference to Wang. The latter, however, clearly refers, not to the mid-1840s, but to the mid-1860s and to the reasons for the introduction of the Regulation of Railway Act 1868.

> **A28 (p. 26)**...*railway managers believed that their shareholders required a steady dividend. This led them, in many case, to employ valuation procedures principally to produce a pattern of reported profit sufficient to justify the desired level of distribution - the aim was profit-smoothing on a large-scale (Monteagle Committee, 1849, Q. 1999;* ***EV19****).*

The evidence of Charles Russell, Chairman of the Great Western Railway was as follows:

'Q1999 You stated , that you thought the objection to having an Auditor appointed by a Government department would be, that his audit would be a merely technical audit; whereas an Auditor appointed by a Company would also take into consideration the question of policy; can you suppose a case in which this disadvantage would occur?

A Mr Russell gave the example of a company, after an accident, having to pay large damages '...to the extent of some 30,000l. or 40,000l.; such a thing is very possible, even though no blame whatever could be imputed to the managing body of the Company in which it had occurred. It would not be very reasonable to charge that sum to the account of one half-year; if a small Company, it might absorb its entire income. The Auditors appointed by the shareholders might reasonably say, "This is a very large sum to charge against the account of one half-year; such accidents can rarely occur; we think the charge ought to be distributed over three or four half-years;" but the official Auditor must say, "No, I cannot permit that; the money has been paid this half-year, and it must be carried to the Account of the Company for this half-year;" and the effect of that would be to render the dividend fluctuating and unequal...'

It is difficult to see how a [hypothetical] example of a transaction that a private sector auditor might treat more sympathetically can be seen as providing evidence on the frequent, actual practices of railway managers. Certainly, Russell does not suggest that widespread manipulation of the accounts was actually taking place.

> **A29 (p. 34)**..*the 'railway mania' was an immense speculation; generous dividends had been forecast and were eagerly awaited. The result was that management overstated profits available for dividend by omitting liabilities, crediting a range of capital receipts to revenue and debiting revenue expenses to capital (Pollins, 1956).*

The evidence consists of the citation of Pollins (1956) paper as a whole.

> **A30 (p. 34)** *Despite these financial* [i.e. those described in A29 above] *machinations, dividends suffered and disappointed shareholders set up committees of investigation which confirmed suspicions that the accounts had been 'cooked'. As one prominent railway historian put it, investors 'awoke one day from dreams of boundless wealth to the reality of general ruin' (Adams, 1886, p. 85;* ***EV20****).*

Adams (1886, p. 85) states 'then came on the great railroad mania of 1844 and, as other countries have done, England awoke one day from dreams of boundless wealth to the reality of general ruin. Free trade in railroads was then pronounced a failure and in due time another parliamentary committee was appointed...'
This section of Adams' broad and far from accurate analysis of the state of UK railways is mainly concerned with the appropriateness of the principles of free trade as a basis for railway regulation.[4] Adams does not mention the state of the railway's accounting arrangements in general or 'financial machinations' or 'cooked' accounts in particular.

> **A31 (p. 34)** *the most famous revelations concerned the Eastern Counties Railway whose chairman was George Hudson, the 'Railway King' (Jackman, 1916, p. 584). An accountant's report [the Quilter Ball report] showed that £318,144 was wrongly omitted from the debit of the revenue account...£35,315 wrongly credited to the revenue account and interest charged to capital account instead of revenue, £84,591 (Monteagle Committee, 1849, pp. 409-14;* ***EV21 and EV22****).*

The Accountant's Report **(EV21)** was prepared at the request of Cash Committee and fully details the fraudulent accounting practices of George Hudson while Chairman of the Eastern Counties Railway.

Jackman (1916, p. 584; **EV22**) states, concerning George Hudson that: 'the names he received as the Railway King and the Railway Napoleon are typical of his shrewd, grasping policy, his work as a stock-jobber and his ability to lord it over railway officials for his own material ends. Others were, doubtless, imitating his example; and the rage for speculation was fostered by the weekly reports and circulars of the many brokers'. The reference to Jackman is clearly not needed to evidence the fact that Hudson was Chairman of Eastern Counties or that he was called the Railway King, as both are unarguable and well-known. If it is to provide evidence in support of the assertion that Eastern Counties was the most famous of a number of revelations it does so only to the extent of Jackman's expressed (and unsubstantiated) opinion that 'others were doubtless, imitating his example'.

