Dividend policy of Spanish railway companies: The accounting for State advance payments (1920-1926)

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Abstract

Some railway companies used different devices for earnings management during the 19th century in order to report higher level of earnings and distribute higher dividends. In Spain, during the 1920s, the State granted public aids to the railway companies to finance the wage increase expenses caused by a new labour normative. The use of the aids and its ambiguous accounting treatment created much mistrust from the society in general to the railway industry. In this paper, we provide novel evidence about the regulation of these aids, because the Government (probably unintentionally) established a maximum level or earnings to report and a maximum ‘permitted’ dividend to the railway companies. MZA and Norte payed the maximum level of dividends during the 1920s by omitting the depreciation charges and by non-recording properly the received public aids. The evidences suggests, overall, that railways used devices for earnings management, the dividends were inflated, and the Government did not regulate with due diligence.

Key words: Railway accounting, Dividends, Spanish Railways, MZA, NORTE.

JEL Classification: M41, M48, N30
1. Introduction

In Europe, it was common that the ownership structure of early railway companies was concentrated on large groups of investors.\(^1\) In some cases, there was no separation between ownership and management, and often, shareholders acted also as directors.\(^2\) These organizational structures, together with the lack of precise and clear normative frameworks,\(^3\) created agency problems (Flesher and Previts 2009, p. 390). Plausibly, this scenario could also create incentives for accounting manipulation, or even for fraudulent reporting practices.

For example, *The Times* claimed in 1866 that railway directors were pressured to ignore all legal and moral obligations to please railway’s owners (Edwards 1986, p. 255). In turn, railway managers defended that shareholders had to receive a stable dividend. This justified applying proceedings for ‘profit smoothing on a large scale’ (Edwards 1985, p. 26).

As the ownership structure became more dispersed, a new conflict arose for railway managers, who had to decide between reporting a specific level of earnings and providing reliable financial statements to shareholders (Edwards 1986, p. 255). Moreover, managers were sometimes assessed as a function of the percentage of dividends on the ordinary shares, which could stimulate fraudulent decision-making. The legal mechanisms to prevent this were usually weak because the dispersed shareholders were disconnected from management and did not have access to the account books (Lee 1975, p. 20).

\(^1\) Conversely, ownership in North American railways was dispersed (Perelman 1997, p. 58). For instance, the *Western Railroad of Massachusetts* had 2,331 shareholders in 1838; the *New York Central* had 2,445 in 1853 and the *Pennsylvania* had more than 2,600 (Sobel 1965, p. 54). In contrast, the *Liverpool-Manchester* had only 364 shareholders in 1824-5 (Pollins 1952, p. 91).

\(^2\) Midway through the 19th century, some railway directors were also shareholders, appointed among shareholders, and who worked as part-time shareholders representatives (McCartney and Arnold 2003, p. 836).

\(^3\) The first phases of railway companies were considered the peak of *laissez-faire*, however since the 1830s there were calls to ensure capital was not used imprudently (Glynn 1984, pp. 103, 106). However, vagueness and imprecision in normative frameworks during the 19th and 20th centuries created difficulties in defining and computing distributable profit (McCartney and Arnold 2003, p. 833). The statutory requirements on available profits for paying dividends and depreciation were vague or non-existent before 1889 (Brief 1966, p. 13).
Against this backdrop, the hypothesis that railway companies took accounting decisions to inflate earnings and maintain dividends is well accepted. Indeed, the literature studying British railway companies in the 19th century provides evidence on several accounting practices to meet these aims. In the case of the Spanish railway sector, several of these practices were also common, and were indeed sustained well into the 20th century, decades after their practice had disappeared in their Anglo-American counterparts. In addition, in this paper, we identify a novel device for earnings management: the accounting treatment for public financial aids. Specifically, we focus on the first third of the 20th century, when the State granted advance payments to railway companies to finance the increases in staff expenses. In doing so, we analyse in detail the case of the two largest Spanish Railway companies, the Madrid-Zaragoza-Alicante Railway Company (MZA, henceforth) and the Norte Railway Company (Norte, henceforth), and to what extent they distributed public aids as dividends. We also study whether despite the use of public funds to pay dividends, dividends were actually ‘ridiculous,’ as some authors have affirmed.

The Spanish case is of interest, as the sector was operated under a concessions system, which meant that the State owned the lines and granted the right of usufruct to the concessionary private railway companies over a period not exceeding 99 years. This meant that the State intervened in the sector by regulating traffic rates, authorising capital increases, limiting bonds issues, granting subsidies, fiscal and tariff exemptions, etc. This created very particular incentives for railway companies, that had to maintain a level of earnings that would allow the payment of dividends without raising undue attention from the State, who could had withdrawn public aid if earnings were too high (see, e.g., Santos-Cabalgante et al. 2017). At the concession’s expiration date, these companies would return their assets to the

4 MZA is the acronym for Compañía de los ferro-carriles de Madrid a Zaragoza y a Alicante. NORTE is the acronym for Compañía de los caminos de hierro del Norte de España.
State. This set an internal countdown that led to predictable changes in investment and extraction of value in the form of dividends as the end of the concession loomed closer.

Thus, we contribute new knowledge by identifying a novel accounting practice used for earnings management in a different country and period, where the railway sector operated under different institutions. This permits identifying novel mechanism for earnings management and dividend payments. As acknowledged in Flesher and Previts (2009, p. 404), ‘[the] study of railway accounting in the twentieth century has hardly begun.’.

The remainder of the paper is structured as follows. Section 2 and 3 reviews the literature on earnings management in the railway industry internationally and in Spain. Section 4 and 5 explains the state advance payments and its accounting by railway firms, which lead an auditor of railway firms in 1923. Section 6 discusses the dividend policy of the two major Spanish railway firms, and finally, section 7 concludes.

