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OPEN LETTER TO::

The Chairpersons of the
Member Organizations of
IFAC International Federation of Accountants
At their national offices
by email

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Ref:
Bank of England and German Bundesbank articles – Money creation
Bank financial statements – IFRS Definition of assets and liabilities

Dear Sirs, dear Madams:

I refer to my Open Letter to you of 1st May 2013 on the subject of **Accounting Perversion in Bank Financial Statements** (see IICPA "Articles & Open Letters"). The response came only from attorneys-at-law defending clients against banks' fraud charges on non-performing loans, from academia, and from monetary reform movements in Europe and the United States.

I am reaching the end of my long professional and academic career, and if asked wether I would ever become a CPA again, I would answer that none of my children have done so. I am a trained international commercial and investment banker. