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Early American corporate reporting and European capital markets: The case of the Illinois Central Railroad, 1851-1861

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EARLY AMERICAN CORPORATE REPORTING AND EUROPEAN CAPITAL MARKETS: THE CASE OF THE ILLINOIS CENTRAL RAILROAD, 1851-1861

Abstract: This study of the annual reports of the Illinois Central Railroad (IC) from the 1850s supports a conclusion that the statements, as to form and content, were developed to serve the needs of two classes of investors and to inform the general community of the activities of the company. The need to report to the public as to the success of the company's role in its "social contract" to develop the state required details of a demographic nature, which were provided by the land commissioner. Operating results provided evidence of the ability to service the debts held by European investors and to inform British venture capitalists of the extent of the company's operations. This communication with the distant capital providers was a new development in financial reporting as the capital-intensive railroads experienced management and ownership separation on a scale not seen before. In summary, the IC provided annual reports more detailed and informative than those of other corporations of the period because of a need to provide European investors with evidence of management's activities.

INTRODUCTION

From as early as the 1850s, the Illinois Central Railroad (IC) published annual reports aimed at both the general, non-investing, American public and the European (primarily British) capital markets, which represented the majority of investors. Although the IC, because of the way it was founded, was a unique corporation that had a greater responsibility to the general public than do most for-profit corporations, its reporting provides an excellent example of duality reporting at its finest since its annual reports addressed the needs of both audiences.

The IC, sometimes called the "Main Line of Mid-America," was America's first coast-to-coast railroad system, extending from Lake Michigan in the north to the Gulf of Mexico. The IC was also America's first land-grant railroad, and thus an experiment in social economy. The transportation that the IC provided was the intended product of the U.S. Congress when northern senator Stephen Douglas of Illinois and southern senators Jefferson Davis of Mississippi (later president of the Confederate States) and William R. King of Alabama (later vice president of the U.S.) joined forces to provide an unprecedented form of federal subsidy that could link agricultural markets and shipping points in the emerging population centers in the Midwest and Mid-south.

The subsidy, in the form of federal land grants, was to shape the modernization of America's frontier. America's rich interior land was almost worthless without the access to markets that railroads were to provide. To opponents Senator King remarked [Carstensen, 1963, p. 128]:

> We are met by the objection that this is an immense grant – that it is a great quantity of land. Well, sir, it is a great quantity; but it will be there for five hundred years; and unless some mode of the kind proposed be adopted, it will never command ten cents.

This paper, based on the IC's corporate annual reports from the 1850s, analyzes the impact of the land grants (public investment) and more traditional private investment, primarily by British investors, on the railroad and the corresponding development of the American frontier. These corporate reports provided not only financial details to benefit the British capitalists who invested in the road, but also a longitudinal view of the results of the company's impact on the development of Illinois and related markets. Further, the farmers and merchants who were to be the principal customers and beneficiaries of the IC's services were also parties interested in the information provided in these increasingly detailed and complex annual reports. The analysis begins with the IC's first report and ends with the onset of the Civil War.

The remainder of this paper is organized as follows. The first section identifies the principal research questions, followed by a review of the origins and background of the IC. A section on the land-grant legislation of 1850 is provided to give the reader historic perspective. Next, the economic development and capital sourcing plan, especially as it pertains to its influence on financial statements for the period 1851 through 1861, is examined. An assessment of the content of the shareholder reports relative to the communication of operating objectives and economic development to the European investors follows. The paper concludes with observations about the research questions, including implications for further research.

RESEARCH QUESTIONS

The IC annual reports of the 1850s were quite detailed and information laden. Therefore, the principal research question addressed in this paper is, why did the IC management publish the type and amount of information found in them? In short, what dictated the form and content of these early corporate reports? Such reports were neither mandatory nor common among other types of entities. Other railroads, including the Pennsylvania, dating from 1847, and the Baltimore and Ohio, commencing in 1827, produced quite different reports in terms of style, content, and form.[1] By undertaking this archival investigation of an antebellum corporate enterprise, the hope is to add to the knowledge of the role of information provided to British capital markets during a period that has been seldom studied.

Although the IC is an important company to study for purely historical reasons, it is also important for contemporary reasons. Recently, the IC agreed to a merger with the Canadian National Railway Co., which creates a railway system extending from Halifax in the east, Vancouver and Seattle in the west, to New Orleans in the south, with Chicago as the geographic center. A further 15-year alliance with the Kansas City Southern Railway, which operates Mexico's Transportation Ferroviaria Mexicana, will produce a 25,000 mile rail network to capture fast-growing cargo traffic stimulated by the North American Free Trade Agreement. Again in the 21st century, the "Mainline of Mid-America" is being positioned to become the "Mainline of North America." More importantly, examining the financial disclosures of the early railroads gives insight into how new technology impacts accounting and corporate reporting. A parallel between the railroad revolution and the Internet revolution can be drawn.

[1]Noteworthy is the fact that railroads, even in their earliest years of development, presented lengthy annual reports with many tables and exhibits laden with data. Thus, the IC was not unique among railroads in this regard. By contrast, the annual reports of industrial companies fifty years later were "postcard" size with very little detailed information since such data were considered "proprietary."

BACKGROUND

The federal land-grant legislation of September 1850 marked the first time that public lands from the U.S. federal government were to be used to aid in the construction of a private rail line [Stover, 1975, p. 15].[2] Senator Stephen A. Douglas was the main supporter of the bill in Congress, with help in the House from Abraham Lincoln. An original bill in 1848, limited to public lands in Illinois, was narrowly defeated. In 1850, Senators King and Davis amended the bill to extend the grants to the southern states. With this new source of support, the bill passed the Senate in May and the House in September. Initially, there was concern that President Taylor would veto the bill because of his possible sympathies for New Orleans. Taylor was a plantation owner from Louisiana, and the bill appeared to favor Mobile over New Orleans. However, Taylor died in July 1850, shortly before the bill was approved by Congress. Fillmore became president and signed the bill on September 20, 1850, within three days after it had passed the House [Stover, 1975, pp. 19-21].

As noted in Senator King's statement in the introduction, the main argument in support of the legislation was the opinion that the federal land was worthless without a railroad in the vicinity, and no railroad would build where there was no population. However, if a portion of the land were given to the railroad, in checkerboard fashion, the remaining land still owned by the government would become far more valuable. Thus, the sale of the land could be used to finance the railroad, which in turn made both the railroad's land and the government's land more valuable. In reality, Congress viewed the land grants not as subsidies, but as investments to make federal land marketable.

As the Illinois legislature began meeting in 1851, there were three rival groups vying for the right to build the railroad in Illinois and receive the federal grant of over 2.5 million acres. The winning group, composed of Eastern capitalists, was led by Robert Schuyler ("America's Railroad King") and Robert Rantoul [Stover, 1975, p. 26]. This group's earlier successful development of the New York and New Haven Railroad seemed to be an important ingredient, given the need for the involvement of credible and experienced management. In return for the rights to the federal grant, the Schuyler/Rantoul group agreed to pay

[2]State governments had previously used land grants to support canal building [Baskin and Miranti, 1997, p. 133].

the state a tax consisting of a percentage of gross receipts. This tax, set by the legislature at seven percent, exempted the corporation from paying Illinois state and local taxes.[3] Eventually, the revenue from this tax enabled the state to pay off its debts from an ill-fated internal improvements program of 1837. The IC was officially chartered on February 10, 1851, when the Illinois governor signed the charter bill after passage by both houses of the legislature.

The IC is the only major rail carrier in the U.S. that operated under its charter name for more than 150 years. Chartered on February 10, 1851, parts of the IC system date back even further. For example, the West Feliciana Railroad in Mississippi, chartered in 1831 as the first railroad west of the Appalachians, became a part of the IC in 1892 [Stover, 1975, p. 228]. As noted previously, the IC was the first land-grant railroad in America. The land-grant details specified that the states of Illinois, Mississippi, and Alabama were granted a right of way through the public lands for the construction of a railroad to extend from the western end of the Illinois and Michigan Canal to Mobile, Alabama, by way of Cairo, with a branch to Dubuque, Iowa, by way of Galena and another to Chicago [Gates, 1934]. The Mobile and Ohio Railroad would be the southern land grant railroad to complete the link of the Great Lakes and Gulf Coast when the lines met on the Ohio River at Cairo.

Notable political and popular figures were associated with the IC. Its corporate attorney in the 1850s was Abraham Lincoln. Some of Lincoln's most famous cases were on behalf of the IC, and his son later became a director of the company. The promoters and senior managers of the early IC included many linked to important names in American financial circles. Jonathan Sturges (1782-1863), a founding director who participated in the syndicate to incorporate the IC, had learned business in the counting houses of Boston, and eventually formed his own investment concern [Johnson and Supple, 1967, p. 22]. Sturges' youngest daughter Amelia married J. Pierpont Morgan in 1861. Tragically, she suffered from tuberculosis and died on their hon-

[3] This exemption had far-reaching implications. When McLean County tried to assess the IC's property, corporate attorney Abraham Lincoln took the case to the State Supreme Court where the local exemption for both land and operating property was validated. The result was that buyers of railroad lands were content to delay payment on land notes for as long as possible so the land would stay under IC ownership and be exempt from taxes. As long as the landholders were willing to pay interest, the IC management was willing to be lenient with respect to payment terms [Decker, 1964, p. 13].

eymoon abroad [Baughman, 1966]. Another daughter of Sturges married William H. Osborn, who was to become a dominant figure in the IC from 1853 to 1882 [Cochran, 1953, p. 422]. Osborn, who became involved in 1853 when President Robert Schuyler "retired," is identified as the president of the IC as early as 1855 [Brownson, 1915, p. 41]. Popular and folk heroes identified with the IC abound. Samuel Clemens (Mark Twain) piloted IC steamboats on the Mississippi and Ohio Rivers from 1859 to 1861.[4] Train engineer "Casey" Jones died on the IC's "Cannonball Express" train wreck at Vaughn, Mississippi, in 1900. George B. McClellan and at least 19 other Civil War generals served as corporate officers of the IC either before or following the war. In fact, the 1857 annual report identifies McClellan (later Lincoln's opponent in the 1864 presidential election) as the only vice president [Stover, 1975]. Another future general, Ambrose Burnside (the inventor of sideburns), was the treasurer in 1860.

Within four years of being chartered, the IC had more than 600 miles of track, making it by the mid-1850s the longest railroad in the world, bisecting Illinois from Chicago to Cairo and veering westward at Galena into Iowa.

FINANCING THE IC

The incorporators' plan for financing the IC was simple and, to insiders, most attractive. They anticipated using the land grant as security for a bond issue, primarily to European investors, the proceeds of which would pay for construction. Thereafter the bonds could be paid off with proceeds from the sale of the land, whose value was enhanced by the passenger and freight transportation provided by the railroad. This plan would permit the incorporators to own the railroad and to operate it with minimal investment.[5] It was outlined in a letter in 1851 from one of the incorporators to a Boston business associate as follows [Johnson and Supple, 1967, pp. 134-135]:

> The fact is that it is expected to pay for the whole Road by the sale of lands – It would be rather a singular thing if it should turn out that this company should own a Road … and cost the stockholders [the present ones]

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[4]Before a bridge could be built across the Ohio River, the IC exchanged freight shipments with the M&O via steamboat. Thus, coast-to-coast rail service was available even before the two lines were connected via the Ohio River Bridge.

[5]The leveraged buy-out artists of the 1980s merely were mimicking the business model of the "Railroad King" who won the bid to build and operate the IC.

> nothing. … Come … see for yourself – all depends on the selling of the Bonds. Please keep this to yourself.

In March 1851, the IC board of directors held its first meeting, elected Schuyler as president, and authorized a deposit of $200,000 with the State of Illinois to guarantee good faith on behalf of the incorporators. The $200,000 came from the sale of stock to the 13 incorporators[6] [Stover, 1975, pp. 28-30]. The incorporators wanted to keep their cash investments at a minimum, and they would later respond to assessments of their stock that would far exceed their original plan or intention. Bond sales were slow, particularly in Europe where investors, especially in Great Britain, were wary of the State of Illinois because it had missed interest payments on several loan agreements related to the financing of earlier public works projects. However, by adding options to buy stock, large quantities of bonds were eventually sold in mid-1852 in both the U.S. and in Europe [Stover, 1975, p. 35].

In the fall of 1851, IC president Schuyler had dispatched Robert J. Walker, a former secretary of the treasury during the Polk administration, to England to sell IC mortgage construction bonds. Walker had many wealthy friends in Great Britain. He was to receive a one percent commission per dollar of debt placed. David Neal, an IC vice president, sailed with Walker on the *Atlantic*, the finest and fastest Cunard line ship. Upon reaching Liverpool, Neal continued to Holland to try to place the IC bonds with Amsterdam and Rotterdam investors. It was initially felt that the bonds would be easily placed because of the 2.5 million acres of land serving as collateral for the debt. Unfortunately for the IC, the missions of Walker and Neal failed miserably. No bonds were sold. Europeans wanted nothing to do with any security with "Illinois" on it, given the investors' experience with their 1837 Illinois bonds, $15 million of which were still outstanding and in default [Stover, 1975, pp. 32-35].

Another reason that the IC bonds could not be placed was that the IC was headed by Robert Schuyler, a "gambler, not a railroad man" in the eyes of the Europeans who had prior investment experiences with Schuyler railroads. Second, William H. Swift, a West Pointer and former army officer, was advising the British investment house of Barings Brothers that the IC land, which backed the bonds, was being appraised at too high a

[6]Actually, the incorporators subscribed to $1,000,000 of stock, but the initial assessment was for only 20% of the stock subscribed [Stover, 1975, p. 32].

value by company officials [Stover, 1975, p. 33]. In actuality, the 2.5 million acres were probably not worth more than $3 million in 1851, but company estimates placed their future value (1856) at a hundred times greater, an appraisal that seemed extremely far-fetched at the time but was to prove accurate. In addition to Barings, the House of Rothschild also turned down the offer to buy IC bonds. Walker and Neal returned to America in December 1851 without a single bond sold.

Spring 1852 brought new hope to the IC. First, $4 million of bonds were sold to U.S. investors. These bonds carried a seven percent interest rate with an option to buy ten shares of stock for each $1,000 bond. This latter feature made the bond sale successful. The IC directors realized that the equity had to be increased since the ownership interest could not be limited to only 13 investors. During the same time that the bonds were sold, the Michigan Central Railroad subscribed to $2 million of IC notes in exchange for the right to use the IC rail line into Chicago after it was built. The Michigan Central had no access into Chicago and was desperate. Consequently, despite the disdain that its management had for the over-leveraged IC, the Michigan Central helped the IC start its construction.

With this start-up capital raised, David Neal and George W. Billings sailed to England in March 1852 to try again to sell IC bonds. This time the English investment syndicate headed by Charles Devaux & Company bought $5 million of IC bonds. The interest rate was six percent and the owner of each $1,000 bond was given the option to acquire five shares of IC stock. Again, it was that option that made the loan attractive to the Devaux syndicate. In addition, extant copies of the bonds (see Exhibit 1) indicate that the investors were allowed to pay in the loaned amount in ten quarterly installments starting in August 1852 and ending on October 1, 1854. This payment schedule coincided with the IC's need for financing its construction progress. With the bond issue fully subscribed by August 16, 1852, Neal and Billings set sail for America knowing that the IC had the financing that would guarantee the construction of the railroad [Stover, 1975, p. 35].

The IC's construction began, but scandal soon overtook the organization. Schuyler, the IC's absentee, part-time president, was its first wreck even before the trains began running. Between the fall of 1853 and the summer of 1854, Schuyler found that holding the dual roles of both the president and the transfer agent for the New York and New Haven Railroad, in addition to his presidency of the IC, was too tempting, and he succumbed

EXHIBIT 1

Illinois Central 1852 Installment Bond

to selling unauthorized shares of the New York and New Haven stock and pocketing the proceeds. When Schuyler became ill in early July 1854, Morris Ketchum, the locomotive builder and one of the IC's founders, took over Schuyler's duties and uncovered his misdeeds. Schuyler resigned from all of his posts and fled to Canada. Even though the IC was not involved in the fraud, European investors were shaken. By late August 1854, IC bond prices had fallen to 62% of their face amount with the stock plummeting as well [Stover, 1975, pp. 35-36].

The commencement of operations, however, soon led investors to forget the Schuyler matter. During the next two years, European ownership of IC securities increased. The price of the IC securities rebounded as the farmland sales in Illinois were being promoted throughout the European continent. By 1856, 80,000 shares of IC stock ($100 par value) and $12 million of bonds were held by European investors, primarily British. The bonds, because of the right to subscribe to stock, were an attractive but speculative investment. In particular, the subscription price of $20 controlled the $100 par stock. This was a highly leveraged way of speculating in the completion of the railroad. The British ownership of IC securities amounted to over 50% of the outstanding subscribed shares; Dutch and American investors each owned 15%. Thus, within the U.S., the IC was viewed as a foreign-owned corporation. Among the largest IC shareholders were noteworthy Englishmen such as Richard Cobden, William Gladstone, John Bright, and Samuel Cunard (the shipping magnate).[7]

Investors were caught off guard on August 10, 1854, when the IC demanded a $5 per share call against the common stock subscribers. This call was followed by another $5 per share call on December 10, 1854. These calls for additional capital contributions were a surprise because the shareholders had subscribed to the IC stock believing that their $20 down payment for each $100 share would be the extent of their investment. This understanding had been based on the early leverage strategy employed by the initial directors. Actually, the 1854 assessments were due to cost overruns on construction

By 1857, IC stock was selling for $120 per share, and bonds were selling at par or higher. According to the *American Railroad Journal,* "no other Company enjoyed the unlimited confidence of money lenders of England and America to the same extent," as the IC [Corliss, 1951, p. 92]. This rapture was quick to change. The Panic of 1857 affected all companies in America. Illinois land speculators who had borrowed to buy federal land on the expectation of rising land prices were hard hit. This, in turn, led to bank foreclosures and land sales at distressed prices. The European investors became concerned about the value of their collateral, the two million unsold acres that the IC held. The value of the land from the federal grant again became an important issue to European investors. By September 1857, there had been more calls on equity investors for capital. At the same time,

[7]Gladstone, Cobden, and Bright were all members of the British Parliament at various times in their careers. Gladstone, a former Chancellor of the Exchequer, became prime minister in 1868. In his early career, he had been junior lord of the Treasury and under-secretary for the colonies. In 1844, he had been responsible for the passage of a railway bill. Cobden and Bright were defeated in the 1857 election, and Gladstone was put out of office that year because of the change in prime ministers. As a result, all three seemed to have leisure time available to deal with IC issues.

both stock and bond prices had dropped about 50% during the year. This led to British investors forming the London Protective Committee. William Gladstone, a former Chancellor of the Exchequer, was elected the head of the group. The IC's 1858 annual report to shareholders noted, with respect to these London meetings [IC, March 16, 1859, p. 2]:

> ...no direct representative of the company, intimate with its affairs and fully cognizant of the various ramifications of its interests, is present to take part in the discussions, can hardly fail to be injurious to the general interests, and the Directors respectfully suggest to the English Shareholders that at least sixty day's notice of any such meeting and its objects, be given, that, if possible, one of their number may be present.

From the time the first bonds had been issued in 1852, the British shareholders had exerted a powerful influence on the affairs of the IC, but the Panic of 1857 caused the overseas investors to seek even more control over the company's operations. The 1858 annual report stated that two gentlemen from the London Protective Committee had visited Chicago to examine the company's books. It is likely that they also inspected the railroad's assets, including the constructed line and the unsold acres of land. Apparently, this visit was positive for both sides, and the result was an attempt to arrange a line of communication between management and the English investors [IC, 1857, p. 2].

In 1859, Gladstone appointed Richard Cobden to come to America to evaluate the true condition of the IC. Cobden was reportedly impressed with what he saw. After seeing the quality of the company's lands, Cobden wrote back to England of his support for President Osborn and his endorsement of the fiscal policies of the company [Stover, 1975, p. 37]. In return for his support, Cobden had a town named for him in southern Illinois as did other British shareholders Lawrence Heyworth and Sir Joseph Paxton [Corliss, 1951, p. 92]. The 1859 annual report [IC, 1859, p. 1] noted:

> At the urgent request of the London Committee, the Directors deferred calls [assessments] in 1858 and 1859, although they believed then, as they do at the present moment, that the fact of this Company situated as it is, with unassessed capital, presenting itself as a borrower for short periods, at high rates of interest, has been the chief reason for the depreciation of its securities in public estimation.

The "interference" with the London Protective Committee was then discussed [IC, 1859, p. 2]:

> *London Committee:* The experience of the past year has confirmed the Board in the opinion expressed in the last annual report, that it is not practicable to act with sufficient promptness and efficiency in concert with a Committee of Shareholders in London, inasmuch as a decision upon the Company's affairs cannot be speedily arrived at by correspondence: therefore the Board will consider their relations with the Committee as terminated, unless otherwise directed at the next meeting of the Shareholders. We are informed that a majority of the present Committee concur in this opinion.