2. Railway Background: Incentives for Earnings Management and Dividend Payment

Despite criticism, there is wide acceptance in the accounting railway literature of Brief (1965)’s thesis regarding the existence of an ‘error or bias’ in the published financial reports of nineteenth-century railway companies. Flesher and Previts (2009, p. 400) also recognized that after the British ‘railway mania,’ railway accounts were deficient in important respects. In particular, one of those deficiencies related with the correct calculation of earnings. The

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5 Perkin defined the speculation phase as ‘feverish gambling, on a scale big enough to entail a financial panic and a national slump’ (1970, pp. 179-180; quoted in Glynn 1984, p. 106). There were three booms of railway mania, in 1824-25, 1836-37, and 1845-47 (Glynn 1984, p. 106). Bryer’s (1991) thesis affirmed that the mania was a deliberated and collusive mechanism of the London wealthy, supported by the Central Government, to defraud the provincial middle-class; suggesting that accounting practices were deeply implicated in the swindle. However, McCartney and Arnold (2003) reject Bryer’s thesis after reviewing new available evidences. In any case, the railway mania was a period characterized by maximum speculation with railway shares. During these years, many railway lines were constructed, without any attempt to operate them. The only objective was to obtain fraudulent profits through buying or selling shares (Marx and Engels 1978, pp. 491-2; quoted in McCartney and Arnold 2003, pp. 835). The speculative euphoria, from 1876 to 1885, in the Barcelona Stock Exchange to the shares of Catalonian railways was known as «febre d’or» (gold fever) (Pascual 2000, p. 23).
devices used by railway companies to manage earnings and pay higher dividends can be
classified in four groups, three related to accounting choices and one to real decisions: \(^6\) (1) depreciation, (2) use of cash-based criteria and delays in implementing accrual-based criteria, (3) charging operating expenses to the capital account, \(^7\) thereby alleviating the income statement, or recording capital items as revenues in the income statement, and (4) the payment of dividends from the capital account.

Regarding depreciation, the literature provides several examples of historical accounting (Arnold and McCartney 2002) and of the evolution of the concept. Early on, depreciation was considered unnecessary and, later, railways recorded it inconsistently or used it for income smoothing. Even, ‘in the United States the courts did not permit depreciation in several of the early cases and authorities believed that there was no legal requirement to provide for depreciation before declaring a dividend’ (Brief 1966, p. 20). Many railway companies did not depreciate their assets because the general opinion was that replacement accounting (to charge repairs and renewals against the income statement) was equivalent to depreciation (Brief 1965, pp. 14-5; 1966, p. 4; Glynn 1984, p. 114). This seemed sufficient when heads of department would periodically issue certificates on the optimal conditions of the permanent way and rolling stock. Brief (1966, p. 10) explained that ‘replacement accounting permits higher “profits” to be earned in the formative years of a company that possesses long-lived assets since capital consumption charges are not recorded until the replacement occurs.’ This means that the true cost of capital consumption was ignored, thereby attaining increases in reported earnings (Bryer 1991, pp. 173, 449). The non-

\(^6\) Arnold and McCartney (2003) questioned the accuracy of some of the well-known references about railway accounting practices by examining their evidences.

\(^7\) Railway companies used double account system that Edwards (1986, p. 251) described as the conventional balance reported in two parts: the capital account, which recorded the capital and the expenses on fixed assets; and the general balance, which informed the credit or debit balance of the capital account, the retained earnings, and the remaining assets and liabilities of the company.
recognition of depreciation is often considered a contributing factor towards the final business failure of the sector (Brief 1966, p. 22), although it may have had some benefits, as authors like George O. May pointed out that, otherwise, the railway line would have been delayed or not built at all (Brief 1965, p. 340).

Despite the early perception that depreciation accounting was unnecessary, several British railway companies depreciated their rolling stock since the 1830s. However, they stopped during the *railway mania* to reduce expenses and maintain their dividend rates (Pollins 1956, p. 347). In 1841, *The Railway Times* expressed concerns that some railway companies were wearing their perishable assets out, distributing excessive dividends and charging the costs of replacement of useless stock against revenues (Brief 1965, pp. 19-20).

Consistent with this view, Edwards (1986) argues that depreciation accounting was abandoned due to a desire to pay dividends when profits were low. Indeed, the pressure to pay dividends meant that during the 19th century, the ‘depreciation fund’ was often considered an available profit (reserve), or ‘surplus account’ (Brief 1965, p. 25), used to paid dividends and avoid fluctuations in bi-annual dividends (Edwards 1986, pp. 255, 258). Carlon and Morris (2003, p. 279) noted that ‘depreciation, if regularly charged, retained funds that could be used for paying dividends, and the possibility of writing back depreciation reserves provided a source of profits from which to declare dividends in bad times.’

After the *railway mania*, companies began to record depreciation charges anew, including those relative to the permanent way, but started using the so-called ‘depreciation provisions’ to smooth the impact of the replacement costs in the income statement. This was

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8 In 1841, the General Meeting of the *London & North Western Railway Company* opposed the maintenance of the ‘depreciation fund’ and approved its distribution as a higher dividend per share (Edwards 1986, p. 255). In 1845, the *Grand Junction Railway* merged with *Liverpool and Manchester Railway Company*, and its ‘depreciation fund’ (18.500£) was distributed as an additional dividend (Arnold and McCartney 2002, p. 202).
9 Other practice was to create a ‘depreciation fund’ (similar to ‘provisions for depreciation’) to charge the depreciation expenses. That fund was reported, together with the retained earnings and creditors, in the general balance sheet (Edwards 1986, p. 252).
a common mechanism for smoothing earnings in the *London & North Western Railway Company Railway Company*, and consequently in many other companies, as it was the leader in the UK’s railway sector (Arnold and McCartney 2002, pp. 204-5). By the end of the 19th century, it was commonly acknowledged that *‘the assets should be “valued” at original cost less depreciation due to wear and tear’*, but this did not occur in practice (Brief 1966, p. 9).

A second common practice to manage earnings and increase dividend payments in the 1840s was to maintain the cash-based criteria and delay the application of accrual-based criteria. This practice became less common after the *railway mania* of 1845-7, when there was an increase in accounting information and a conceptual change towards accrual-based criteria (McCartney and Arnold 2003, p. 843). The cash-based criteria permitted reporting higher earnings and, thus, paying higher dividends (Edwards 1985, p. 25), as *‘reported profits and dividends were higher than they would have been if modern accounting practices prevailed’* (Brief 1965). As noted in Brief (1966, p. 4), the use of cash accounting meant that when *‘a firm pay(s) dividends out of profit, defined gross of depreciation, serious liquidity problems might arise when replacement was required’*. An advantage of procedures such as cash accounting or replacement accounting was that they were *‘simple and extremely flexible in practice, thus permitting a wide range of accounting discretion’* (Brief 1966, p. 10).

A third common practice that impacted distributable earnings, and permitted reporting higher profits and paying higher dividends (Arnold and McCartney 2003) was the incorrect allocation between capital and operating items: it was common to charge the operating expenses against the capital account (instead of the operating account) or to record the capital entries as revenues in the income statement. During the *railway mania*, managers omitted liabilities, and charged capital items as revenues and operating expenses as capital items (Pollins 1956). In particular, repairs, maintenance, and renewal expenditures inflated the value of assets because they were charged to the capital account (Brief 1966, p. 20). In 1867,
Joseph Lee Thomas\textsuperscript{10} claimed that the railway accounts were reporting dividends that companies could not pay because the allocation of debits and credits to the capital and operating accounts was not correct (Glynn 1984, p. 109). A further example can be found in Lee (1975, pp. 21-2), who explains that financial interest costs (from debts, bonds, etc.) were charged to the capital account while the lines were under construction, and during this period, companies had limitations to the distribution of dividends. However, when ‘under construction’ and ‘constructed’ lines (i.e. open to traffic) coexisted, it was easy to continue charging all interest costs to the capital account to alleviate the income statement.

The final device used by railway companies was the payment of dividends against the capital account. The railway Act (1835) of the Great Western already required that dividends were paid over “clear” profits, avoiding the excessive payment of dividends and their charge against the capital account (Lee 1975, p. 20). In the middle of 1840s, the dividends payment against the capital account was usually a legitimate practice (Wang 1918, pp. 155-6; quoted in Edwards 1985, p. 26), or at least it was regular in Britain during the 1850s (Brief 1965, p. 16). In fact, the Herapath’s Journal (p. 186) already considered in 1849 that the closure of the capital account\textsuperscript{11} of the railway companies was caused by shareholders’ pressure, who wanted to make sure that dividends payments were charged on the operating account and not on the capital account (quoted in Edwards 1985, p. 28). George Hudson, known as ‘the railway king,’ was accused of manipulating the accounting books and paying dividends against the capital account (Glynn 1984, p. 107). In 1880s, the payment of dividends out of

\textsuperscript{10} Thomas was a railway shareholder, member of the Institute of Mechanical Engineers and associate member of the Institute of Civil Engineer, who wrote a letter to shareholders titled ‘Present Position of Railways.’

\textsuperscript{11} During the construction phase, the capital account reported the financial resources and their application to the construction of lines. After the lines were in operation, it was considered that the capital account should remain closed, because there would be no financial resources or construction costs. That assumption was a mistake because the infrastructure continued requiring improvements, renewals, enlargements, etc.
capital was legal when the Articles of Association of the railway company included the regulation of that casuistry (Brief 1966, pp. 11-12).

Next, we review the literature on Spanish railway companies’ dividend policies. In addition, we identify a novel device for earnings management in the Spanish context of the 1920s: the accounting treatment of public financial aids.

3. Dividends of Spanish railway companies

Earnings management in railway companies had two clear (opposite) purposes: 1) increasing earnings to distribute higher dividends (Pollins 1956),\(^\text{12}\) or 2) reporting a negative image to receive (or maintain) public financial aids (Edwards 1986, p. 257; Villacorta 2014). In the case of Spanish railway companies, there is limited evidence on how profitability was shaped by managerial incentives. Pascual (2000, p. 12) notes that shareholder profitability has received little attention, and only Tedde (1978, pp. 139-41, 162-81; 1996, pp. 265-84) references this issue. Tortella (1973, pp. 11-2) affirms that the early railways were constructed ahead of demand, and thus, traffic income did not cover the variable costs, limiting the payment of dividends or interests. Tortella notes that ‘[railway] companies were a ruinous business both during and after crisis’ (1999, p. 250), and Nadal (1973) defends that the business was more profitable in the construction phase than in the operation phase.

Studying Catalonian railway companies, Pascual (2000) concludes that shareholder’s profitability was disappointing in relation to the paid-in capital.\(^\text{13}\) He also concludes that the

\(^{12}\) Different examples about the payment of inflated dividends in railway companies: the Eastern Counties Railway, managed by George Hudson (Lee 1975, p. 22).

\(^{13}\) Pascual (2000) analysed the market profitability of railway shares. He concluded that the average profitability of investment in variable-rate securities of the Catalonian railway companies was, between 1849-1935, very low both in current pesetas and in constant pesetas. Particularly compared with interest rates. However, shareholders who bought shares in the crisis periods of 1866-1875 and 1890-1905, had significant capital gains (pp. 33-5).
Tarragona-Barcelona-Francia Railway Company ‘TBF’ transferred large sums from the capital account to the income statement from 1876 to 1890 to increase dividends. From 1920 to 1926, this company used the refundable advance payment, granted by the State, with the same purpose (pp. 16-9). Pascual (2000, pp. 20-2) estimated that the profitability of TBF’s shares was explained, at least partially, by the transfer of capital items to the income statement during the period 1875 to 1900; and by the application of the state advance payments from 1900 to 1926.

Referring to Spanish railway dividends in general, Herranz-Loncán (2003, pp. 53, 59) affirms that companies paid ridiculous dividends to their shareholders, while the financial results were akin to those of the European railways. Despite this claim, Herranz-Loncán also defends that the State should have granted higher subsidies, and further regulated the sector to ensure higher service quality to guarantee higher returns for shareholders. With respect to the largest Spanish railway companies (MZA and Norte), there is a dearth of evidence on their dividend policies and possible earnings management strategies. Pascual (2000, p. 22) affirms that ‘[…] thanks to the refundable advance payment granted by the State to the Norte railway company from 1900 to 1926, the railway could distribute dividends during these years. Otherwise, dividends had not been paid.’ However, Pascual focuses on