Edwards (1989)

> **A32 (p. 167)** *The response of some managers* [to pressures for dividends from shareholders and the need to raise more capital] *was to overstate profits by omitting liabilities, crediting a range of capital receipts to revenue and debiting revenue expenses to capital. It appears that the main body of railway shareholders were easily deluded by favourable reports ....the true financial facts could not be suppressed indefinitely. Dividends suffered and, as one prominent railway historian put it, investors 'awoke one day from dreams of boundless wealth to the reality of general ruin' (quoted in Edwards, 1985, p. 34) . Disappointed shareholders set up committees of investigation...[which] confirmed suspicions that the accounts had been 'cooked'. The most famous revelations ...[concerned] the Eastern Counties Railway , whose chairman was George Hudson (Monteagle Committee, 1849, pp. 409-14; **EV21**).*

The evidence consists of a reference to the Monteagle Committee **(EV21;** see A31 above and the citation of Edwards (1985) p. 34, that effectively summarises the case made in an earlier paper (see A29-31 above).

> **A33 (p. 117)** (During the 1840s, shareholders often demanded higher dividends] *Railway directors responded to this kind of pressure; according to an editorial in The Times (27 August 1866) 'Directors were often tempted too disregard all moral and legal obligations to make things pleasant to their proprietors'* ***(EV23)***.

An earlier part of Edward's paragraph clearly shows that it is intended to refer to the 1840s, in support of a recurrent theme in the literature that shareholders [during the 1840s as well as at other times] pressurised their directors over dividend levels and that directors responded to this pressure. The reference is to an article in the <u>Times,</u> dating from 1866, that is clearly focused on the contemporary situation in the 1860s and makes no particular reference to shareholder pressures or back to the 1840s.

<u>Bryer (1991)</u>

> **A34 (p. 476)** [Hudson] *was accused of...paying dividends from capital.*[but] [h]*e had done nothing many others had not also done. Therefore, as Carlyle asked in 1849, "why should this, the chief terrier among them, be set upon by all the dog fraternity" (Lambert, 1934, p. 275;* ***EV24****).*

Lambert (1934, p. 275) says that 'in the City all seemed glad of his fall although the view of the middle classes was more charitable, as indicated by Carlyle; "The rage of fellow-gamblers, now when he has merely lost the game for them, and ceased to swindle with impunity, seems to us a very baseless thing. One sordid, hungry canaille are they all. Why should this, the chief terrier among them, be set upon by all the dog fraternity".

In assertion A34, by the construction of the sentence, 'others'must mean other railway directors, yet Lambert is obviously referring to the similar intentions (at least in Carlyle's opinion) of Hudson and those who invested in his companies and not to the conduct of Hudson's fellow railway promoters. Indeed, Hudson's demise caused such excitement at the time precisely because his practices were **not** common to other railway company directors.

<u>Jones and Aiken (1995)</u>

> **A35 (pp. 206-7)** *The main concern of* [Monteagle] *committee members and witnesses was that railway companies were frequently charging items of expense to the capital account, and items* [of] *capital* [to] *the profit and loss account, hence distorting the determination of profits available for dividends payments...This potential for directors to distort the determination of profits was noted by many witnesses (footnote : for evidence that railway companies were misappropriating capital for the purposes of revenue see as examples, First Report, 1849, Q. 1175-6, Q. 2171, Q. 2385-8, Q. 2520-1)....[further] examples of these witnesses include Second Report, Q. 2633-4, Q. 2795-9, Q. 2859, Q. 2962-5; Third Report, Q. 3209-10, Q. 2732-40, Q. 3056-7, Q. 2902-5, Q. 3399;* ***EV25 and EV26****).*

The evidence of the four witnesses to the Monteagle Committee was as follows:

a G. Begbie, was an experienced public Accountant who had worked in the City but had little experience of railway accounts and 'seldom' looked at such accounts, because of the time needed in his own business (Q.1172) The referenced section was as follows;

Q. 1175 If there be the possibility of fusing together the capital and the expenditure accounts, and charging to capital that which ought properly to be charged to expenditure, does it not amount to an indefinite power of creating an artificial balance upon the account of income and expenditure, and of varying the dividend according to the will and pleasure of the parties making the account?

A Unquestionably.

Q. 1176 Supposing you were a purchaser of Railway securities, or that as trustee you were authorized to invest money in Railway securities, should you feel any confidence whatever in the value of the securities in which you were dealing, so long as there was a possibility of blending together the account of capital and the account of income and expenditure?

A None whatever.

b Mr. Andoe was an Inspector, a senior official (Q. 2112) in the government Audit Office (Q. 2110), where he had been employed for 38 years (Q. 2111). The main burden of his evidence was that a thorough audit by outside professionals such as himself need not interfere with the management of the body undergoing the audit. There was no suggestion in his evidence that he had any knowledge or experience of railways, or of any private company. However, in the referenced section, he was asked about closing the capital account:

Q. 2171 So long as there is a capital account remaining open and unexpended, and a concurrent income and expenditure account, upon the balance of which latter the dividend is declared, is there not an undefined power, by transferring either income from the capital to the expenditure account, or, what is more probable, transferring items of charge and expenditure to the capital expenditure, of increasing the balance at the will and pleasure of the parties concerned, and of declaring what dividend is most expedient?

