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Mary Ellen Oliverio
Pace University

Bernard H, Newman
Pace University

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**REPORTING ON COMPANY FINANCIAL INFORMATION
BEFORE GAAP: IN THE *WALL STREET JOURNAL* FOR THE
YEAR 1900**

by

Mary Ellen Oliverio, Ph.D.

and

Bernard H. Newman, Ph.D.

Mary Ellen Oliverio is Adjunct Professor of Accounting at the Lubin School of Business of Pace University.

Bernard H. Newman is Professor of Accounting at the Lubin School of Business of Pace University.

ABSTRACT

Although there were no nationally accepted accounting standards, financial reporting had begun approximately three decades prior to 1900. Barron is credited with “defining the need for financial journalism” in the 1870s (Wendt 1982, 103). *The Wall Street Journal* (hereafter referred to as *The Journal*) had begun publication on July 8, 1889, and soon became a national business newspaper that had gained credibility as a source for sound financial information. By the beginning of the new century, the extent and quality of financial reporting reflected the experience of approximately three decades in a number of publishing efforts and also reflected the need for such information.

The question that motivated this exploratory review of reporting of financial information was: “What was the nature and extent of financial information reporting in *The Journal* before there was an organized, clearly specified body of accounting principles – before GAAP?” From a reading of *The Journal* for its first two decade, there was discovered a series entitled *Studies of Value*, which began publication on January 4, 1900. These columns seemed worthy of review as a source for understanding how *The Journal’s* reporters coped with their task without the availability of established, authoritative accounting guidance.

This was an initial exploratory historical survey that provides merely a tentative first review of the nature of the accounting information presented in the series of articles used. While there is complete silence as to the motivation for the series, there is a hint at what motivated the decision makers at *The Journal*. The hint is in the final note in the column on “Railway Accounts” on January 2, which identified the criticism of the statistical reports provided by the Interstate Commerce Commission. Could such a series enhance the quality of railroad reporting? might have been the question that supported the series. After an initial content analysis, some highly tentative conclusions are provided including the following ones:

1. The economic reality of activities and achievement of the railroads seemed to be drivers of the information provided. With no generally accepted accounting standards, conventionally accepted, those providing the information and those seeking the information – such as the business newspaper, *The Journal* – began with the assessment of economic reality. This basic strategy – of beginning with reality – may have encouraged the considerable use of nonfinancial information which was valuable in assessing the reasonableness of dollar values for items in balance sheets or income accounts.
2. The regular and constant attention to performance of this key industry seemed to have motivated companies to reveal the information in as accurate a form as possible, even though there were questions, from time to time, of “integrity of earnings” and completeness of disclosures.
3. Owners and managers in the industry saw the need for uniformity. It is not clear how much the motivation reflected a wish to remain independent of Federal Government regulations.

4. This railroad industry, which was active in the financial market place, responded to the wish for financial information in a responsible fashion.
5. The silence of any reference to an accountant, an accounting firm, an accounting publication in any of these columns may imply that accounting was not yet perceived to be a field of specialization requiring professionals in the field to inform the business reporters. While the CPA examination had been administered in 1896, there was only a small group certified as of the end of the century.
6. *The Journal* appears to have engaged in highly responsible reporting of financial information. Their editors seem to have understood the value of objective financial information.

INTRODUCTION

Interest in reliable financial information was intensified as the financial status of the U. S. was assessed at the end of 1899. The opening words of an article in the *Annual Financial Review*, a Supplement to the *New York Times*, January 1, 1900 noted: “A prosperity panic—such at the close of the year has been Wall Street’s spectacle. . . Extraordinary in every way is the financial record of 1899” (*The New York Times*, Supplement, Allaway).

The president of the New York Clearing House Association noted that the United States was the envy of the world . . . Traffic on the railroads was increasing and showing greatly improved earnings. . . “ (*The New York Times*, Supplement, Woodward).

Callaway, president of the New York Central Railroad System, reflected the optimism of railroad leaders:

The business of the railroads for the last twelve months has been good, but there is every reason to believe that for the next twelve months it will be better; and, what is best of all, there are signs on every hand that the promise of continued prosperity is not limited to one year. . . (*The New York Times*, Supplement, Callaway) .

Such optimism anticipated a change in the economy -- a marked change from the financial depression which began in 1893 and lasted approximately five years. The railroads, dependent on the level of economic activity in the country, which had seen dramatic increases to railway mileage in the decades before 1890, witnessed lower rates of additions through most of the 1890s, but by the middle of 1898 the rate of increase begins to rise higher, even if still modestly. (See Johnson and Van Metre.)

Financial reporting had begun approximately three decades prior to 1900. Barron is credited “defining the need for financial journalism” in the 1870s. (Wendt, 103) *The Wall Street Journal* (hereafter referred to as *The Journal*) had begun publication on July 8, 1889, and soon became a national business newspaper that had gained credibility as a source for sound financial information. During the period from the initial publication through the end of the century, there had been efforts to improve the quality of financial reporting of railroads, notwithstanding that the field of accounting was still in its initial stages of professional growth.

The question that motivated this exploratory review of reporting of financial information was: “What was the nature and extent of financial information reporting in *The Journal* before there was an organized, clearly specified body of accounting principles – before GAAP?”

From a reading of *The Journal* for its first two decade, a series entitled *Studies of Value*, was discovered, which began publication on January 4, 1900. These columns provided a relevant source for gaining an understanding of *The Journal’s* engagement with financial information and an understanding of how reporters coped without established, authoritative accounting guidance.

The discussion that follows has these sections: 1. Status of reporting of financial information in *The Journal* prior to 1900; 2. Selection of content and nature of exploratory analysis; 3. Financial reporting in general in *Studies in Value*; 4. Accounting-related topics in *Studies in Value*; 5. Inadequacies of information provided by railroads; 6. Comments of approval for reporting; and 7. Conclusions and some questions.

1. STATUS OF REPORTING ON FINANCIAL INFORMATION IN *THE JOURNAL* PRIOR TO 1900

While the organization that was later to be the American Institute of CPAs dates to 1887, the status of accounting guidance in the U. S. as of 1889, was indeed embryonic. Yet, *The Journal* founders stated in simple language the fundamental principles guiding their news business. These were:

To get the news; to publish it instantly, whether bull or bear; no operator controls or can control our news. Any prominent man can say in our columns substantially what he pleases over his name. (*sic*)

Value of Reliable Information

The founders of *The Journal* understood the value of reliable financial information as they stated in their account of purpose: “We believe that such a paper will be of use to operators, bankers, and capitalists who can find in its columns essential statistics so that their pith and bearing can be easily remembered. . . “ (*The Wall Street Journal* 7/8/89).

Earlier recognition of such value had been noted. For example, Clews, who worked on Wall Street, referred in his memoirs to “inadequate information, false information, and defects of news agencies,” that created serious problems in gaining reliable details. Gilpin, the late governor of Colorado, envisioned a railway that would link the countries of the world, but he felt the initiative “is better in the hands of the nations than under control of individuals.” He further stated:

And especially does this remark apply to the United States, where too often the directors of railroad corporations are more autocratic in their control than ever was the autocrat of all the Russias (*sic*). Once elected, they have not the slightest regard for the interests of share-holders (*sic*), adopting the most important measures without even consulting them, and presenting in their reports only such information as they desire to convey. In this secrecy lies one of the greatest evils of railroad management, for here is an organized system whereby the powers conferred by stockholders for their own benefit are used for dishonest and unlawful purposes (Gilpin 1890, 64).

Accounting Not Perceived as a Specialized Field

From the reading of the early years of *The Journal*, it is clear that accounting was not perceived to be a field that required specialists. This was not a unique perception; business, itself, was not perceived to require special skills and knowledge. Although Wharton had established some study of business in 1881, it was 1900, for example, before academic study of accounting was introduced at New York University.

Accounting-related financial information appears to be considered closely related to the economic activity it represents. The accounting figures appeared to be reconciled with the relevant reality, such as the reasonableness of a revenue figure given the amount of tonnage carried. References to “bookkeeper” or “accountant” are practically nonexistent. The first reference to a bookkeeper or accountant noted was in the March 28, 1890 issue which quoted a column from *The Philadelphia Press*, which reported that the confidential bookkeeper and the chief accountant had been discharged for sending information to a party in New York!

While, from the initial weeks of publication, there were advertisements in *The Journal*, there were none noted for accountants in the early issues. In 1898, on a limited number of occasions, there was an advertisement by one accountant, whose ad merely stated:

GEORGE RUSSELL,
RAILROAD AND COMMERCIAL
ACCOUNTANT
(21 years experience)
120 Liberty Street New York
Telephone: 3063 Cortland

There were accountants employed, yet references to them are highly infrequent in the pages of *The Journal* in the years through 1900. It appears that the reporters of *The Journal* talked with the owners or key executives of the companies to obtain information, including financial information. For example, seeking a change in attitude re disclosure of information was the subject of a letter signed by the founder of the paper that appeared in the first Supplement.

This first Supplement to *The Journal* was published on November 27, 1889 and dealt with financial reporting from companies. In it was included a letter which was a plea from Edward D. Jones, one of the founders, for disclosure of information. The letter was addressed to the governor of Kansas. An excerpt from the letter:

I write you again because Kansas is the only State with a Railroad Commission which refuses to give the reports of railroads to it to the public at once. . . . The secretary of the Commission writes that the reports are suppressed at the instance of railroads which complain at garbled abstracts....(*The Wall Street Journal* 11/27/89).

Attention to Accounting

The value of accounting for all industries was implied in a comment about Governor Roosevelt’s message which was discussed in *The Journal* in early 1900. The comment was:

If the Legislature complies with Governor Roosevelt's recommendations in respect to requiring public statements to be made by industrial corporations, or trusts, of their assets and liabilities, earnings and operating expenses, its action will have far reaching effect, because there are very few of the large industrial corporations which do not have offices and do business here.

There is no question of the authority of the State of New York to require such statements of its own corporations and also of the corporations of other states as a condition of doing business here.

For a good many years the only specific knowledge attainable concerning the operations of the American Sugar Refining Company has been derived from the annual sworn statement required by the laws of Massachusetts as one of the conditions of doing business in that state. (*The Wall Street Journal*, Roosevelt's...)

Accounting appears to have been a complement to the pioneering management strategies of railroad companies. Chandler noted:

...during the 1850s American railroads became the pioneers in modern management. . . . They also had to perfect organizational procedures, such as the through bill of lading, intercompany billing, and the operation of the car accountant's office (which kept track of "foreign" cars on its road and its own cars on other roads) This type of technological and organizational standardization, planned and carried out by quasi-professional associations of railroad managers...(Chandler 1990, 55, 56).

Evidence of the interest of railroads in determining appropriate accounting is illustrated with a story in *The Journal* in 1898:

The complaint about using up in operating expenses a large part of heavy gross increases is not well founded. In the boom days of 1880s, the railroads operated at much greater cost than at present, but they charged all extraordinary expenses and many operating expenses to the capital account. The result was that when the test came the railroads were found wanting. The bad times have taught the roads most important lessons. They are operated very much more efficiently than ever before and at a very much less cost. The hard times from 1890 to 1897 taught lessons in economy of operation which will never be forgotten. . . A new and eminently proper custom has grown up, and that is in prosperous times to improve the roads and equipment out of current earnings, and charging such expenses to operating expenses. . . (*The Wall Street Journal*, The Right Course...).

And in the final month of 1899, the following story appeared in *The Journal*:

On December 12, in this city [NYC] will be held the annual meeting of the board of accounting officers composed of the leading accountants of all roads east of

Pittsburg [sic] and Erie. The primary object of the formation of this board, was to secure uniformity in bookkeeping methods and in annual statements. By doing this they facilitate their own work and make life easier for State commissions and the Interstate Commerce Commission. They also give students and investors a better chance to make fair comparisons and judge of the intrinsic worth of any given property. There is a general movement in this direction on the part of the railroads all over the country (*The Wall Street Journal*, Uniform Accounts...).

The Act establishing the Interstate Commerce Commission in 1887 gave the Commission the right to prescribe a uniform system of accounts and the manner in which accounts are to be maintained. The Commission, however, was not granted definite authority to inspect and audit the accounts of railroads. There were recommendations for accounting in the first decade of the Commission's activity, but they appear to be merely suggestions. Only later, in 1906, did the Interstate Commerce Commission under an Act of June 29, 1906, specify a system of uniformity accounts and give the Commission authority to inspect and examine railroad accounting records and reports. In 1907 and 1908, the Commission issued an accounting series describing that system. Further refinements were published by the Interstate Commerce Commission in later years (Johnson and Van Metre 1912, 260-261).

Prior to the Act of 1906, which became effective in 1907, there was discontent with the Commission's efforts. Under the heading, "Railroad Accounts," (1/2/00) was a discussion of a letter Mr. Stuyvesant Fish [status not identified] sent to the Interstate Commerce Commission in which he criticized the statistical reports issued by the Commission. The four points were:

- First – an alleged overstatement of earnings of the published reports of the commission.
- Second – that taxes should be included in operating expenses.
- Third – that the "preliminary income account" does not agree with the final report.
- Fourth – that certain terms used by American accountants are incorrectly used.

After some discussion of the statistician's response, the conclusion of the article was:

It would be very unfortunate if any attempt to graft English methods of railroad accounting on our system were to succeed even in a measure. Mr. Adams [the ICC statistician] does not hesitate to assert that the science and practice of railway accounting has reached a higher stage of perfection in this country than in England and it is impossible for any one with even moderate experience in accounts to refuse complete assent to this assertion. There is, unhappily, in some quarters a disposition to retrograde in this matter. Some leading railroads still publish very obscure and incomplete reports and in at least one case, that of a very important and recently reorganized railroad, the form of annual report adopted is subject to serious criticism on the ground of incompleteness (*The Wall Street Journal*, Railway).

Johnson and Van Metre noted that:

Careful accounting is essential to an efficient performance of the railroad service, and a general understanding of railway accounts is necessary to an intelligent interpretation, by the student or the investor, of the financial and physical condition of a particular railroad company or system (Johnson 1921, 250).

The reporting of financial and related information in *The Journal* in the opening month of 1900 reflects the non uniform nature of the information provided by railroad companies. Yet, at the same time, the reporters at *The Journal* sought and obtained information that made possible, for example, comparisons between two periods of one company's operations or among several companies.

2. SELECTION OF CONTENT AND NATURE OF EXPLORATORY ANALYSIS

Railroad leaders, heading one of the leading industries in the United States and an industry that required large amounts of financing, had given attention to accounting. There was concern that more regulation was forthcoming. From the extent of information provided in *The Journal*, it appears that some railroads regularly provided financial information for reporters at the *Journal*. Additionally, there were direct efforts on the part of *The Journal's* reporters to gather information through interviews and visits. *The Journal* also responded to inquiries from readers. These three sources appear to have influenced the *Studies in Value*.

The first column entitled *Studies in Value*, was published on January 4, 1900, on the first page of the six-page newspaper. Unfortunately, there was no discussion about the objective or reason for introducing the series in an earlier issue or in the issue on January 4th. There was no writer identified with the series. The series ran through much of 1900; however, after the first month, the column appears for most issues, but not all. Also, with few exceptions, after January the column was on the second page, usually in the first column. There was no explanation of why there was no column when it was missing.

Selection of Content

In this exploratory analysis, only the *Studies* that appeared from January 1, 1900, through December 31, 1900, were considered. The subject matter of most of the columns was related to the railroads. Only occasionally was an article devoted to another industry. For example, there were three columns noted for the entire year related to General Electric. Seldom was there a month when one or two columns were devoted to other industries. All other columns dealt with railroads. Columns related to industries other than railroads were not given any consideration in this analysis.

The morning editions, published six days each week, available on microfilm, were the source of the *Studies*. (There is an excellent database which was available to the authors for only a brief time that permitted access to each issue and to an index of each item in the issue)

Method of Exploratory Analysis

The goal of this macrolevel exploratory analysis was to gain an overview of the scope of treatment of financial information in the columns and of the nature of discussion. There was no effort at this point to determine, for example, which topics were most frequently presented or the adequacy of the information presented or the quality of the accounting interpretations.

There were no observable patterns for the column. From reading the columns, a first approximation categorization was possible. Columns, in general, either provided financial information about a specific company or comparative information about two or more railroads, or a discussion of an accounting topic that was discussed generally or, at times, in relation to a railroad or several railroads.

The exploratory analysis is based on consideration of these two types of columns, plus illustrations of opinions made by the columnists that reflected judgments about the quality of information provided. No frequency analyses were made of the columns.

3. FINANCIAL REPORTING IN GENERAL IN *STUDIES IN VALUE*

The most common topic of *Studies in Value* related to financial reporting based, in most instances, on information provided by the entity. In other instances, the reporter seems to have initiated the task of gaining information, and in a limited number of instances, the inquiry of a reader was the motivation for the column. The central importance of railroads in the economy is reflected in the dominance of railroads as the industry highlighted in practically all the *Studies in Value* during the year 1900.

Discussion of an Annual Report

The discussion in the column of January 17, 1900, is based on facts and figures taken from the annual report “just issued” by Southern Pacific. The columnist notes:

Mr. Muhl [from discussion later it appears that this is the president] is greatly to be commended for the manner in which he has brought together the company’s figures. He has succeeded in reducing to clearness and order a very complex organization.

The columnist presents the figures in a manner to recompute what is presented. Difficulties in making conclusions are noted. At one point appears the comment:

It is not altogether easy to state the exact capital stock outstanding, as all of the stock of proprietary companies has not yet been exchanged for Southern Pacific stock...We may take it that \$190,000,000 or thereabouts will cover it. ...The above includes only operating expenses proper with no allowances for betterments of any kind, and no charge for interest on open accounts....

Further on, the columnist final calculation ends with a net surplus available for the stock of \$5,265,817 (earnings of \$18,613,637 less fixed charges of 13,347,820.) This difference is the

sum of \$46,220 from the president’s statement on page 15 of the report. The following explanation is provided:

...the discrepancy is doubtless due to some small item misplaced in our figures, probably in the case of New Mexico & Arizona and Sonora Railroads. The agreement is sufficiently close, however, to permit the following general showing ...[here are provided gross earnings, operating expenses and ultimately surplus; both total figures and cost per mile are included]

A Statement for 10 Months of the Fiscal Year

Illustrative of a common type of financial report that reflected activity for less than a full fiscal year is that of Norfolk & Western, which was discussed in the column of June 4, 1900. Presented are results for 10 months of the fiscal year and the columnist notes that such results “enable a pretty close estimate of final results.” The financial information provided in the categories established by the Interstate Commerce Commission was:

Gross earnings	\$11,498,526	Inc. \$1,800,853
Maintenance of way	1,230,615	Dec. 8,950
Maintenance of equipment	<u>1,684,938</u>	Inc. <u>227,299</u>
All maintenance	2,915,553	Inc. 218,349
Conducting Transportation	3,467,543	Inc. 227,299
General expenses and taxes	<u>578,181</u>	Inc. <u>85,161</u>
All expenses.	<u>6,961,277</u>	Inc. <u>530,809</u>
Net earnings	4,537,249	Inc. 1,270,044
Fixed charges.	<u>1,898,746</u>	Inc. <u>37,111</u>
Surplus	2,638,503	1,232,933

Totals to date as well and the increase or decrease over the comparable period of the last fiscal year are shown. The column includes discussion of key figures. Among the comments is:

The remarkable feature of the company’s operations is of course the way in which expenses have been kept down in the departments other than maintenance. In the year ending June 30 last the company showed expenses per cent of gross earnings as follows:

Conducting transportation	33.1%
General expenses and taxes	<u>5.5%</u>
Transportation, general and taxes	38.6%
for the ten months ending April 30, 1899, the proportions were:	
Conducting transportation	33.5%
General expenses and taxes	<u>5.5%</u>
Transportation, general and taxes	39.0%

the proportions being about the same as for the entire year, as is natural for the ten months ended April 30, 1900, however, the company reports

Conducting transportation	30.1%
General expenses and taxes	<u>5.0%</u>
Transportation, general and taxes	35.1%

which is a saving of almost 4 percent, in the ratio of these expenses as compared with the previous year. The indications are that the proportions for the year will be about the same as those for the ten months.

Comparisons of Financial Performance

Often the topic of a column was a comparison of a particular railroad's performance over a number of years or a comparison of two or more railroads. Two illustrations reflect such columns.

Progress in conduct of transportation for six years. The January 20, 1900, column dealt with Lehigh Valley's progress in the economical conduct of transportation during the prior six years. Figures for 1894 through 1899 are provided for passenger miles, freight ton miles, and coal ton miles. The percentage increases for the six years were passenger business, 48 percent; general freight business, 108 percent, and in anthracite business, over 25 percent (the figures to compute this last percentage are not provided, but a comment is made that bituminous coal and coke percentage is not large, less than 6 percent of the whole.) The column ends with:

It is worth noting that Lehigh Valley is carrying no less than 424 tons of freight and coal in each freight train mile, and, allowing for helping engine mileage, 347 tons per traffic mile. This is certainly a better train load than is shown by any other of the anthracite roads – though of course comparisons are not safe because of loose methods of reporting.

Comparison of two roads in the same territory. St. Louis Southwestern and the Kansas City Southern Railroad are the subject of the September 6, 1900, column. The columnist notes that in addition to being in the same territory, the preferred stock of the two is "near the same figure." Figures provided are totals and per mile and relate to items including: gross earnings, taxes, rentals, net income, interest charges, surplus, price of pfd. stock, ratio of operating expenses, rate per ton per mile 1900, rate per passenger per mile in 1900.

After presenting the figures, the columnist states, in part:

It will be seen in the above tables that Kansas City Southern has a much lower freight rate per ton mile than the Southwestern, although it should be stated that the rate of .00693 (Note: – *the figure shown in the tabular presentation is .00683; the figures from which this ratio was derived is not presented!*) is not the average rate for the year, but the rate as we have received it for one of the active months. Nevertheless, the average rate is not much higher. Passenger rates are practically

the same for both systems. . . . both roads are practically thrown upon the resources of their own earnings to keep up their property to the standard required.

4. ACCOUNTING-RELATED TOPICS IN *STUDIES IN VALUE*

The background of the reporters who were responsible for the columns that dealt with accounting would be very interesting to have. However, efforts to date have been unsuccessful. (The archives of *The Journal* were contaminated during the World Trade disaster and had to be destroyed, so reported a librarian at the Princeton, NJ, location) As noted earlier, accounting was not seemingly considered a specialized field. The focus here is on the nature of the discussion; the value of the substantive discussion and the quality of the accounting judgment are not considered. Illustrative of the range of topics follows:

Overall Meaning of Railroad Figures

The interest in railroad figures is implied in the second column (1/5/00) in the series which was titled: "Railroad Figures that Mean Something." The column opens with this paragraph:

We have several times been asked to make a compilation of railroad figures which, in moderate compass, shall contain the main facts and figures necessary for a proper understanding of a company's position, and which, while not undertaking to supply all the materials necessary to a full and final judgment of value, shall yet present enough to permit an intelligent, if preliminary estimate, of worth.

Then the column continues with an explanation of a change in point of view of what is important at this point in relation to an earlier period:

The time has gone by when a railroad's balance sheet (and especially its "current liabilities and assets" told the whole story. The haphazard method of finance which made floating debt bring forth bankruptcies has given place to a closer system by which the generation of floating debts through income account is carefully watched and in which the main questions are those concerning net earnings capacity, and above all the integrity of net earnings.

Earnings capacity and fixed charges of railroads influenced the compilation of what was perceived to be the basis of meaning. The five main divisions were listed as:

- I. Capital and charges
- II. Gross earning capacity
- III. Expenses and maintenance
- IV. Efficiency
- V. Summary of income account

There is then provided an illustration using the Southern Railway Company. The column concludes with:

When a railroad's figures have been digested into the foregoing classes it is possible to glean from a preliminary survey a good deal of information about its affairs. Whatever there is of vital importance will show up in one or other of the groups and can be followed up by a more detailed examination of all the figures. . . This kind of grouping, moreover, affords a certain rough and ready means of comparing final results in the case of one company with another or one company with itself....

Figures That Reflect Efficiency

The discussion of "A Rough Efficiency Test" was the topic of a column in late January (1/23/00). Attention was focused on expenses "other than maintenance" which had been determined to be "a species of test of general efficiency." The writer noted that "our argument was that a decline in the ratio of these expenses to gross earnings was evidence of improved management and vice versa."

The assumption identified was that a railroad's maintenance expenditures were governed in the main by circumstances where volume of business done is not necessarily predominant. There are two types of such expenditures: 1. The continuing expenses which are more or less fixed or; 2. those that are permanent and required for running trains and conducting transportation. While it was assumed that a railroad has more or less direct control over its maintenance expenditures, "its control over expenditures other than maintenance is determined by the character of its management, and is largely indirect."

The analysis that illustrated the topic was based on figures taken from those of the Pennsylvania Railroad in 1896. The "other expenditures" that reflected "character of management" were disaggregated into: a. dependent on train mileage; b. dependent on tonnage, and general or fixed. Train mileage charges are governed directly by charges in train load, and it is in these expenses where savings are made by improved management. In the items, "dependent on tonnage," which mean expenditures related to station service, depot expenses, and such, increases should not increase in anything like the ratio of increase in business, although such costs are not necessarily fixed and should reflect in a measure large changes in tonnage and passenger movement.

The Meaning of Net Earnings

A *Studies in Value* column (7/25/00) entitled "What Railroad Net Earnings Are" highlights that while it is possible to provide a simple definition, such a definition is generally insufficient because of the difficulty in "the proper definition of operating expenses." The core of the problem, as discussed in this column, is that while operating expenses should include charges for the conduct of the business and "the sufficient maintenance of plant," there is not general agreement in practice as to what constitutes "sufficient maintenance."

There was reported general agreement that expenses were to be charged with whatever is required to keep the existing plants intact and in good condition. At the same time, additions to

the existing plants are charged to capital accounts as well as are improvements made to such assets for the purpose of expanding revenues.

This column elicited a question from a correspondent in Montreal and a discussion of the question was the topic of a later *Studies in Value* column (8/1/00), “What are Net Earnings?”

The correspondent’s contention was

...in addition to maintenance of originals or renewals thereof) additional rolling stock should be supplied and maintained at cost of revenue to the extent that would be necessary in order to make up for the loss in traffic volume, which would otherwise result from the temporary withdrawal from time to time of engines and cars for the purposes of repairs and renewals.

The columnist in this instance concluded that what the correspondent was noting was actually covered in the statement of principle in the earlier column. The judgment made was...“He (the correspondent) is undoubtedly right in claiming that this should be provided for at the cost of operation, as otherwise there would be a drain upon capital productivity. . . “Finally, the column states:

The far-sighted and capable railroad man will, in dealing with all such questions, bring them to the one supreme test – that of maintenance of relative efficiency or earning power. Earning power can be impaired from the outside by conditions over which he has no control, as for example, permanent change in general conditions, character of business, and so on, and it can be impaired by unwise use of plan, insufficient maintenance, mistakes in management, and so on.

How Operating Expenses Are Assessed

One topic discussed in three successive *Studies in Value* (6/13, 14, 15/00) was the operating ratio. The first such column begins with a brief discussion that while a few annual reports have been received, most of the large railroads would not have full statements until August and later. The purpose of the column was to “offer people a few suggestions regarding the proper reading and intelligent understanding of railroad figures. . . and principal of these points is the question of the ‘operating ratio.’” There is noted that . . . “it was in the last depression that the cult of the “ratio” first became general. It was the opinion of the columnist that the fact that the ratio was simple, easily learned and seemingly effective led many people to think “it had permanent value.” Yet, the reader was reminded that, “the ratio must be used correctly and kept within proper limits to have value, since it was a partial standard of operating expenses.”

Because of difficulty of specification, the Interstate Commerce Commission established a regular classification of operating expenses, which was generally used by railroads. The four classes of expenses were:

1. Maintenance of way
2. Maintenance of equipment

3. Conducting transportation
4. General expenses

The column then notes that there is no established relationship between expenses for maintenance of way and gross earnings. The measure of a railroad sufficiency of expenditure for maintenance of way is the amount spent per mile of track. The amount does not fluctuate with gross earnings except in a very general way. The ratio of maintenance of way expenses to gross earnings might fluctuate very materially with entire propriety, so long as the expenditure per mile were sufficient. There were provided figures developed by the Interstate Commerce Commission from railroad reports that indicated maintenance of way expenses per mile for different groups (based on mileage of single track, except for one group listed).

Readers were cautioned to consider location with “due regard to exceptions in individual cases,” because there are circumstances where the maintenance of way expenses to gross earnings might vary largely and yet the requirements for maintenance of way are fairly met.

The next day’s column (6/14/00) focused on the second class as specified by the Interstate Commerce Commission. Again, the same general principles hold good for maintenance of equipment” – “that is that it is not dependent on or governed directly by gross earnings, but is more or less governed by the quantity of equipment to be maintained and the mileage made by that equipment.”

The final column (6/15/00) on the subject of operating ratio discusses the other two classes. In discussing the third class: “conducting transportation,” the factors identified as influencing the ratio are:

1. price of transportation sold.
1. train-load
2. density of business

Conducting transportation varies more directly with gross earnings than any other item, assuming no change in train mileage. This ratio to gross earnings varies inversely to gross earnings but in degree slighter than that of general expenses.

General expenses, which are characterized in the column as fixed, were noted to remain constant or to fluctuate within narrow limits, as “they represented mainly regular expenses of permanent organization.” Such expenses should vary inversely to gross earnings. The actual size of the ratio tends to vary inversely to the volume of business. An excerpt:

Figures from the Interstate Commerce Commission indicate, for example, that the ratio for railroads in Group 1 with gross earnings per mile were \$14,606, incurred general expenses per mile of \$308 which is a ratio of 2.7 percent, while in Group IV with gross earnings per mile of \$4,414, the general expenses per mile were \$156 which is a ratio of 3.5 percent.

The third column concludes with a repetition of the caution in the first column:

As the final ratio is the product of all these diverse conditions and factors, to say nothing of the factor of rates or price of product, it is surely clear that regarded alone this final ratio is absolutely meaningless, so far as any indication of efficiency of management, sufficiency of maintenance or economy of operations is concerned. This was what we originally started out to demonstrate.

5. INADEQUACIES OF INFORMATION PROVIDED BY RAILROADS

There were comments made by the columnists noting inadequacies in the information provided. No column was discovered for the year that dealt only with the matter of adequacy of data. However, comments were included from time to time. Illustrations of some key matters are noted here.

Outdated Reporting

The column (2/26/00) discussed at length the inadequacy of reporting by Delaware & Hudson:

With the Lackawanna now in the hands of men thoroughly conversant with modern methods of railroading, Delaware & Hudson is about the last of the old companies remaining in the hands of “old school” railroad men and run on old methods of operation, bookkeeping and everything else. No doubt some day the wave of reform will strike Delaware & Hudson—it has indeed already been splashed a little with spray, as it were – and when it does the full merits of the property will no doubt become apparent....

That the property is rich is beyond question but the company’s reports have been issued in such form that it has been impossible to tell whether the road, equipment and coal mines have been properly kept up. No one but those actually managing the property can know anything definite..... Furthermore, the remarkable bookkeeping operations of a short time ago by which the canal was written off and the coal lands were written up so as to make the final result about the same were a striking commentary on the views of the management regarding the real significance of writing off. They have not tended to encourage the public to accept, as final, statements of accounts that do not themselves contain materials for such a process of checking as would assure their correctness. A form of report that was perhaps good enough thirty years ago is not good enough today, any more than the management of thirty years ago is good enough for railroads of today.

Complexity of Reporting

The column (3/4/00) reported discontent with what was provided in the annual report:

The annual report has –to our thinking unwisely – complicated the income account with strictly Profit and Loss items such as Bond premiums and commissions to bankers and in a consolidated income statement the purely

bookkeeping dividend paid by Iron Mountain has no place. It only serves to complicate the account and obscure the actual earning capacity. . .

The Missouri Pacific report is one of the most bulky issued but it lacks a complete statement of operating expenses for the whole system and furthermore continues to use the old classification. These faults should be remedied. Next year's report should contain a full statement of expenses arranged on the Interstate Commerce plan.

Insufficient Information Reported

Operating expense. The columnist responded to a reader (4/19/00) who asked to compare the Atchison and Missouri Pacific...After presenting some figures, the columnist stated:

It is, however, necessary to examine them [operating expenses] in detail and this is not a very easy thing to do by reason of the fact that the Missouri Pacific annual report does not anywhere group total operating expenses according to the Interstate Commerce classes. Nevertheless, we shall attempt a rough comparison.

Operating expenses and net earnings. In a column (12/22/00) devoted to Missouri Pacific, the columnist noted the unusual interest in the company, including the speculation based partly upon the acquisition by Rockefeller interests of a considerable block of the company's stock, and partly on the results expected to follow the change in operating methods instituted in the spring of this year.... The columnist ends with the comment, "It is hoped that the company will in the report for this year bring its operating expenses into the form now almost universally adopted by the leading companies. The classification now used by the company has no reason for existence, being hopelessly out of date."

The columnist noted that "there are a number of unofficial comments such as results for the year will show somewhat more than twice as much earned on the stock in 1900 as was earned in 1899...It is a pity, however, that the company does not conform to the practice of other companies and publish monthly net earnings.

6. COMMENTS OF APPROVAL FOR REPORTING

From time to time, there were positive comments about the financial information provided or obtained. Some illustrations follow.

Numbers Reflect Integrity

The columnist noted (1/18/00) that for Southern Pacific:

We consolidated the results for the whole system. It may be of interest to examine expenses in some little detail with the object of establishing the integrity of net earnings....

After calculations, the concluding paragraph was:

From this hasty survey of expenses it is beyond question that the net earnings of the company are beyond suspicion....

Manner of Presentation Is Approved

In the discussion of the annual report of Pennsylvania Railroad (3/6/00) the columnist concluded:

The form that has been adopted by the company for its full annual report will be found to contain all the information formerly given in the president's, general manager's and comptroller's reports, but presented in a better manner.

Completeness of Information Provided

The column that discussed the Missouri Pacific report (3/19/00) noted:

The Missouri Pacific reports give each year details of the repairs and renewals of equipment in a form more complete than usually employed in railroad reports. The figures now cover the operations of seven years, and perhaps offer some slight indications as to what may be considered safe averages.

Footnote Appreciated

The discussion of railroad grain tonnage in the North West, the subject of a column (6/26/00) begins with:

There is naturally a good deal of curiosity with regard to the effect of the spring wheat failure upon railroads in the Northwest as far as Minnesota and the two Dakotas are concerned. Some of the railroads serving that territory give in their annual reports a statement of commodities transported, so that it is easy to see there from what proportion is borne by grain. Other companies do not. Neither Northern Pacific nor Great Northern has been accustomed to include this statement in their reports issued to stockholders. It may, therefore, be of interest to give some facts bearing upon this. We have obtained figures covering business in the State of Minnesota for all the railroads in that State and in one case we are able to give figures covering the entire line. For some of the roads, as has been said, the entire figures are given in the stockholders reports, and we take those from the latest reports issued....

An Amazing Individual Identified

While discussing *Studies in Value*, one story deserves some comment. This story dealt with an individual, under the heading of *A Potent Factor in Values*. The story reflects a business leader who knew bookkeeping...and much more. The column (12/24/00) began:

Five or six years ago it was common to hear ...when Mr. Hill's name was mentioned:

“Ah, yes? Great Northern may be all right now, but just watch it! Hill is a great bookkeeper no doubt, but Great Northern will have to go under sooner or later. No company can operate as cheaply as he claims to operate Great Northern.”

Mr. Hill's “bookkeeping,” however, has proved equal to the strain put upon it and one by one the critics have been obligated to admit that there was some flaw in their calculations....

Five years ago “Hill methods” of railroading attracted the attention of a few who studied railroad figures in other than a superficial way. The first general recognition they received was in 1895, when the Deutsche Bank interests in Northern Pacific required Mr. Hill's advice and co-operation (*sic*) in the management of that property....

Meanwhile the foreign interests and their representatives here took advantage of an opportunity to secure Mr. Hill's advice and co-operation (*sic*) in the management of Baltimore & Ohio with the object of introducing his methods into the operation of the railroad after reorganization. Mr. Hill joined the board, found the company a manager after his own pattern, and the result is a matter of public record. . . .

Now, Mr. Morgan has sought Mr. Hill's help for Erie, and this has given the general public a confidence in the road that it never had before. Experience has taught people that Mr. Hill's presence in a board of directors means good railroading and dividends.

And so in five short years Mr. Hill has grown from being regarded as but one of many capable railroad men, to what is generally recognized as the most commanding individual figure in our railroad world today. But it is not that Mr. Hill himself has greatly changed; it is that people are beginning to understand better the secret of his success. His “methods” are not in the least mysterious. They represent simply the application of first principles to railroad practice. We take some credit to ourselves for having brought them to public attention five years ago when they were much less known than they are now. We do not now hear so many people, as then, call them mere “bookkeeping” – and yet there is some truth in the phrase. Accurate and complete information placed promptly in the hands of subordinates trained to know and understand its meaning, clear grasp of “theoretical” first principles by the “practical” men. . . .He has no patent on these things; he has always been ready to share his facts, his experience, his views....

7. CONCLUSIONS AND QUESTIONS

There appears to have been some degree of satisfaction with the information provided by railroad companies before a uniform accounting system was established by the Interstate Commerce Commission.

This was an initial exploratory historical survey that provides merely a first review of the nature of the accounting information presented in the series of articles used. While there is complete silence as to the motivation for the series, it appears there is a hint at what motivated the decision makers at *The Journal*. The hint is in the final note in the column on “Railway Accounts” on January 2, as excerpted on page 5, which identifies the criticism of the statistical reports provided by the Interstate Commerce Commission. Could such a series enhance the quality of railroad reporting? might have been the question that supported the series. Some highly tentative conclusions follow:

Conclusions

1. The economic reality of activities and achievement of the railroads seemed to be the driver of the information provided. With no generally accepted accounting standards, conventionally accepted, those providing the information and those seeking the information – such as the business newspaper, *The Journal* – began with the assessment of economic reality.

This basic strategy – of beginning with reality – may have encouraged the considerable use of nonfinancial information which was relevant in viewing dollar values for items in balance sheets or income accounts.

2. The regular and constant attention to performance of this key industry seemed to have motivated companies to reveal the information in as accurate a form as possible, even though there were questions of “integrity of earnings” and completeness of disclosures.
3. The visibility of key executives in the industry may have encouraged wise attention to real numbers.
4. It is likely that it was a positive acknowledgment of honorable business practices to read about your company in *The Journal*.
5. The management in the industry saw the need for uniformity. It is not clear how much the motivation reflected a wish to remain independent of Federal Government regulations!
6. An industry, railroads, which was very active in the financial market place, responded to the wish for financial information in a responsible fashion.

7. The silence of any reference to an accountant, an accounting firm, an accounting publication in any of these columns may imply that accounting was not yet perceived to be a field of specialization with individual professionals who had an understanding beyond that of business reporters.
8. *The Journal* appears to have engaged in highly responsible reporting of financial information. Their editors understood the value of objective financial information.

Questions

1. Who were the reporters? Did they have some accounting background? How did they prepare for their assignments?
2. Who were the accountants in the railroad companies -- were they apprentices? How many were CPAs?
3. How did practitioners interact with the Interstate Commerce Commission as accounting rules were established?
4. Who provided leadership in the establishment of accounting rules at the Interstate Commerce Commission?
5. What other reporting of financial information was generally available to the public?

Limitations

As noted, this study was called “exploratory.” In-depth analyses would be of value that would provide answers such as: which railroads were given prominent attention? Why? how timely was the information? how sound were the interpretations?

Only one publication was considered in this study. A study of other publications that were dealing with accounting information during the early years of the 1900s would be of value. A comparative study of the information in *The Wall Street Journal* and in other publications is needed.

Final note

As the new International Accounting Standards Board gets underway and attempts to establish the general framework for developing accounting standards, considerable question about the superiority of U. S. GAAP has surfaced with the debacles at Enron, Waste Management, Arizona Baptist Foundation, and other entities where inadequate accounting has been alleged. Critics are noting that the “rules”-driven FASB statements may encourage the disclosure of violations; a more conceptual basis for guidance may be appropriate, according to some critics of accounting practices and procedures. Can accounting standards be intuitively reporter friendly? reader friendly?

The efforts of reporters in 1900 to deal with the reality – noting the actual status of the railroads and the nature of their services – may provide some clues to what kinds of shifts in framework are needed for the 21st century.

While there were hints of complexity, particularly in the columns that dealt with accounting-related topics, the overall impression is that financial reporting was understandable by those who wrote the columns and those who read the columns. Can the practitioners in a field that has become a specialization with academic study required provide information that can be read – and interpreted with confidence by reporters and ordinary readers? Is universal understanding possible? Some philosophers, for example, have attempted to write for those without academic study in the field; some physicists write successfully for non-physicists. What is the prospect for accounting statements adhering to established standards being confidently read and interpreted by reporters, for example, who have not formally studied accounting? Is it reasonable that today's reporters should be able to provide the type of reporting parallel to that noted in the *Studies in Value*?

This historical review began with the question about financial reporting before GAAP. The reporting was impressive. The writing reflects confidence in understanding what was being presented in the *Studies in Value*. Reporters and readers raised interesting questions. The interest in financial information was evident and seemingly met by this national business newspaper, *The Journal*.

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