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14 TBF was acquired by MZA in 1899.
15 Pascual (2000, p. 16, fn. 9) provides figures on the use of public funds to distribute dividends by Catalonian railway companies. Among others; in the period 1875-1890, dividends were paid with liquid resources of the capital account, when these funds should had been used to build the last section of the Barcelona-Francia line. During 1920-1926, the distributable earnings were financed through the refundable advance payments granted by the State to avoid their financial collapse. Specifically, between 1875 and 1885, the managers of TBF transferred 23.7 mill. pesetas from the capital account to the income statement, to pay dividends. That amount corresponded to bond trading and to a State subsidy of 7.26 mill. pesetas, granted to construct the section Girona -Portbou (the subsidy was not recorded in the balance sheet, but in the income statement, so during the period of 1875-1885, earnings exceeded 17.08 mill. pesetas over the real figure). Between 1886 and 1890, 5.08 mill. pesetas were transferred form the capital account to the income statement with the same purpose.
16 5.12% on the paid-in capital in current pesetas and 4.11% in constant pesetas.
17 McCartney and Arnold (2003, p. 829) also affirm that ‘railway returns were no more than modest from the middle of the nineteenth century onwards.’
18 The author does not support the idea that the railway investment was excessive or misguided; instead, he identifies the inability of the Spanish State to manage the public service of transport as the cause to the failure of the railway sector.
TBF, and generalizes the evidence found in TBF to Norte. Somewhat in agreement, Villacorta (2014) suggests that Norte manipulated its financial statements to minimize earnings, show a more negative image and thus, continue to receive advance payments from the State. With respect to MZA, Martínez Vara (2006, p. 115) affirms that if the company had not received public funds during 1920-1923, it would have reported losses. However, no prior study directly analyses the accounting for advance payments by these two large companies in Spain and thus, little is known of their accounting practices to ensure dividend payments.

4. The State advance payments and their varied accounting treatments

The legal mechanism to build and operate railway lines in Spain was the concessions system. The State owned the lines and granted the right of usufruct to the concessionary private railway companies over a period not exceeding 99 years. At the concession’s expiration date, companies had to return their assets to the State. The State intervened in the sector regulating traffic rates, authorising capital increases, limiting bonds issues, granting subsidies,\(^{19}\) fiscal and tariff exemptions\(^{20}\), etc. Public funds to railway companies were justified due to the underdevelopment of capital markets and the insecurity of the institutional context (Comín et al. 1998, p. 39), and were granted to cover wage increases and to renew the rolling stock. Questions surrounding the accounting treatment of these advance payments granted by the State to railway companies motivated the first auditory to these companies in 1923.

\(^{19}\) The construction of lines could be financed by subsidies, and a third part of them could be paid with funds of the provinces and villages interested in these lines (MZA’ Articles of Association of 1857).

\(^{20}\) The exemptions could be in form of tariff returns to the railway companies (paid when the imports of material) and other tax returns, or the exemption of rights of mortgages.
4.1. Advance payments for wage increases (1920-1926)

The beginnings of the 20th century witnessed a social and labour revolution. A maximum daily working time of eight hours was legally fixed on 1st October 1914, however, different industries (railways among others) did not comply with the regulation until 1920. The new regulation caused an increase of the hourly wage and a decrease in the productivity per employee that, jointly with the increase in the cost of coal, posed financial difficulties for the sector. Railway companies requested an increase of traffic rates to the State because they considered impossible to renew equipment and infrastructure and to pay decent wages to the staff. Finally, on 26th December 1918 and despite opposition (from chambers of commerce, and farming and breeder associations), the State authorised a maximum surcharge of 15% over the current rates (Martínez Vara 2006, p. 115).

Railway companies requested a new increase of the traffic rates in 1920, to cover the following expenses: operating expenses, financial charges, and a “reasonable” remuneration of the capital. They did not achieve their objective, but, by the Royal Order of 23rd March 1920, the State accepted to finance them through advance payments. These payments were granted to finance the increases in staff costs caused by the new labour legislation. Advance payments had to be refunded to the State but were interest-free. The advance payments disappeared in 1926, when the State began to invest directly in the infrastructure. Since then, the State intervened substantially the railway companies, conditioning their management (Villacorta and Martínez Vara 2009, p. 121).

21 This change began already in 1883 with the creation of the Commission of Social Reforms. That entity studied the policies to improve the welfare of the working class. Later, it was passed the Work-related Accidents Act – first social insurance- (1900), the Institute of Social Reforms (1905), the National Institute of Prevision (1908), el Retiro Obrero –retirement pension- (1919), and the maternity insurance (1929).

22 Martínez Vara (2001, p. 27) considers that, undoubtedly, the labour legislation caused increases in labour costs, but less than the railway concessionaries denounced.

23 Brief (1966, p. 6) explained that many of the railway companies in England and in the United States went bankrupt or were reorganized at the end of 19th century, and most of them were nationalised and kept under some kind of institutional control in the 20th century. In USA the rail industry began a long period of decline in
Interestingly, these public aids came with a condition: railway companies had to refund these advance payments to the State when their earnings exceed the level of earnings reported in 1913\textsuperscript{24} [see Exhibit 1]. Later, this condition changed, and companies had to refund the advance payments when their earnings exceed the average of earnings of the period 1923-1925\textsuperscript{25} [Exhibit 2].

**Exhibit 1**

![Image](image1.png)

Source: Royal Order (March 23, 1920, Art. 2º)

Translation (by authors): the refund of the advance payments will be verified, in subsequent periods, if the net earnings exceed the level of net earnings of 1913.

**Exhibit 2**

![Image](image2.png)

Source: MZA Annual Report (1927, p. 13)

Translation (by authors): the refund of the advance payments in 1926, 1927 and 1928 will have to be made whether the earnings of these periods are over the average of earnings corresponding to the last triennial, from 1923 to 1925.

Brief (1966, p. 10) explained that in a laissez-faire economic context (as the Spanish one during the 1920s) a company would apply the accounting principles and practices that provide the highest utility depending on its goals and its external constraints, which would lead to a diversity of accounting practices across firms. Next, we review the accounting practices adopted by MZA and Norte to recognize these advance payments.

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24 Earnings MZA (1913): 23,168,881.56 ptas; Earnings Norte (1913): 12,970,629.60 ptas.
4.1.1. Accounting for advance payments in MZA

MZA received advance payments to cover the wage increases from 1920 to 1926. The company reported these advance payments as liabilities in the balance sheet [see Exhibit 3]. In addition, as the company used the advance payments to pay the increase of the staff expenses, the amounts applied to this concept were also recorded as revenues in the income statement [see Exhibit 4]. MZA provided explanations on these figures in its Annual Reports [see Exhibits 5 and 6].

