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SOME OBSERVATIONS ON THE EXTENT OF BANK AUDITS IN AMERICA: 1800-1863

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It is easy, in the light of today, to look back on the America of yesteryear as a simple bucolic society. And it is true enough that both technology and commercial techniques in the period prior to the Civil War were crude indeed by today's standards. Yet the (largely agrarian) economy did function and prosper; accounting records were (sometimes) kept. And though we may believe that ethical standards of daily conduct were perhaps higher, or people more naive and trusting, surely there was no shortage of devious minds at work, eager to reallocate the wealth of others to themselves. What, then, of the safeguards of that era?

The study described here investigates the extent to which something resembling auditing may have existed or may even have been required by state law. (Most banks which existed had some sort of state or territorial charter before 1863, prior to the creation of a federal central banking system.)

There is no paucity of suggestions that some corroboration of banks' financial statements may have been desirable. Asset valuation was incredibly complex, since most banks (including some totally nonexistent ones), many private companies, and some municipal agencies issued their own notes. Specie also circulated — in some places. (Further, from 1791-1811 and again from 1816-1836, the Bank of the United States, with its own authority to issue "money," existed.)

Uncollectibles were common and were rarely voluntarily written off. Branch banks came and went, often dragging down the parent during their own demise. Monetary panics and localized runs on banks were commonplace. Physical custody and transportation of specie were crude. One might suppose that depositors and governments would have demanded such reassurances as a primitive attest function might provide.

SOURCES

Ideally, accounting history ought to be researched using purely primary sources: original accounting records, reports and supporting evidence. Realistically, this is often extremely costly and awesomely time-consuming, as there is no single repository of primary records. The broader the topic (the less, that is, one wishes to focus solely on, for instance, a single bank), the greater the justification for relying on secondary sources in the form of the works of other historians, though not necessarily accounting historians. Fortunately, there is a richness and diversity of sources on bank hsitory, such that reliance on the judgment of only one or two key authors can be avoided.

One set of documents is a group of studies, done independently and with apparently little recognition of each other, of the banking systems in individual states. Many of these works appear to have been doctoral dissertations which were subsequently published. These works tend to be scholarly, thorough, and rather detached or unopinionated.

There is another set of sources: books written during or shortly after the period 1800-1863. These works are no more abbreviated than the dissertations; indeed, several are in multiple volumes. The authors tend to write in the florid, sardonic style which characterizes much early American prose. The books, though not lacking in scholarliness, read much more like polemics than the first group; the author usually had an axe to grind. These "classics" can be delightful reading, for they shed light not only on the history of accounting and of banking, but on the changing role of the historian and writer. Among the best are the work of Appleton (1857), the economist-journalist Raguet (1840), and a man with the appropriately Dickensian name of Gouge (1833). The somewhat later work by Knox (1903), himself a major commercial figure, is also worthwile.

Of course, these authors, both of the nineteenth and twentieth century, were focusing on banking practices and regulations. References to financial reporting are abundant in some works. (Cable (1923) devotes a whole chapter to the topic.) Others glossed over this facet of banking. The same is true of references to audits and bank examinations. The absence of references does not, of course, prove the absence of accounting and auditing; any such inferences are mine.

EXTERNAL REPORTING BY BANKS

It may be said that the pattern of reporting to the public by banks during this period both parallels and foresees the history of reporting by industrials. That is, reporting was voluntary and sporadic until it was mandated by law in that particular state, and such laws were frequently forthcoming only after abuses: swindles, frauds, panics, and suspensions.

One of the earliest examples of mandatory reporting was in Massachusetts, where, by 1802 (possibly earlier) banks were required to submit semi-annual financial statements to the Chief Magistrate. (Felt, 1839, p. 213). There apparently was no audit required, nor are we told whether the Magistrate's office disseminated the statements to others. In this case, the impetus behind the law was probably prevention, rather than reaction to a particular calamity. The Commonwealth of Massachusetts appears to have evolved the most sophisticated and conservative banking system and laws of any state during those times, including the celebrated "Suffolk system," which required a deposit by country banks in city banks to assure that the country banks' notes would be honored.

It may not be surprising that New England, the longest settled and most industrialized portion of the early nation, developed the first banking regulations. Rhode Island, for one, was a pioneer in both financial reporting and auditing. A compulsory law governing bank reporting was passed in 1809. Even before that, however, bank records were frequently examined — we are not told whether or not in an unannounced manner — by committees selected by the board of directors. (Was this the "audit committee primeval?") Knox, who documents this, goes on to add, "It will be seen that the Legislature of Rhode Island" dealt with the banks in an enlightened manner, and as a result the financial institutions of the State attained a high degree of excellence." (Knox, 1903, p. 373.) Yet even within New England there was no uniformity; Connecticut did not pass a regulatory law until 1836, and reporting in that state and in Maine lagged behind that of their neighbors (Van Fenstermaker, 1965, p. 29).

Elsewhere, in the "Western" United States, reporting was even more haphazard. Though the Territory of Missouri (later a state) had few banks prior to the 1840's, a highly simplistic balance sheet of the State Bank of Missouri was published in the leading newspaper, *The*

Intelligencer, as early as 1820, apparently voluntarily and without audit. (Cable, 1923, p. 337). Rather more detailed balance sheets are available from the Miner's Bank of Dubuque, the first major bank in Iowa, for several reporting dates in 1838, (The fiscal year was an uncommon phenomenon at that time.) though Iowa was still a part of Wisconsin at the time. Alas, the Miner's Bank later failed anyway, and Iowa was left more or less bankless from 1846-1857! (Erickson, 1971, pp. 24 ff.)

Overall, the quality of financial reporting was often abysmal, even where the report itself was mandated by law. As Gouge lamented,

> "Compelling the Banks to give an annual statement of their affairs, is also a favorite measure. But it is not easy to compel them to give a faithful statement. The accounts of the Banks that break look nearly as well on paper as the accounts of the Banks that continue payments. They who are acquainted with the secrets of Bank management say little reliance is to be placed on these accounts." (Gouge, 1833, p. 51).

On the subject of comparability, the ever-disputatious Raguet asserts,

> "The want of knowledge arises from the circumstance, that the nine hundred banks and branches now operating in the United States, are the offspring of six and twenty states, three territorial and one central government, between which there has never been any system of uniform action in relation to the terms of charters of banks, or in reference to uniform periodical returns of their condition as to liabilities and resources. . .In some there is studied mystification in the mode of stating the account, designed to render it unintelligible, and which nobody but the president or cashier of the bank could explain; whilst in others there is a total disregard of particularisation, by placing under the general heads of 'miscellaneous,' 'other liabilities,' 'other specie funds,' and other such items, many important elements of a statement, without which the whole document is deprived of its entity,"

This articulate precursor of Briloff goes on to remark archly that all these reports are then aggregated by the Secretary of the Treasury for his annual report to Congress on the state of the banking system. (Raguet, 1840, pp. 188-189.)

BANK EXAMINATIONS...SOMETIMES

Having looked at evidence from witnesses of the times, as to the lack of reliability of many bank statements, we might expect that means of increasing reliability would be devised. After all, business was already sophisticated enough to adjust its accounts for the time value of money, such that, "Whosoever sells on trust puts on this goods an additional price, equivalent to the interest for the time to which payment is deferred." (Gouge, 1833, p. 22)

It is not evident when the first bank examination or audit took place. The Bank of the United States, in its 1833 report, mentions no audit, and indeed goes to some length and verbosity to defend the propriety of its payment and its planning. (Bank ... 1833, p. 9). A later report of a bank with the same name (chartered in Pennsylvania after President Jackson let its federal charter expire, later failed and revived), shows a line item, "Deduct for the fees and expenses of the Audit, $1,500.00," in a sort of combined cash flow and surplus statement for the year. (Bank ... 1849, p. 36)

In the states, various combinations of laissez faire, audits by committees appointed by legislatures, and examinations by state agencies, existed simultaneously. An 1822 North Carolina balance sheet, for instance, states at the bottom, "I hereby certify that the above statement exhibits the true state & condition of the Bank of Cape Fear on 31st December 1822." The signatory, a Mr. Anderson Clark, is not otherwise identified. (Van Fenstermaker, 1965, p. 30).

A more colorful and enthusiastic opinion was rendered by a committee (membership unknown) in Connecticut in 1836. This followed on the heels of the state's first regulatory law, which, among other things, directed that such a committee be appointed jointly by the State Treasurer, the Comptroller of Public Accounts, and the Commissioner of the School Fund. Vested with the authority to examine under oath and to scrutinize any documents, the committee visited all but one bank in the state, and averred that, "the soundness and solvency of all the banks examined by us is, in our judgment, unquestionable. We believe that the public may place entire confidence in their ability to meet all their engagements; and inasmuch as the present is a time of suspicion and distrust of pecuniary concerns, we feel bound to express ourselves fully on this point. We think nothing short of a state of general bankruptcy can deprive any of our banks of the means of redeeming all their bills." (Knox, 1903, pp. 376-377.)

Of the actual examination technique we know as little as we do of the identity of the auditors. In the neighboring state of Rhode Island, also in 1836, the state authorized a Board of Bank Commissioners to conduct examinations. The Board was later replaced by various designated state officials, only to be revived again in 1857 (not coincidentally, after the banks had temporarily suspended specie payment.) The initial examinations were at preannounced dates, with the not astonishing result that banks glamorized their balance sheets as of those dates by accumulating specie only for the occasion; unannounced audits proved to be more efficacious for the Commissioners. (Knox, 1903, p. 372.) Brice tells us that on an earlier occasion in the same state, an examination, by a temporary committee appointed by the legislature, uncovered one bank — the first one examined — with $580,000 of notes outstanding and some $86 in actual specie! (Brice, 1892, p. 82.) (The same incident is reported, with somewhat different numbers in Gouge, 1833, v. II, p. 47.)

A Louisiana Act of 1842, appointed a Board of Currency. In a commendable display of audit independence, a member of the Board could not be a partner, director or officer of a bank. The Board was to perform a thorough examination of each bank, at least quarterly. Lack of cooperation from at least some of the banks (who had their own political allies) apparently weakened this attempt at regulation. (Caldwell, 1935, pp. 78 ff.)

The law in South Carolina had more teeth in it. The 1840 law was labeled, with refreshing candor, "An Act to provide against Suspension of Specie Payments by the Banks of this State." It was manifestly a reaction to the Suspensions of 1837 and 1839. It called for *monthly* balance sheets, prepared under oath, by the president or cashier for each bank; a monetary penalty of a hundred dollars a day discouraged late filings. Further, the Comptroller General had the power to examine the books of each bank. Failure to make the books available for audit was a misdemeanor. The state also revoked the charters of banks which did not comply. (Clark, 1922, pp. 150-151.)

FRAUDS AND FRUSTRATIONS

It should not be supposed that "audits" by lay committees were more ineffectual than those by state officials. So little is known about the latter that it is not clear that they were in any sense more qualified than the former. After all, the citizens appointed to committees were often business or professional men (we find no mention of women), that is, "people of substance." We might assume that such individuals were familiar with business practices and with the recording process. Moreover, they may possibly have been more zealous than certain state officials whose salaries rested on political appointments. Their activities in the contiguous states of Illinois and Missouri provide some similarities and contrasts.

In Illinois, the state officials themselves had an unusual incentive to be zealous. In 1822, the state auditor plaintively noted that state officials were being paid in State Bank of Illinois notes, which — partly due to the questionable financial conditions — only commanded consumer goods at about 50% of par! (Dowrie, 1913, p. 40.)

This looseness led to the usual remedy of appointment of citizens' committees. In a commendable example of lay conservatism, a Dr. Murphy (not otherwise identified as to his medical specialty, if any), a member of the committee examining the State Bank in 1840, filed a separate report, demonstrating that almost a quarter of the alleged $4,000,000 (rounded) of assets ought to have been listed as suspended debt. (Dowrie, 1913, p. 94.)

At that, the 1840 committee was more successful than its predecessor of 1825, which was unable to thread its way through the loose and incomplete bookkeeping; nor was an accountant appointed by the governor any more successful three months later. It was discovered, however, that the branch at Shawneetown collected a fee for each note protested! (Dowrie, 1913, pp. 394-396.) In 1834, the state treasurer himself made a complete examination of the bank and all its branches, but was thwarted by the sloppy bookkeeping.

In Missouri, the first regular examination by a committee in 1838, was somewhat unsystematic and relied very heavily on the cooperation and credibility of the bank's officers. The 1840 audit was more complete, including the branches and involving more counting and vouching. After a few years of reversion to more casual examinations, the 1848 audit was quite thorough, including a computation of the rate of profitability of each branch. The 1850 committee was more zealous yet, inquiring carefully into specific asset valuations, testing the worth of each investment, and recommending the writeoff of some $300,000 of notes, principally those of their neighbor, the State Bank of Illinois. (Apparently, sloppy bookkeeping does not pay.) The 1854 committee instituted *sampling* in the verification of coins in boxes, though this seems to have stemmed from lassitude rather than from statistical knowledge. (Cable, 1923, pp. 475-488.)

There was no shortage of devious minds nor fraudulent schemes in those days. A Michigan examination of 1838 found that entries were in ink, but the names of debtors and creditors in pencil and subject to change. In the same audit, the teller profferred a box of coins, which was found to be full; a spot examination by the commissioners revealed that the other boxes were full of nails, except for one which was full of broken glass. (Quoted in Erickson, 1971, pp. 22-23).

CONCLUSION

This article explored the major facets of the state of bank accounting and auditing before the Civil War. The crudity of both may seem blatant by today's standards. For the times, however, perhaps we are looking at a tableau of honest men attempting to do their best to minimize dishonesty and failures. The later era was marked by more uniformity and less catastrophe (on the whole, until 1929), but perhaps also by less romance and less "creative accounting."

It is worth noting that in most of the states which have been researched, the quality of examinations appears to have increased during the nineteenth century, though not — to be sure — in a linear fashion. Apparently, legislatures and "auditors" learned from their own mistakes; some were faster learners than others. As suggested by Penn Square and other recent debacles, we are still learning.

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PENNSYLVANIA RAILROAD ARCHIVES OPENED

The Hagley Museum and Library in Wilmington, Delaware has opened the records of the Pennsylvania Railroad for research. This 1,600-linear foot collection includes minutes, board files, and other corporate records of the PRR and nearly four hundred of its predecessor and subsidiary firms. The records of the Pennsylvania Railroad constitute a major resource for the study of railroad corporate strategy, technology, labor relations, and operating practice. For further information, contact the Manuscripts and Archives Department of the Hagley Museum and Library, P.O. Box 3630, Wilmington, DE 19807, or call 302-658-2400, extension 330.