A Yes, and I should say a dangerous power.

c James Foster, stock-broker (Q. 2378) stated that the accounts of railway companies were inadequate to enable him to advise clients. Then, in the referenced section:

Q. 2385 In what respect do you consider them [the accounts] to be imperfect?

A I should not say so much imperfect, as involved; a kind of mystery in the whole statements of many Companies, making them difficult to understand.

Q. 2386 Do the accounts furnish you with the means of accurately distinguishing between the expenditure belonging to capital and the expenditure belonging to income?

A No

Q. 2387 Is that one of the great defects?

A It is a great defect.

Q. 2388 Does not the absence of any such strict separation deprive you of all security with respect to the fidelity of the balances which are rendered, and, consequently, the state of the funds out of which the dividends are declared?

A It does.

d John Swift, a solicitor (Q. 2498) [actually Solicitor of the London and North Western Railway] was asked about the lack of confidence in railway boards of directors, and the referenced sections says:

Q. 2520 Do you not think that one of the great causes for distrust [ie of Boards by shareholders] has been a suspicion, whether well or ill founded, that he dividends have been paid, not out of the profits, but out of the capital of the company?

A Yes, I think so: I have thought so all along.

Q. 2521 Is not that a question which refers to the fidelity and truthfulness of the account, as well as the management of the Company itself?

A It may be said in that sense to do so; but a question which has been put before illustrates what I mean; there may be an erroneous judgement, though in the exercise of a perfectly honest discretion, with respect to the application of a particular item of expenditure to capital or to revenue, without supposing fraud; on the other hand, there may have been great dishonesty with regard to those items. I think the apprehension of the part of shareholders has rather been, that there has been a want of prudence and common sense in dealing with the affairs of the Company; a question rather affecting the discretion and prudence of the Directors than the honesty of the accounts.

The evidence of the further eight witnesses to the Monteagle Committee was:

a George King had formerly been Company Secretary to two railway companies. The main points in his evidence were:

Q. 2732 What is the effect upon the dividend; supposing a considerable sum of the expenditure account is charged to capital, how does it operate upon the dividend?

A By making it more or less, according to the extent to which this impropriety is carried.

Q. 2733 Is not the consequence of that, wherever such a practice is allowed to prevail, to give the Directors for the time being [power to give] an imaginary value to the property which is entrusted to them?

A		It is; and there is a most serious consequence resulting from it. In the Eastern Counties case, for instance, there is a 9s. dividend declared, and a person calculates according to that dividend the value of a share. If that dividend is only 3s. instead of 9s., his shares are worth virtually only one-third of the amount calculated upon. Supposing he Eastern Counties, still taking that case, were going to be sold to the London and Birmingham, the London and Birmingham would, taking the dividend as the basis of calculation, have given three times more for the line than its real value...

Q. 2739	In many of those [railway company] accounts, which at present exist, is the essential separation between income and expenditure of capital carefully kept?

A		Not according to my view.

Q. 2740	And you consider that separation to be essential to the interests of the Railway?

A		Certainly I do.

b W. J. Chaplin MP was a director of the South Western Railway. To the suggestion of the Chair that that it was important that 'the account of capital should be clearly distinguished and distinguishable from the account of income and expenditure'', Chaplin replied it was 'quite essential [as] without it is clearly demonstrated, you would never be able to judge of the legitimate profits (Q. 2795-6).

On being asked if it was possible, from an inspection of railway accounts to infer whether the account of capital and of income and expenditure was duly separated :

A		I do not think it would be possible, unless you were told so by the principal, whom you confided in as an honest man ...... I think there are a variety of ways, if parties were so disposed, in which they might conceal the real state of the account, and I do not see that that is to be prevented by any inspection (Q. 2798-9).

c John Bagshaw, MP, had been involved in railways since 1836 and had been a director of the Eastern Counties Railway since 1844. He agreed with the Chairman's suggestion that the separation of capital and revenue accounts was of paramount importance, then:

A... I think they [ie railway directors] have been going on in a very vicious system; they have adopted one general consolidated fund, if I may use the term; as the money has come in, so it has been expended, without the least reference to what Act of Parliament that money was raised under (Q.2902).

Q. 2903 Do you not consider, even without attributing any misfeasance to any Board of Direction, that under that system it become almost impossible for them to ascertain the exact state of their affairs, or the value of their property?

A I should say it was almost impossible.

Q. 2904 Supposing a disposition to exist to enhance the value of the property at any one time, are not the means given to effect that operation so long as there is this fusion of the capital with the income and expenditure accounts?

A No doubt it is so; but you lordship will recollect that there are always borrowing powers given to Railways. I think those borrowing powers have sometimes been exercised in a way which has been very convenient at the moment......

Asked whether the money raised by loan capital could also be misused for dividend payments:

A I have not the least doubt, but if there is the will to do it, there is also the way (Q. 2905).

d Captain Laws, managing director of the Lancashire and Yorkshire Railway, was asked whether it was important to separate capital and revenue expenditure:

A Most essential; there is no safety for the bondholders or shareholders if it be not made (Q. 2962).

But to the suggestion that enforcement of such a separation was a wise discipline upon railway directors (Q. 2963), Captain Laws answered:

A Clearly so; as a Director, I would not take it upon myself to direct the debiting of things to capital that ought to be debited to revenue, because it cannot continue; you must be brought up at last; it is merely putting off the evil day...You had better bring it fairly before the proprietors; and, I believe, you would not find many Directors that ought to have an interest in taking any other course; if they asked themselves quietly, "Why should they do this?" I think they would answer, that they ought not to do it; "We cannot make the thing better; why should we attempt to give it the appearance of being better than it really is?"

e Mr P. Blackburn, Chairman of the Edinburgh and Glasgow Railway, presented some accounts of his company to the Committee:

Q. 3208 In this account, you make a clear and distinct separation between the capital account and the revenue account?

A Yes

Q. 3209 Do you consider that distinction to be one which is essentially necessary in stating the affairs of the Railway?

A It is the most essential feature in the financial account.

Q. 3210 Practically speaking, is not that distinction not only necessary to be set out upon the face of the account, but is it not necessary that it should be strictly and honestly adhered to in order to satisfy the shareholders [or potential shareholders], that the dividend is a fair dividend out of the profits...?

A It is most necessary.

f Mr. Samuel Laing was the Chairman and managing director of the Brighton Railway Company. Asked about the need to show the separation of capital and revenue accounts he described it as 'a vital point in all Railway accounts' (Q. 3056):

Q. 3057 Will you state what you conceive would be the inconvenience which might result from not adhering, both in the form of the account and in the details of administration, to that separation between capital and expenditure?

A Of course there is a great temptation always to make you own concern appear as flourishing as possible, and make the dividend as large as possible. That can only be obtained by abstracting from the capital...and any confusion of accounts both renders it more easy to commit fraud, where fraud is intended, and those in the management of Railways, where there is no intention of fraud, sometimes to unintentional errors in that respect.

g T. H. Hutton, formerly an accountant in the City and currently Official Assignee in Bristol was asked:

Q. 3399 If no depreciation account is kept, so long as any capital account continues unexhausted, is there not a constant temptation and liability to pay expenses, which ought to be defrayed out of the depreciation fund, or, in other words, out of the current income, out of the capital?

A No doubt of it.

h Sir John Easthope, former Chairman of the South Western Railway:

Q. 2633 Is it possible to conceive Railroad accounts satisfactory in themselves, or explanatory either to their shareholders, or to parties strangers to the Railway, but who may be desirous of making investments in such Railway, unless on the one hand the accounts of income and expenditure, and on the other hand the receipts and expenditure of capital, are clearly distinguished?

A Certainly not.

Q. 2634 Will you state the inconvenience that you conceive may arise or has arisen from the intermixture of those two accounts; how does it bear upon the dividend?

A ...if the Chairman and the more active Managers...make a mistake in designating that which is annual expenditure, and ought to be charged to the annual expenditure, and instead thereof charge it to the capital account, of course it improperly increases the dividend, and thereby gives a fictitious value to the shares. If it is done intentionally, there is scarcely a limit to the mischief that may be committed; if outlay which belongs to annual expenditure is charged to the original construction, it is obvious that all those who are not in the secret, buy the shares upon a dividend that is calculated upon a false statement. [As an illustration suppose that in the case of a new line] Parliament has given a power to pay a percentage upon the capital; if the money that is paid as interest upon such capital is charged to the capital account, and a part of the line is opened, and the revenue arising from the receipt is charged to the dividend account, it is delusive, and just in proportion as that is the case, or anything of a similar nature, so, in proportion it is wrong on practice, and ought to be prevented. A model account would tend to prevent it.

The evidence provided by the referenced witnesses to the Monteagle Committee has been quoted in full, because of the considerable importance of the Morteagle Committee as an evidential basis for existing beliefs about the accounting practices of the early railway companies. The witnesses all agree with the proposition (forcefully presented from the Chair) that a strict distinction must be maintained between capital and revenue items, and point to the consequences of this rule not being adhered to; but none of them suggest that such non-adherence was at that time a serious problem in railway companies, or point to any specific examples, apart from George King (EV26a) who referred to the inflation of profits and dividends on the Eastern Counties Railway. On the other hand, Captain Laws, managing director of the Lancashire and Yorkshire Railway (EV26d), did not believe many directors would find it in their interests to window dress the accounts in this way, and William Andoe (EV25b) and George Begbie (EV25a), on their own admission, had no specialist knowledge of railway companies and their accounts although James Foster (EV25c) a stock-broker, regarded railway accounts as inadequate as a basis for advising clients, and the lack of clear separation between revenue and capital expenditure as one of their 'great defects'.

Simmons and Biddle (1997)

> **A36 (pp. 5-6)** [There were two major concerns about railway accounts: first:]...*the examples, typified by George Hudson's*

> *activities but by no means unique, of railways which buttressed dividends by drawing from capital to meet revenue charges*...[the other was that companies borrowed beyond statutory limits].

The evidence provided consists of the citation at the end of the section concerned of Pollins (1956) paper in general

> **A37 (p. 119)** *There were numerous mini-Hudsons too, without his brains or vision, who played with the finances of the companies they were involved with: William Chadwick for example, whose scandalous manipulation of the business of the North Wales Railway was closely scrutinized by a House of Lords Committee in 1849 (**EV 27**).*

The Monteagle Committee investigated in detail the affairs of the North Wales Railway Company, and its First Report (which is the evidence here) was devoted to the affairs of that company, which received its enabling Act in 1845. However, in January 1846 the directors, one of whom was William Chadwick (then deputy Chairman, and later Chairman) abandoned the idea of building the authorised line (which was never constructed) and instead used the money they had raised (nearly £47,000, mostly from shareholders) to make a series of loans to various friends and relations of the directors (including the minor son of one of them) transactions which were concealed from the shareholders. Later, in 1848, the directors attempted to dissolve the company, and even though the dissolution Bill failed to pass the Lords, they (illegally) distributed the subscribed capital as if the company had been dissolved.

The conduct of the directors, especially Chadwick was scandalous, but this evidence offers no support to the idea that railway directors were manipulating accounts to inflate profits. In fact the company's accounts are not referred to in the Monteagle Report.

> **A38 (p. 214)** *Although Hudson from the outset used questionable accounting practices, the YNMR* [York and North Midland Railway] *appeared to be extraordinarily prosperous*. [His resignation from the] *Eastern Counties Railway* [led to] *a Committee of Inquiry which found that in three years over £200,000 in dividends had been paid out of capital. Similar malpractices quickly came to light on Hudson's other lines **(EV 28 and EV17).***

The evidence provided consists of references at the end of the section concerned to Peacock (1988-9) and to Lambert (1934). Peacock (**EV28**) reports the findings of the Committees of Inquiry which were established in 1849 on all four of the major railway companies controlled by Hudson. These included the Cash Committee which was set up on the Eastern Counties Railway (see under A6, A31 and A32 above). Dividends had been paid out of capital on two other lines (The York and North Midland Railway and The York, Newcastle and Berwick Railway) though not on the fourth (The Midland Railway). In the case of the two York companies however, the payment of dividends out of capital was on a much smaller scale than on the Eastern Counties, and the real scandal in these two companies arose from the revelation that Hudson had appropriated company funds by various illicit means and had made contracts with companies of which he was a director. Peacock also maintains that in the case of the York and North Midland, the first company controlled by Hudson, fraudulent accounting practice began as soon as he was in a position to effect it, although without citing any real evidence for this (see also McCartney and Arnold, 2000).

Lambert (1934; **EV17**) provides a considerable amount of evidence (if not referenced with any great precision) that dividend payments at the Eastern Counties were found to have been paid out of capital; see also A25 and A34 above

Discussion and conclusions

There has been a wide-ranging debate in recent years within accounting history circles concerning the validity of alternative approaches to the evidential bases that underlie the so-called 'old' and 'new' accounting histories. It has also been suggested that, in history more generally, a good deal of 'evidence gathering' has been carried out and that attention should increasingly shift towards more 'interpretative' approaches. In sub-disciplines of history that have been developed comparatively recently, however, this may not be the case and it appeared to us that in 'accounting history' the amount of systematically collected evidence that has been gathered to date is very modest and that, if anything, it has borne an excessive weight of conclusions or interpretation.

In order to test out this expectation, the paper examined the evidential basis for a widely-held view on an important subject within the accounting history literature, the belief that the accounting practices of early (pre-1850) railway companies were highly unsatisfactory, because railway company directors manipulated these accounts in order to exaggerate the reported profit figures.

Our reading of the relevant core literature of articles and books yielded a large number of comments or assertions about the (highly deficient) accounting practices of the early railway companies; to keep the paper to a tolerable length, assertions on even closely related topics were excluded. These assertions rested upon a mix of citations (of contributions within the relevant literature) and references (to original, early or merely other materials outside the core literature).[5]

The total set of assertions made within the relevant literature by definition rests upon the total set of references to materials outside that literature. Of the (28) references that collectively support the prevalent view about the accounting practices of the early railway companies, we found that more than half (15) were simply wrong, either because they did not relate to the matter at hand (EV1, EV18, EV23) or provided the basis for a quotation taken clearly out of its intended context or that demonstrably failed to provide a basis for the conclusion reached (EV4, EV6, EV8, EV10-13, EV19-20, EV22, EV24, EV27).

Three of the references were to expressed opinions that were not substantiated; in one case (EV9) the opinion was at best, 'wayward' but the other two opinions (EV3, EV7) were more plausible. In one case (EV2), the expressed concern of the Monteagle Committee is referred to, that no means existed of enforcing the rule (CCCA, 1845: 121) prohibiting payment of dividends out of capital, and their view that in 'several instances' (unspecified) this had been ignored. In two other cases (EV25, EV26) the testimonies of several witnesses to the Committee are referenced; each witness agreed with the proposition (emanating from the Chair) that a strict distinction should be maintained between capital and revenue items, and pointed to the consequences of this rule not being adhered to but none suggested that such non-adherence was at that time a serious problem in railway companies, or pointed to any specific examples, apart from dividends on the Eastern Counties Railway.

Three (EV14-16) referred to archivally-based evidence of payments of dividends out of capital by one company during a five-year period, but where the payments were small and had been made under circumstances of sufficient complexity as to cast real doubts as to whether or not they were out of capital and if so, as to whether this was intentional. Good evidence was, however, provided in four cases of George Hudson's fraudulent accounting practices at the Eastern Counties Railway in particular and to a lesser extent at two other railway companies (EV5, EV17, EV21, EV28).

The paper has tried to present the available information in a way that will enable readers to form their own views although it would be disingenuous not to add our own conclusion that the initially impressive mass of evidence referenced in the literature, reduces to perilously little hard evidence, beyond that relating to three important companies chaired by George Hudson in 1845-9. We therefore do not believe that the evidential basis for the conventional wisdom is remotely adequate for the certainties that have been expressed in the literature and see the process of citation and referencing other material as effectively a process of 'myth' creation.[6]

An obvious question arises here: if there is no substantial body of evidence to support the conventional wisdom, why has it been so widely accepted? The answer may lie in the 'Whig interpretation' of accounting history, that vision of the steady moving forward of 'progress', so beloved by some historians. From this perspective the history of corporate financial reporting is a story of ever-increasing governmental regulation and increasingly professionalised auditing practice riding gallantly and ever more successfully to the aid of naive and easily deceived shareholders, rescuing them from the clutches of unscrupulous company promoters and directors. The early period with which this paper is concerned is characterised by (at best) amateur auditing and virtually no government regulation at all, so that it is only too easy to assume that railway company directors were able to exploit the lack of constraints on their behaviour and prepare whatever accounts they liked.

We believe that the reality of early nineteenth century accounting is more complex than this, although our conclusion that the process of citation and referencing of other research materials has produced a myth, a set of beliefs unsupported by real evidence, does not mean that the conventional wisdom is necessarily wrong or that the accounting practices of early railway companies were therefore entirely satisfactory. Instead, until a far larger body of evidence has been rigorously analysed, we simply do not believe that the story can properly be told.

Moreover, although we have no evidence that the flaws in the conventional wisdom identified in this paper are pervasive in accounting history, we see no reason to believe that the area we have examined should be unique or even atypical. In the context of the argument we have made concerning the newness of the accounting history sub-discipline we think it a reasonable working hypothesis to suppose that these flaws may well be symptomatic of a widespread, even generic problem.

If this argument is plausible, a number of more general conclusions follow. First, much of the argument between 'old' and 'new' accounting historians about the approach to evidence is actually somewhat redundant. The claim that the 'old' accounting historians are distinguished by the rigour with which their conclusions are 'grounded in the archive' rings hollow if the treatment of early railway accounting is at all representative. Indeed in some cases, to say they 'have approached historical records with insufficient rigor and reverence' would be something of an understatement. There are, however, equally serious implications for accounting history writings that provide a re-interpretation of the existing literature, rather than ground their conclusions in newly discovered sources. Any substantial flaws in the evidential foundation for the conventional wisdom concerned may simply invalidate the re-interpretations, however challenging, that have been constructed thereon. The task of generating a real evidential base, a *sine qua non* of informed debate, is still (largely) ahead of us.

Bibliography

Accountant (1885)

Adams, C. F., *Railroads: their Origin and Problems (*New York: Harper and Row, 1886)

Brief, R. P., 'Nineteenth Century Accounting Error', *Journal of Accounting Research* Vol. III, 1965, pp. 12-31.

Brief, R. P., 'The Origin and Evolution of Nineteenth Century Asset Accounting', *Business History Review*, Vol. XL, 1966, pp. 1-23.

Broadbridge, S., *Studies in Railway Expansion and the Capital Market in England 1825-1873 (*London: Frank Case, 1970).

Bryer, R. A., 'Accounting for the "Railway Mania" of 1845 - A Great Railway Swindle?', *Accounting, Organisations and Society*, Vol. 16 No. 5/6, 1991, pp. 439-86.

Carnegie, G. D. and Napier, C. J., 'Critical and interpretive histories: insights into accounting's present and future through its past', *Accounting, Auditing and Accountability Journal*, Vol. 9 No. 3, 1996, pp. 7-39.

Chandler, R. A., Edwards, J. R., and Anderson, M. 'Changing Perceptions of the Role of the Company Auditor, 1840-1940', *Accounting and Business Research*, Vol. 23 No. 92, 1993, pp. 443-59.
Clapham, J.H., *An Economic History of Modern Britain, the Early Railway Age, 1820-1850 (*Cambridge: Cambridge U P, 1964).

Companies Clauses Consolidation Act (1845) 8 & 9 Vict. c 16.

Economist (1848)

Edey, H. C. and Panitpakdi, P., 'British Company Accounting and the Law, 1844-1900', in *Studies in the History of Accounting*, A.C. Littleton and B.S. Yamey (eds.) (London: Sweet and Maxwell, 1956), pp. 356-79.

Edwards, J. R., 'The Origins and Evolution of the Double-account System: an Example of Accounting Innovation', *Abacus* Vol. 21 No. 1, 1985, pp. 19-43.

Edwards, J. R., 'Depreciation and Fixed Asset Valuation in Railway Company Accounts to 1911', *Accounting and Business Research*, Vol. 16 No. 63, 1986, pp. 251-63.

Edwards, J. R., *A History of Financial Accounting (*London: Routledge, 1989).

Evans, G. H., *British Corporation Finance, 1775-1850: A study of preference shares* (Baltimore: The Johns Hopkins Press, 1936).

Fleischman, R. K., Mills, P. A. and Tyson, T. N., 'A theoretical primer for evaluating and conducting historical research in accounting' *Accounting History*, (new series) Vol. 1 No. 1, 1996, pp. 55-75.

Fleischman, R. K. and Radcliffe, V. S., 'Divergent Streams of Accounting History: a Review and Call for Confluence', Proceedings of the Sixth Interdisciplinary Perspectives on Accounting Conference, Manchester, July 2000

Glynn, J. J., 'The Development of British Railway Accounting 1800-1911', *Accounting Historians' Journal*, Vol. 11 No. 1, 1984, pp. 103-18.

Glynn, J. J., 'The Development of British Railway Accounting: 1800-1911', in *Accounting History, some British contributions*, R.H. Parker and B.S. Yamey (eds.) (Oxford: Clarendon Press, 1994), pp. 327-42.

Jackman, W. T., *The Development of Transportation in Modern England (*Cambridge: Cambridge University Press, 1916).

Jones, S., 'A Cross-sectional Analysis of Recommendations for Company Financial Disclosure and Auditing by Nineteenth Century Parliamentary Witnesses', *Accounting, Business and Financial History*, Vol. 5 No. 2, 1995, pp. 159-86.

Jones, S. and Aiken, M., 'The significance of the profit and loss account in nineteenth-century Britain: a reassessment', *Abacus*, Vol. 30 No. 2, 1994, pp. 196-230.

Lambert, R. S., *The Railway King (*London: Allen and Unwin, 1934).

Lancashire and Yorkshire Railway Reports and Accounts (1845-50)

Lee, G. A., 'The Concept of Profit in British Accounting, 1760-1900', *Business History Review*, Vol. XLIX No. 1, 1975, pp. 6-36.

Lee, T. A., 'Company financial statements: An Essay in Business History', in *The evolution of corporate financial reporting*, T.A. Lee and R.H. Parker (eds.) (London: Nelson, 1979), pp. 15-39.

Lee, T. A., *Company Financial Reporting* (Second Edition) (Wokingham: Van Nostrand Reinhold, 1982).

McCartney, S. and Arnold, A. J., 'George Hudson's financial reporting practices: putting the Eastern Counties railway in context', *Accounting Business and Financial History*, Vol. 10 No. 3, 2000, pp. 293-316.

Merino, B. D., 'Critical Theory and Accounting History: Challenges and Opportunities', *Critical Perspectives on Accounting*, Vol. 9, 1998, pp. 603-16.

Miller, P., Hopper, T. and Laughlin, R., 'The new Accounting History: an Introduction', *Accounting, Organizations and Society*, Vol. 16 No. 5/6, 1991, pp. 395-403.

Napier, C. J., The Past, Present and Future of Accounting History, paper presented to the 10th Accounting, Business and Financial History Conference, Cardiff, September 1998.

Parker, R. H., 'Regulating British corporate financial reporting in the late nineteenth century', *Accounting Business and Financial History,* Vol. 1 No. 1, 1990, pp. 51-71.

Peacock, A. J., *George Hudson 1800-1871, the Railway King* (two volumes) (York: A J Peacock, 1988-89).

Pollins, H., (1952a) 'A Note on Railway Constructional Costs, *Economica,* Vol. 19, 1952, pp. 395-401.

Pollins, H., (1952b) 'The Finances of the Liverpool and Manchester Railway', *Economic History Review*, Vol. V, 1952, pp. 90-7.

Pollins, H., 'Aspects of Railway Accounting before 1868', in *Studies in History of Accounting,* A.C. Littleton and B.S. Yamey (eds.) (London: Sweet and Maxwell, 1956), pp. 332-55.

Pollins, H., 'Railway Auditing: A Report of 1867', *Accounting Research*, Vol. VIII, 1957, pp. 14-22.

Pollins, H., 'Aspects of Railway Accounting before 1868', in *Railways in the Victorian Economy: Studies in Finance and Economic Growth*, M.C. Reed (ed.) (Newton Abbot: David and Charles, 1969), pp. 138-61.

Railway Regulation Act (1844) 7 & 8 Vict. c 85.

Railway Times (1841-43)

Report of the House of Lords (Monteagle) Select Committee on the Audit of Railway Accounts; First, Second and Third Reports; BPP (1849, Cmd. 371, 421) Vol X: 1-646.

Smith A., *The Bubble of the Age; or, The Fallacies of Railway Investments, Railway Accounts and Railway Dividends* (London: Sherwood Gilbert and Piper, 1848).

Simmons, J. and Biddle, G., *Oxford Companion to British Railway History (*Oxford: Oxford U. P., 1997), sections on 'accounting, crime, Hudson, manias, profitability'.

Times (1850, 1866)

Tomlinson, W. W., *The North Eastern Railway* (Newcastle: Andrew Reid, 1915).

Tyson, T., 'An archivist responds to the new accounting history: the case of the US men's clothing industry', *Accounting, Business and Financial History*, Vol. 5 No. 1, 1995, pp. 17-37.

Wang, C. C., *Legislative Regulation of Railway Finance in England* (Urbana: Illinois, 1918).

Watts, H., 'British Railway Audits: The Long Track from 1845 to 1868', *Accounting History*, Vol. 4 No. 1, 1979, pp. 14-35.

---

[1] 'Early' has been defined, conventionally, as up to 1850, a date widely seen as constituting a watershed because of the effects on railway company accounting practices of the crisis which followed the collapse of the railway mania of 1845-7 (see Pollins 1956, p. 339; Edwards, 1985, p. 40).

[2] Throughout, this paper is confined to breaches of the accounting conventions of the time; apart from reasons of length, the variability of depreciation practice has been excluded from the paper because of the absence of a consensus view at the time.

[3] Note, for example, the quotation from the Times in 1849 that Mr Hudson's position was 'absolutely a new thing in the world altogether' (Lambert, 1934, p. 261).

[4] On p. 85 alone, the 'railway mania' is misdated to 1844 (instead of 1845-7) and the Railway Regulation Act of 1844 is then portrayed as a consequence of the mania.

[5] Only one assertion provided no evidence at all (A26); twenty-two looked to a single historical source or body of evidence; three (A31, A35, A38) utilised two such references, two (A27 and A32) provided both a reference and a citation while ten assertions were based solely upon the citation of other contributions to the core literature.

[6] Strictly speaking, the myth was abroad even before the formation of the literature we have examined; as noted at the beginning of the paper, Pollins (1952a) states: 'It is notorious that...frauds and scandals relating to railway accounts were made known in the late 1840s, when almost every railway company had its accounts examined by some sort of committee of inquiry' (pp. 400-1). Thus, Pollins had seemingly accepted the myth as real, even before writing this paper, chronologically the first in the 'core relevant literature' that has been identified.