EARLY CORPORATE REPORTING, 1851-1861[8]

At a time when the patterns and expectations about the content of published annual reports were not well established, the IC was thorough in its reporting. In retrospect, the European investors should have been able to get a reasonable understanding of the company's operations from the published reports. The stockholder report series began with a three-page report dated November 20, 1852. That report covered the activities from the founding of the company on February 10, 1851 through November 1, 1852. A rudimentary receipts and expenditures statement and a budget (ways and means) statement are all that accompany the single-page letter of President Schuyler.

This first report provides few clues about the capital formation and construction issues that would develop in the years to follow. This is not unexpected given the fact that most of the issues had not yet been worked out and probably no real plans had yet been developed. The next report (from approximately November 1852 to December 31, 1853) has not been located although it is listed in the catalog at the Newberry Library. The next available report, which contains financial statements for 1854, although dated January 1, 1855, is addressed to the Directors of the Road. There were 441 shareholders identified as subscribing to 127,690 shares as of that date. The statements provided in the 1854 report are identified with the capital letters A, B, C, and D. The four are (A) a type of balance sheet, (B) a form of expenditures statement, (C) a unique interest fund state-

[8]The IC annual reports are available at the Newberry Library in Chicago [see Mohr, 1951, for holdings], the Williams Library at the University of Mississippi, and the Bruno Library at the University of Alabama.

ment, and (D) a budget (ways and means) reporting the status of bonded indebtedness.[9] The latter two appear to respond to the terms of the mortgage bond indenture agreement of June 23, 1852, between the IC and the bond trustees. The terms of the agreement, as detailed in sections six, seven, and eight of the indenture, appear to establish a special account for the funding of interest payments. Steps were taken to prioritize interest payments, including assigning operating revenues for that purpose as needed and earmarking 250,000 acres of land as security for the payment of interest.

By the end of 1855, the first full year of operations, the report had expanded to over 50 pages of fine print. The financial statements are provided on four pages (pp. 13-16) and follow the pattern of the previous year but without the alphabetic designators. Although there was no external auditor, the statements for years after 1854 were examined and approved by a three-man audit committee of the board of directors.

The need to produce such summary statements from detailed records, as found in these early years, versus using the records themselves seems clear. There was no "income statement" because operations did not begin until late 1854. Also, the company did not begin public land sales until October 1, 1854, although, as indicated earlier, land had been pledged as security on various bond issues and to secure the interest fund.

A full balance sheet appears for the first time for the year ended 1856. Each line of the balance sheet is keyed to abstracts, identified as A through H and printed immediately below the balance sheet, that provide details on the capital stock, the construction bonds, the free land bonds, and the other keyed lines on the balance sheet; e.g., short-term debt (scrip) and floating (working capital) liabilities. The statement set concludes with a novel determination of net earnings, which is then reconciled with the interest fund to assure adequacy of that account. The next year's statements follow this pattern of reporting, and a

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[9] Alphabetic designation of reports, it should be observed, was found to be a common practice in the Baltimore & Ohio Railroad statements beginning shortly after it was established in 1827 [Previts and Samson, 2000]. However, the B&O statements are different in content. So it does not appear that the IC was simply following the pattern of other established roads, but more likely was responding to the information needs of the British creditors who were concerned about the integrity of their interest payments and the related principal. Lardner [1850, p. 424] referred to detailed reports with numbered statements in his 1850 book on railway economics. He stated that such practices were not typical in Britain, but were used by Belgian railroads.

resume of cash transactions (a cash-flow statement with full particulars) is added. With minor exceptions, through the year ended 1861, the form and content of the IC financial statements seem to follow what was established by 1856, with a balance sheet detailing the assets committed to the interest fund as the principal statement. The IC's income statement, designated as the "Interest Fund Account" (see Exhibit 2), was not carried to stockholders' equity, but to an account essentially equivalent to "Bondholders' Equity." Again, this was an indirect capitulation to the British venture capitalists and their claims to the earnings streams of the company. The concept is in sharp contrast to proprietary theory, which would call for the residual to be credited to owners' equity.

Comparative columns are added in some instances in the annual reports, such as for expenditures, so that trends between years, starting in 1852, can be studied. In fact, the reports are useful benchmarking documents with many examples of five-year trends.

The 1857 report contains an opening statement that asserts that the annual report is indeed a report to provide information useful for investment decision making [IC, 1857, p. 1]:

> The Directors submit herewith the Reports and Statements of the Officers of the Company in charge of the several Departments of its business, to which the careful examination of the Shareholders is invited, as affording sufficient data to enable each proprietor to form his own judgment as to the value of his investment and the details of its administration.

Many examples can be found of analyses of managerial decisions; for instance, the 1859 report [IC, 1859, p. 6] includes a study of the advantage of burning coal over wood. Finally, the economic development of the region is highlighted.

REGIONAL ECONOMIC DEVELOPMENT REPORTING

Beginning with 1854, the tenor of the annual reports began to change with respect to the information content about the railroad's impact on economic development. The 1854 report referred to the growth of new towns along the line and the financing by bankers of coal fields in the vicinity of the railroad. Economic development was occurring and following the path of the railroad. The report [IC, 1854, p. 1] states that:

> The Prairie lands of Illinois are the garden of North America, and when peopled will become the granary of

EXHIBIT 2

IC Interest Fund Account, 1856

ABSTRACT I. INTEREST FUND ACCOUNT.