Exhibit 3: MZA’ Balance Sheet

Source: MZA Annual Report (1921, p. 65)
Translation (by authors): Pasivo equals liabilities, Acreedores varios equals Sundry creditors, Libramientos por pagar equals Receive orders of payments, Depósitos en fianza equals Guarantee bonds, Caja de Previsión del personal equals Provident fund to employees, Ayuntamiento de la línea de Mérida a Sevilla equals Councils of the Mérida-Sevilla railway line, Varias cuentas acreedores y cuentas de orden equals Sundry accounts payable and suspense accounts, Anticipo del Estado equals Advance payments by the State.

Exhibit 4: MZA’s Income Statement

Source: MZA Annual Report (1921, p. 69)

**Exhibit 5**

*Exhibit 5*

Source: MZA Annual Report (1921, p. 5)

Translation (by authors): Sundry Income. Non-traffic income was 22,430,583.56 pesetas in 1920. Within, the figure of 20,562,140.65 pesetas is the amount of the advance payments granted by the State invested by MZA.

**Exhibit 6**

*Exhibit 6*

Source: MZA Annual Report (1921, p. 6)

Translation (by authors): Staff Expenses. The causes that explain the wage increases of 27,434,000 pesetas include, firstly, the improvements granted to the staff, which have been the reason for the advance payments by the State since April; this advance payment is 20,562,141 pesetas.

Table 1 Panel A shows the figures related to advance payments that MZA reported in its financial statements. The figures of the balance sheet are accumulated figures. The difference between years allows identifying the advance payments granted each year (column 4). The income (column 5) is merely recorded to counterbalance the wage expenses increase. The accounting treatment changed in 1923 when the company began to report the figure of the accumulated advance payments also on the assets side of the balance sheet. It is unclear why.
4.1.2. Accounting for advance payments in Norte

Norte recorded the advance payments as a suspense account on the balance sheet, both in the assets and in the liabilities sides since 1920. The item shows the accumulated figure of advance payments, which increased until 1926 (last year for the aids). Outside the period of study, the accumulated figure decreased just in 1928, probably because the company refunded part of the advance payments to the State. Extraordinarily, in 1923, an item related to the advance payments is recorded as an expense in the income statement. The figure seems to be the difference between the wage expenses increases and the advance payments granted by the State. Thus, the part of the increase in wage expenses not “covered” by the advance payments. Norte seems to consider that these “non-covered” expenses (non-financed) is actually an expense for the company. Table 1 Panel B summarised the data reported.

To sum up, after a first review of the Norte’s financial statements, it seems that the advance payments were not recorded as a debt (as was the case of MZA from 1920-1923). The advance payments were recorded in the both sides of the balance sheet, without any impact on the liabilities (we have to remind these advance payments were refundable).

4.2. Advance payments for material (1924-?)

In 1877, MZA and Norte had 55% of all steam engines in Spain, and on the eve of the First World War the percentage had increased to 74% (Comín 1978, p. 103). In the 1880s, railway companies began to build their own rolling stock, importing the main components from abroad (Wais 1974, p. 125), and Spain began to build its own locomotives (Muñoz Rubio and Vidal Olivares 2001, p. 83). During these years, the working conditions of the rolling stock became worrisome. In fact, in 1886, the Directory of Public Works required railway companies to report inventories of their traction and transport material, information about the
antiquity of the material, and the number of accidents (Cordero and Menéndez 1978, p. 300). The obsolescence of the rolling stock was however not the only problem of railway companies. During the expansion phase (1875-1900), MZA and Norte had acquired many smaller railway companies, that used different materials. This lack of uniformity aggravated the management of the railway stock (Cordero and Menéndez 1978, p. 303).

From 1890 to 1906, the first large-scale renewal of steam engines was undertaken to increase their power, as a response to transport demand (Comín 1978, p. 105). The steam engines, with an estimated useful life over 25-30 years, were substituted (Cordero and Menéndez 1978, pp. 292-4). However, this renewal was incomplete and insufficient, and a quarter of century later, the same problems arose with greater severity (Artola 1978, p. 409; Cordero and Menéndez 1978, pp. 292-4). Indeed, the conditions of the rolling stock and the fixed assets deteriorated quickly. Renewals were scarce and new acquisitions limited, whereas the traffic continued increasing. The situation became serious between 1916 and the end of the First World War, when the railway sector was in such an alarming situation that it was close to paralysis of railway transport (Cordero and Menéndez 1978, pp. 301-2). Railway companies did not have enough funds to renew and modernize the fixed assets and the rolling stock at the speed the increasing traffic required, particularly after the First World War (Villacorta and Martínez Vara 2009, p. 119).

The characteristics of Spanish railway companies, and their financial situation, made it nearly impossible to renew the rolling stock and the infrastructure. In fact, Cambó (1918) defended that the State had to assume the maintenance of the railways as the only solution to

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26 During the expansion phase, the Spanish railway companies established policies of concentration by takeovers and commercial agreements with smaller companies, or by the construction of railway branches (Tedde 1978).
27 In 1917, a third part of the total of the Norte’s steam engines were out of use because they were subject to major repairs (Vidal 1999, p. 650).
28 The autor wrote Elementos para el estudio del problema ferroviario en España (6 volumes) in 1918. One of the best resources to understand what was called the Railway Problem.
expand and renew the network. He pointed out two errors that had led to this situation: first, the assumption by the State that railways were a private business and not a public service; and, second, the assumption that the capital account (the establishment account) remained closed after the construction of the rail lines (i.e., that no further investment was needed on a large scale). Among the solutions to solve the so-called *Railway Problem*, the author suggested the nationalization of Spanish railways (Artola 1978, pp. 413-4).

Between 1915 and 1929, there were improvements in speed as a result of the modernization process promoted by the dictatorship (Cordero and Menéndez 1978, p. 307). In 1924, the *Railway Statute* regulated that the State would order and finance the acquisition of railway material. This caused that the new rolling stock was bought using funds from the ‘railway box’ (similar to a railway piggy bank). From 1926 to 1929, 453 locomotives, 675 wagons for travellers, 665 wagons for mail, and 11,464 wagons for goods were put into circulation. Apart from the renewal of the rolling stock and infrastructure, other decisions implemented by the State included electrification, the construction of a double track in the matrix lines, and the standardization of the material or the grouping of rail lines into railway networks to reduce distances (Cordero and Menéndez 1978, pp. 292-4, 318).