CREDIT BY RECEIPTS FROM OPERATION:

	JANUARY.	FEBRUARY.	MARCH.	APRIL.	MAY.	JUNE.
Passengers	$60,986 30	$58,978 31	$84,676 43	$106,357 89	$100,443 56	$107,568 51
Freight	78,555 99	57,872 46	77,819 90	86,443 65	86,075 49	82,393 85
Extra Baggage	153 86	296 80	429 74	782 10	1,444 01	1,199 50
Mails	4,649 06	4,649 07	4,649 07	4,645 93	4,645 93	4,645 93
Express	1,957 50	1,957 50	1,957 50	1,957 50	1,957 50	1,957 50
Rents	502 98	502 98	502 98	502 98	502 98	502 99
Rent of Road	3,035 57	2,796 07	4,119 87	5,501 81	6,955 66	9,655 96
Rent of Engines and Cars						
Storage and Dockage	199 58	199 58	199 58	199 58	199 58	199 59
Totals	$150,040 84	$126,752 77	$174,355 07	$206,841 41	$202,224 02	$208,093 89

	JULY.	AUGUST.	SEPTEMBER.	OCTOBER.	NOVEMBER.	DECEMBER.	TOTAL.
Passengers	$93,995 17	$87,459 60	$110,651 12	$112,377 51	$51,682 52	$59,831 45	$1,064,978 46
Freight	77,169 96	118,108 05	109,505 82	111,397 03	85,567 10	67,578 31	1,037,987 55
Extra Baggage	965 31	721 51	647 82	509 55	796 54	687 81	8,584 49
Mails	4,686 90	4,686 90	4,686 90	4,649 25	4,649 26	4,649 26	55,893 46
Express	1,998 52	1,998 83	1,998 83	1,500 00	1,628 58	1,628 58	22,558 54
Rents	486 83	486 83	456 84	924 06	924 06	959 07	7,285 58
Rent of Road	9,525 10	8,130 98	10,677 46	9,242 33	8,646 26	6,514 63	84,881 70
Rent of Engines and Cars				2,625 01	2,625 01	2,625 02	7,875 04
Storage and Dockage	271 09	271 09	271 09	588 91	588 91	581 17	3,669 75
Totals	$189,099 18	$221,893 82	$238,925 88	$244,123 65	$187,058 19	$145,055 25	$2,293,964 57

To this add amount credited Operation by Construction Account, being for conveyance of Construction Materials, charged at one cent a ton per mile	24,496 29
Also, Fuel and Supplies used on Construction Engines, the same having gone into Operation Expenses	22,050 00
Also, Balance of Profit and Loss Account	16,653 20
Gross earnings from all sources, 1857	$2,357,203 06

LESS OPERATION EXPENSES:

Insurance		$5,017 96
GENERAL EXPENSES—		
Sundry Expenses	$30,882 93	
Advertising	2,467 64	
Stationery and Printing	25,277 84	
Telegraphing	5,023 44	
Foreign Agencies	34,209 05	98,360 90
MAINTENANCE OF WAY—		
Repairs of Road	$351,405 79	
Repairs of Bridges	11,929 43	
Repairs of Hand Cars and Road Tools	10,801 18	374,136 40
STATION EXPENSES—		
Station Agents and Clerks	$89,090 38	
Station Labor	86,142 64	
Station Expenses	38,512 68	
Pumping Water	29,078 35	
Switchmen and Watchmen	32,357 72	
Repairs of Station Buildings	13,558 66	
Repairs of Water Works	11,647 16	300,987 59
MAINTENANCE OF MACHINERY—		
Repairs of Machinery in Shops	$20,289 23	
Repairs of Passenger Cars	52,684 45	
Repairs of Freight Cars	88,944 42	
Repairs of Coal Cars	6,736 37	
Repairs of Passenger Engines	62,805 13	
Repairs of Freight Engines	79,889 49	310,850 09
Forward		$1,089,361 94

TRAIN MEN— Forward		$1,089,361 94	
Passenger Conductors and Brakemen	46,445 94		
Freight Conductors and Brakemen	44,776 00		
Passenger Engineers and Firemen	38,545 73		
Freight Engineers and Firemen	51,853 08		
Cleaning Engines	29,701 40	211,322 15	
SUPPLIES—			
Oil	$44,674 23		
Tallow	1,846 54		
Waste	5,847 41		
Baggage Checks and Badges	1,334 28		
Hauling Supplies	6,518 09	60,220 55	
Salaries		78,437 68	
FUEL—			
Preparing Fuel	$101,635 38		
Wood	158,112 00		
Coal and Coke	21,860 74	281,608 12	
Legal Expenses		6,162 20	
Snow Expenses		25,135 26	
Operating St. Charles Air Line		1,914 34	
CLAIMS—			
Damages to Persons	$3,278 95		
Damages to Property	4,313 05		
Damages to Stock	16,275 85		
Lost and Damaged Frieght	14,850 95		
Lost Baggage	1,716 02	40,429 85	
Repairs of Fencing		1,639 05	1,791,231 14

Leaving net earnings for 1857, from Operations of Road		565,971 92
From this deduct Charter Tax	145,645 84	
And balance shown at debit Interest Fund account, per last Report	28,852 60	174,498 44
		$391,473 48
Add amount arising from sales of Interest Fund Lands, etc., as per Land Office Report		300,529 44
Net balance at credit, as shown in General Balance Sheet		$692,002 92

> the Mississippi. The Illinois Central R.R. passes through the best of them, bringing them within easy reach of a market. Its lands also include large and valuable Coal fields.