In 1934, MZA and Norte created a pool of rolling stock that was managed jointly by the two companies. They also constituted a shared office of studies and an office to unify the railway material. According to Cordero and Menéndez (1978, pp. 319-20), these solutions prove how difficult the situation had to be, because no railway company was able to solve the challenge of the railway material independently. Requests for financial assistance to the State were continuous, and despite the aforementioned aids received, railway companies that aids were insufficient.

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*Caja ferroviaria* was a reserve created to finance new works and material expenses (Tedde 1978, p. 215).
5. The first auditory in Spain: the auditory of the railway companies (1923)

The accounting treatment of advance payments to railway companies was an important issue at the time. Many voices questioned whether railway companies needed the financial aids. This context eventually led to the first auditory of railway companies (Villacorta and Müller 2014, pp. 153-4), which took place in 1923, when an inquiry committee audited Norte and MZA. This is in line with the views in Brief (1966, pp. 6, 22), who affirmed that ‘[…] the confidence of the investing public is increased if the method of valuation is unambiguous’ or, in other words, ‘the method of accounting for assets could have been one of the factors that contributed to this instability [in the railway industry].’

The report\(^{30}\) criticized both the need for the aids as well as the accounting treatment by railway companies. In particular, it was very critical with Norte, indicating that Norte did not report expenses covered by the advance payments in the income statement, and only recorded the aids on the balance sheet as both assets and liabilities. This treatment led to incorrectly calculated results that allowed the distribution of nonexistent dividends. The report concluded that Norte did not need the advance payments as the company could have covered its expenses with its own resources (Peña and Pérez 1940, p. 119). The report recognized, however, that without the advance payments, Norte could not have distributed dividends. Despite this overall negative assessment, the report considered that the State should continue helping Norte financially to invest in enlargements and in new infrastructures. Norte responded to the report explaining that the differences on how to record the advance payments between the company and the State was because of the different understandings on

\(^{30}\) The report is included in Peña and Pérez (1940, pp. 88-121).
the concept of advance payments.\footnote{In this sense, the State defended its role in advancing money for paying the wage increases (just as a lender function), but the staff expenses had to be supported by the companies. Conversely, Norte defended that the spirit of these advance payments were not as the report defended.} The report also criticised that Norte’s Board of Directors used the reserve fund (fondo de reserva) to ensure future dividends to shareholders (Peña and Pérez 1940, p. 115). The company explained that the expenses for the replacement of the rolling stock and for renewal of the rail lines had to be recorded in the income statement, against the inquiry committee’s opinion, which required the use of the reserves to charge these expenses. The company defended that each reserve had a specific purpose and none of them had the objective to cover replacements or renewals. Norte further responded that it would be unfair to request the application of shareholders’ reserve funds to infrastructures that, in the end, would be owned by the State (Peña and Pérez 1940, p. 118); in particular, Norte affirmed ‘[The State] cannot mandate the railway companies to invest theirs profits (ancient and modern ones) to improve the rail lines, which are not owned by them. Railways only have a temporal usufruct, and the State could rescue the lines at the next day’ (Peña and Pérez 1940, p. 116). The inquiry committee recalculated Norte’s earnings and defended that the company had to return to the State 12 mill. pesetas. That figure was the excess earnings of 1923 over the earnings of 1913, the limit marked by the normative [see Exhibit 1 and 2]. Norte disagreed with that conclusion because the committee had calculated these earnings by charging expenses against reserves of the company.

In relation to MZA, the report of the inquiry committee is brief. In fact, less than one quarter of the report concerned the accounting practices of MZA. The auditory considered that the accounting of MZA was ‘good, clear, acceptable, and sometimes farsighted’ (Peña and Pérez 1940, p. 119), and suggested several items where the company could lower expenses (for example, reducing wages, employees, free tickets, etc.) Like with Norte, the report concluded that, without the advance payments, MZA could not have paid dividends.
due to the necessary investments in renewals and replacements of the rolling stock and the infrastructures, but also, that the State had to continue providing financial aid. The auditory also affirmed that, even without the advance payments, MZA could have covered the renewal of new investments. Given the similarity in the assessments over the need for financial aid, it is curious that the report was harder with Norte, perhaps, due to difficulties in the communication between the parties, as can be seen from Norte’s response to the conclusions of the committee report: ‘[…] the tenth conclusion, the latter of the report, is related to a financial assistance that has not been mentioned anywhere, thus we do not know what it means. […] the paragraph is unintelligible and we cannot make any comment about it.’

(Peña and Pérez 1940, p. 119).

In response to the report, Norte and MZA reduced their estimates of the future traffic to justify the unfeasibility of applying alternative accounting methods. The banks were also mobilized by the railway companies to explain ‘the disastrous consequences of a state intervention in the railway companies before the rescue of the railway concessions’ (Artola 1978, pp. 423-4).

6. Dividend policies of MZA and Norte

Table 2 shows different variables reported in the financial statements of MZA. Adjusted earnings is calculated as the difference between net earnings and the advance payments registered as revenues in the income statement. They represent the net earnings that MZA would have reported if it had not received the advance payments. The sixth column evidences that the earnings would had been losses from 1920 to 1923 and a very low figure from 1924

32 Literal: ’En fin, la conclusión décima, última del informe, se refiere a un auxilio que no hemos visto mencionado en ninguna de las anteriores y que no sabemos, por lo tanto, a qué se refiere. […] De todos modos, resulta para nosotros ininteligible el párrafo en cuestión, y no podemos hacer, por lo tanto, sobre él comentario alguno.’
to 1926. This confirms the view of Martínez Vara (2006, p. 115) who affirmed that if MZA had not received public funds during 1920-1923, the company would have reported losses. Moreover, the dividends from 1924 to 1926 would have been virtually non-existent.

[Insert Table 2 about here]

As section 4.1.1. explained, MZA accounting for the advance payments during the period 1920-1923 was appropriate, because the advance payment were recorded as a debt on the liabilities side of the balance sheet. But, in relation to the period 1924-1926, the company changed its reporting regime, and the advance payments start to also appear on the assets side of the balance sheet. Thus, since 1923, MZA reported the advance payments as Norte did over the whole period. Both companies (MZA in the period 1923-1926) did not report the advance payment as a debt of the company, despite the fact that this was an amount that had to be refunded to the State.

There is no evidence to suggest that the State indicated that the amounts would be condoned. However, perhaps the suggestion by the auditory committee that the financial aids were necessary and that the State should continue to provide them led MZA to reconsider these aids as a debt. The fact that the State regulated the conditions under which the advance payments would be returned, by conditioning the refund to earnings reporting, allowed much discretion to the railway companies, that by carefully choosing a level of earnings below those of 1913, they could ensure that no refund had to be made.

Indeed, regarding dividend policies, from 1921 to 1929, MZA payed a ‘fix’ dividend of 28.5 pesetas per share [see Graph 1]. As was noted before, when the State regulated the conditions of the advance payments, it established that railway companies had to refund the aids if their net earnings exceeded the net earnings of 1913 (latter, this threshold changed). It established (probably unintentionally) a maximum limit of earnings to report. Otherwise, railway companies would had to refund those public aids.
In relation to Norte, Table 2 Panel B shows the variables of net earnings, total of dividends and dividends per share. According to the figures reported by both companies, Norte paid a ‘fixed’ dividend of 28,5 pesetas per share from 1924 to 1930, and MZA from 1925 to 1929 [see Graph 1]. Table 2 Panel B also shows that despite the decrease in earnings by 1926, the dividend paid was maintained.

In 1927, the Government reminded that the maximum dividend permitted was 28,5 pesetas, as response to the railways companies which were proposed to pay a higher dividend [see Exhibit 7].
Exhibit 7: Fixing a maximum dividend

Translation (by authors): Fixing a maximum dividend. During the first days of August 1927, the Presidency of the Council of Ministers published the following note. Few weeks ago, the shares of the main railways (Norte and Madrid-Zaragoza-Alicante) had an extraordinary increase, thus the Government was forced to inquiry the causes that cannot surprise whether they depended on the railway earnings. But, the Government expressed its opposition when the purposed increase was over 475 pesetas, 28 pesetas and 50 cents per share; and stated that it did not authorize such distribution of dividends if the State did not participate as creditor. The State had granted aids and refundable advance payments in a period when the mismanaged companies overwhelmed the State due to their frequent requests, which the Government began to dismiss. The new and unjustified increase on the purposed dividends push the Government to impede the payment of a dividend over the 28.50 pesetas or to create reserves with the intention of distributing dividends, if before that, the railway companies do not pay their debts to the State.
7. Conclusions

This paper documents the use of a novel device to manage earnings and sustain high dividend payments in railway accounting: the accounting treatment for advance payments granted by the State. Spanish railway companies used ‘traditional’ earnings management methods commonly used in the railway industry, but also innovated in response to their institutional setting. We provide evidence on the use of a novel device: the reporting of public aids in the financial statements. From 1920 to 1926, MZA reported a revenue item to counterbalance the wage expenses increase. Norte did not account the increase of wage expenses linked to the application of the new labour normative in the income statement, and continued recording the usual level of staff expenses. Thus, despite the use of different accounting treatments, the earnings of both companies were calculated without considering the real wage expenses increase and neither really captured the increase of staff expenses caused by the change in the labour normative. Moreover, during the 1920s, these companies did not account the depreciation expenses neither. This delay was caused probably because, as Brief (1966, p. 10) explained, ‘replacement accounting permits higher “profits” (because) […] capital consumption charges are not recorded until the replacement occurs.’

All of the above led to report higher earnings than true earnings and to distribute dividends, thereby decapitalizing the companies. Accounting practices were not conservative or cautious. Otherwise, probably the dividends would have been non-existent, and railway companies would have gone bankrupt long before.

According to Brief (1966, pp. 6, 22) ‘[…] the confidence of the investing public is increased if the method of valuation is unambiguous’ and ‘the method of accounting for assets could have been one of the factors that contributed to this instability [in the railway industry]’. The accounting method of the advance payments was very ambiguous. It is difficult to understand the accounting treatment of the advance payments given by each
company. In fact, the ambiguity of the issue led to the first auditory in Spain in 1923, proving the instability and distrust caused by the accounting methods used by railway companies.

The role of the State is critical regarding this topic. It seems that the State was a somewhat naïve regulator. First, it established a threshold to request the companies refund the advance payments, which perhaps assumes that earnings were viewed as exogenously given, and free of managerial intervention. Ex post, this threshold acted as a maximum de facto limit to reported earnings. Second, the State also set the ‘permitted’ maximum dividend to railway companies at 28,5 pesetas. Probably, both limits worked as incentive to manage earnings.

British railways stopped depreciating assets to alleviate the expenses of the income statement and maintain a specific dividend rate during the railway mania (Pollins 1956, p. 347). In Spain, the auditory report suggested alleviating the expenses of the income statement (by charging them against reserves funds). The report tried to demonstrate that railways did not need public aids. However, the railway companies considered it unfair because the owner of these rail lines was the State and thus, that the State had to make such investments. Moreover, companies did not have any incentive to record depreciation expenses due to the proximity of the reversion of the lines. Their objective was to collect enough money to refund the capital stock and obligations, and to distribute a surplus by reducing until the minimum the investments and prolonging the use of the rolling stock, even beyond their useful life (Artola 1978, pp. 423-4).

MZA and Norte received public aids, which they distributed as dividends. The lack of an accounting framework, the non-existence of an external auditory, the common presence of political leaders in the Boards of Directors, and the reversal of the concession term were a breeding ground to mismanage public funds. In Spain, our ‘railway mania’ appeared in 1920s, when railway companies payed highest dividends per share.
References


Martínez Vara, T., 2006. Salarios y programas de Bienestar Industrial en la empresa ferroviaria


Villacorta Hernández, M.A., 2014. Prácticas de manipulación contable de la compañía de los


Railway’s Sources:


Legislation:

1855 Railway Act 3-June (Ley General de Ferrocarriles)
1920 Royal Order 23-March (Real Orden)
Table 1. The reporting of Advance Payments for wage increases