When rail operations began, management presented financial information in great detail, including monthly revenues and costs at each depot along the line. Revenues by depot were also listed by the nature of the item shipped. The 1855 report included a spreadsheet with 32 columns for the transportation of different types of commodities, including wheat, rye, hogs, whiskey, apples, butter, cheese, and coal. Such detail, in ever-declining print size, continued throughout the pre-Civil War era. By 1860, the spreadsheet had 42 columns, all prepared without benefit of computer. The IC management also provided extensive commentary on the economic environment within which the company operated. For instance, in the 1855 report, a table listed every station along the line, with columns for the population, the number of houses, and the number of churches, schools, stores, hotels, mills, factories, and physicians in 1850 and 1855 [IC, 1855, p. 3]. The 1855 report went on to mention the growth in the importance of coal traffic on the railroad: "We are fully persuaded that the coal traffic will become one of the most important elements of profit to this road" [IC, 1855, p. 4]. The report also included a forecast of $2.5 million of income for 1856 and a prediction that the road could be operated for fifty percent of its gross revenues.

Given that the IC owned a great deal of land, it was only appropriate that the annual report discuss the sale of land to settlers, which amounted to $5,598,577.83 for 528,863 acres, or over $10 per acre in 1855. The 1855 report also mentioned that since the 1851 grant, the federal government had disposed of nearly three million acres of land within 15 miles of the company's tracks, and that the counties adjacent to the railroad had experienced a population increase of over 250,000 between 1850 and 1855 [IC, 1855, p. 5]. At the time the report was issued in March 1856, the IC had 515 stockholders, mostly British, holding 129,256 shares, each share having thus far been assessed for an average of $20 [IC, 1856, p. 9].

Management identified itself with the economic development in the region in the 1855 report with the following paragraph [IC, 1855, pp. 10-11]:

> …an examination of the statistics of the progress of the country since it has been opened by railroad com-

> munication, evidences the great value of the Company's lands, from which, in the opinion of the Board, the entire cost of the road will be realized, leaving free of cost to the Stockholders, the revenues of this great highway, which unites the waters of the Northern Lakes, with those of the Ohio and Mississippi, soon to be joined at Cairo by the Mobile and Ohio Railroad, … and will, when completed, form the great avenue of communication from the Northern States, to the important cities of the Gulf of Mexico.

The above comment was after the 1854 assessment call on stock subscribers, yet management still was maintaining that the entire cost of the road would be paid for from land sales, leaving the revenues "free of cost to the Stockholders."

In the annual report section entitled the "Report of the Land Commissioner," there were indications that the report might have some public relations or marketing objectives, a factor not atypical from modern annual reports.[10] It was noted that some of the company's land "is rolling, undulating like the waves of the ocean under the influence of a gentle breeze" [IC, 1854, p. 42]. Other pages celebrated the fertility of the soil, the massive deposits of coal and other minerals, and the fact that the lands were well watered. This line of argument concluded with the impact on economic development [IC, 1854, pp. 43-44]:

> In no other instance, probably, have such abundant benefits flowed from like causes. To the Government, the lands were comparatively valueless; to the State, they were in no way profitable; to the farmers, their productiveness was of no avail, while the quarries of stone and marble, and mines of coal with which the lands abound, were wholly undeveloped. … This Company took these lands thus comparatively valueless…, and by the expenditure of about twenty millions of dollars, imparted vitality to the whole matter by the construction and equipment of this road.

In the event that stockholders, many of whom were in far off England, failed to understand the underlying meaning of the preceding statements, a concluding paragraph attributed to the company president bragged [IC, 1854, p. 46]:

> The gain to the State has been a largely increased popu-

[10] For a study of the public relations and marketing aspects of annual reports, see Graves et al., 1996.

> lation of industrious, intelligent, and enterprising citizens, chiefly producers, a very heavy increase of taxable property, an immense acquisition of trade and capital, and seven per cent of the gross receipts of this road, which will soon go far towards relieving the people from all taxation for State purposes.

President Osborn was publicizing the economic progress of the state being served by the company, thereby promoting the IC's cause. Whether this was for the purposes of encouraging further land sales or merely an attempt to appeal to the penurious interests of European investors cannot be known.[11] Nevertheless, it should have accomplished both purposes.

The 1856 annual report continued the story of economic development, with analyses by the directors of changes that had occurred in virtually every town along the line. For Kankakee, it was noted that the population had swelled to 3,000 and that "this will become a smart inland town, being beautifully situated; eligible lots are worth $750 to $1,200. It is difficult to realize that 3 years since the tract of timber, about 900 acres, on which the town is located, was sold at $15 per acre." For most towns and villages, the report was glowing with respect to development. For Cairo, it was noted that land prices had doubled from the preceding year [IC, 1856, p. 2].

Much of the 1857 annual report was devoted to the problems the company had faced due to the Panic of 1857, a major snowfall in January and February, and record floods late in the year. All of these dislocations slowed railway operations. Still, there was room for continued discussion of economic development. For example, it was noted that on the west side of the tracks from Calumet to Mattoon, a distance of 150 miles, there had been erected 639 dwellings, 400 out-buildings, 114 orchards, and 56,352 plowed acres, none of which existed a few years earlier [IC, 1857, p. 9].

The question remains as to why IC management elected to publish such detailed annual reports, given that they were not

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[11] The European investors, noting the extensive and "lavish" IC advertisements for land in their newspapers and magazines had been concerned about the "waste" of money. However, the ads did seem to support the outcome of drawing large numbers of European immigrants as the availability of rich, cheap farm land was appealing in a place where land was held by the nobility and the landless worked for this gentry. Victims of the Irish potato famine were also targets of the ads. The IC reports were intended to soothe the European investors' concern that the ads were a waste of money.

mandated to do so by the corporate charter. It appears that both subsequent contracts, (1) the bond indenture with British investors and the corresponding need to establish organizational legitimacy, and (2) the need to promote land sales, were addressed by the form and content of the annual reports. Such detail also might have been a way of signaling directors and distant investors that management had control over operations. To this end, writing to J. Newton Perkins, the treasurer, in July 1856, Osborn observed [Cochran, 1953, p. 423]:

> I do not think any of them [directors] are aware of what an immense machine this is to handle and I do wish them to understand more fully the details of this enterprise. I am left alone to this business and have no time for my family and for those hours of leisure which the other gentlemen enjoy.

If Osborn thought the directors did not understand the extent of operations, he surely had even stronger feelings about the distant European venture capitalists.

Management was desirous of reporting more than financial numbers. In the broadest sense of corporate reporting and communication, the accounting that occurred went "beyond the numbers" to include evidence relating to economic development. Management indeed believed that the IC was the core of economic development in the Midwest, and that development was a virtue for which the IC should be recognized. Ultimately, the IC was the source of many precedents. Later land-grant railroads adopted the IC's classification and appraisal system as well as its contract and credit systems. In addition, the IC's colonization and advertising techniques were later used by other land-grant railroads [Decker, 1964, p. 101].

SUMMARY AND CONCLUSIONS

This study of the earliest annual reports to shareholders of the IC supports a conclusion that the statements, as to form and content, were developed to serve the needs of two classes of statement users, European investors and politicians, on the one hand, and the general community on the other. The balance sheet orientation and the interest fund emphasis indicate the need to provide the European bondholders with the data required by the bond indenture. A preliminary and supportable premise of this work is that the bond indenture was the legal agreement and document that drove the development of the IC's financial report content. At the same time, the European stockholders demanded more information than would an investor who could see the trains passing by on a daily basis, or who could see land being sold and farms and towns being developed. Further, the need to report to the public as to the success of the company's role in its "social contract" to develop the state required the details of transactions of a demographic nature, which were provided by the land commissioner. Operating details, on a station-by-station basis, also served as evidence of the impact of the railroad's service in areas that had heretofore been wilderness. In modern parlance, the details of the reports might be rationalized by the need to establish organizational legitimacy [see Deegan, 2002; Milne and Patten, 2002].

Alternatively, a critic might suggest that instead of trying to impress readers with the quality of reporting, management was merely trying to defend itself against investor criticisms with a quantitative response in the form of detailed analyses of routine items. The large quantity of data helped to hide recognition of conceptual issues for which management either had no answers or for which publication would cast the company in an unfavorable light, such as the deduction of depreciation expense.

During the 1850s, the IC was more than a railroad; it was the change agent in a major social experiment, an attempt by government to foster economic development by using raw, fertile land to motivate not only corporate investors, but to attract a productive population as well. The glue that held this experiment together was the financial capital provided by European investors. This experiment, as detailed in the narrative of the annual reports to shareholders, proved successful, at least that is the conclusion based on the information provided by IC management. Population and agricultural productivity swelled, despite major disturbances, including the Panic of 1857.

This project has assisted in identifying several reporting practices that had not heretofore been acknowledged. Examples are the early use of cash-flow statements, the identification of "net earnings," and extensive social economic reporting. Perhaps a more important example is the British investors' practice of sending representatives to America to examine (audit?) the IC during the late1850s. To what extent this can be compared to the external audit of today is conjecture at this point, as well as whether this was the start of British auditors coming to America on behalf of English investors as occurred extensively several decades later. In any event, the dispatch of representatives of British investors was reassuring for those providers of capital as to the soundness of the IC assets, the progress made by the railroad's development program, and the reality of its financial numbers. Given Schuyler's scandalous departure and the volatile and speculative economic condition of the "Wild West," the use of an inspector/auditor representative seems most prudent given that the investors' agency problem was magnified by distance. Finally, while not original with the IC, additional assurance of proper control over funds was ensured by the use of the audit committee of the board of directors.[12]

The examples in the preceding paragraph are not necessarily to be construed as "firsts." However, these early uses support an *a priori* belief that the corporate form of business, and the need to please distant European investors, served to justify and instigate such reporting practices. Further study, employing a larger set of antebellum railroad reports, is needed to support this assertion. For example, the Mobile and Ohio Railroad, the IC's southern sister, first issued British notes in 1854 through George Peabody, commencing the M&O's relationship with the London capital market [Samson et al., 2003, p. 338]. The M&O annual reports seem to be equally informative as those of the IC.

Finally, this study represents an initial inquiry into the annual shareholder reports of the IC. This major corporation, which began as an economic development project to some and a leveraged land speculation to others, appears to have enjoyed success by the end of the period under study. Sharing in this success were European investors who made up the majority of the IC's owners and creditors. More than just sharing in the success, the European investors were seemingly responsible for the detailed financial reporting of the IC. The need to satisfy investors in another hemisphere led to detailed financial reporting at the IC and at future railroads that emulated it. This narrative ends with 1861, as by then the nation was engaged in a violent Civil War whose outcome would change the character and role of the IC and other railroads. That is another story.

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[12]For more on the early use of audit committees, see Flesher et.al., 2005.

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