Panel A: The reporting of the MZA’s Advance Payments for wage increases

<table>
<thead>
<tr>
<th>Year</th>
<th>Assets</th>
<th>Liabilities</th>
<th>Advance Payments per year</th>
<th>Operating Account</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Income</td>
</tr>
<tr>
<td>1920</td>
<td>22,942,186,56</td>
<td>22,294,186,56</td>
<td>20,562,140,65</td>
<td>-</td>
</tr>
<tr>
<td>1921</td>
<td>53,531,768,64</td>
<td>30,589,582,08</td>
<td>30,284,753,17</td>
<td>-</td>
</tr>
<tr>
<td>1922</td>
<td>84,121,350,72</td>
<td>30,589,582,08</td>
<td>32,000,000,75</td>
<td>-</td>
</tr>
<tr>
<td>1923</td>
<td>115,004,250,00</td>
<td>30,882,899,28</td>
<td>30,667,800,00</td>
<td>-</td>
</tr>
<tr>
<td>1924</td>
<td>130,977,063,07</td>
<td>15,972,813,07</td>
<td>15,972,813,07</td>
<td>-</td>
</tr>
<tr>
<td>1925</td>
<td>142,288,366,80</td>
<td>11,311,303,73</td>
<td>14,056,074,99</td>
<td>-</td>
</tr>
<tr>
<td>1926</td>
<td>155,066,616,80</td>
<td>12,778,250,00</td>
<td>12,778,250,00</td>
<td>-</td>
</tr>
</tbody>
</table>

Source: MZA Annual Reports (1921-1927)

Panel B: The reporting of the NORTE’s Advance Payments for wage increases

<table>
<thead>
<tr>
<th>Year</th>
<th>Assets (1)</th>
<th>Liabilities (2)</th>
<th>Advance Payments per year</th>
<th>Operating Account</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Revenues</td>
</tr>
<tr>
<td>1920</td>
<td>22,979,963,51</td>
<td>22,979,963,51</td>
<td>22,979,963,51</td>
<td>-</td>
</tr>
<tr>
<td>1921</td>
<td>54,600,000,00</td>
<td>54,600,000,00</td>
<td>31,620,036,49</td>
<td>-</td>
</tr>
<tr>
<td>1922</td>
<td>85,800,000,00</td>
<td>85,800,000,00</td>
<td>31,200,000,00</td>
<td>-</td>
</tr>
<tr>
<td>1923</td>
<td>117,000,000,00</td>
<td>117,000,000,00</td>
<td>31,200,000,00</td>
<td>-</td>
</tr>
<tr>
<td>1924</td>
<td>132,729,029,14</td>
<td>15,729,029,10</td>
<td>15,729,029,10</td>
<td>-</td>
</tr>
<tr>
<td>1925</td>
<td>147,029,029,20</td>
<td>14,300,000,10</td>
<td>14,300,000,10</td>
<td>-</td>
</tr>
<tr>
<td>1926</td>
<td>160,029,029,20</td>
<td>13,000,000,00</td>
<td>13,000,000,00</td>
<td>-</td>
</tr>
</tbody>
</table>

Source: Norte Annual Reports (1921-1927)

Note: (1) Suspense Account: Amounts paid to the staff on behalf of the State; (2) Suspense Account: Advance payments granted by the State to wage supplements; (3) Difference between the payments made to the staff and the advance payments received by the State.
### Panel A: MZA dividend policy

<table>
<thead>
<tr>
<th>Year</th>
<th>Net Earnings</th>
<th>Dividends</th>
<th>Dividends per share</th>
<th>Advance Payments recorded as revenue in the Income Statement</th>
<th>Adjusted Earnings (without advance payment)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1920</td>
<td>16.934.224,39</td>
<td>7.454.070,00</td>
<td>15</td>
<td>20.562.140,65</td>
<td>-3.627.916,26</td>
</tr>
<tr>
<td>1921</td>
<td>18.086.019,00</td>
<td>10.932.636,00</td>
<td>22</td>
<td>30.284.753,17</td>
<td>-12.198.734,17</td>
</tr>
<tr>
<td>1922</td>
<td>21.420.033,53</td>
<td>10.932.636,00</td>
<td>22</td>
<td>32.000.000,75</td>
<td>-10.579.967,22</td>
</tr>
<tr>
<td>1923</td>
<td>22.164.651,77</td>
<td>10.932.636,00</td>
<td>22</td>
<td>30.667.800,00</td>
<td>-8.503.148,23</td>
</tr>
<tr>
<td>1924</td>
<td>19.331.127,10</td>
<td>10.932.636,00</td>
<td>22</td>
<td>15.972.813,07</td>
<td>3.358.314,03</td>
</tr>
<tr>
<td>1925</td>
<td>20.026.544,75</td>
<td>13.914.264,00</td>
<td>(1) 28</td>
<td>14.056.074,99</td>
<td>5.970.469,76</td>
</tr>
<tr>
<td>1926</td>
<td>21.087.661,50</td>
<td>14.162.733,00</td>
<td>(2) 28,5</td>
<td>12.778.250,00</td>
<td>8.309.411,50</td>
</tr>
</tbody>
</table>

Source: MZA Annual Report (1921-1927)

### Panel B: Norte dividend policy

<table>
<thead>
<tr>
<th>Year</th>
<th>Net Earnings</th>
<th>Dividends</th>
<th>Dividends per share</th>
<th>Advance Payments recorded as revenue in the Income Statement</th>
<th>Adjusted Earnings (without advance payment)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1920</td>
<td>22.026.691,77</td>
<td>8.256.000,00</td>
<td>16</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>1921</td>
<td>20.698.287,27</td>
<td>12.384.000,00</td>
<td>24</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>1922</td>
<td>22.034.460,49</td>
<td>12.384.000,00</td>
<td>24</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>1923</td>
<td>22.316.878,94</td>
<td>12.384.000,00</td>
<td>24</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>1924</td>
<td>22.614.662,41</td>
<td>14.706.000,00</td>
<td>(3) 28,5</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>1925</td>
<td>21.398.885,99</td>
<td>14.706.000,00</td>
<td>(3) 28,5</td>
<td>-</td>
<td>-</td>
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<tr>
<td>1926</td>
<td>15.148.617,63</td>
<td>14.706.000,00</td>
<td>(3) 28,5</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

Source: Norte Annual Report (1921-1927)

Notes: (1) 22 pesetas correspond to the railway’ profit and 6 pesetas to the return of the private property of the company; (2) 22 pesetas over the profit of railways and 6,5 pesetas over the return of the private property of the company. (3) 22 pesetas correspond to the railway’ profit and 6, 5 pesetas over the return of the reserves’ interest after the application of the new railway regime;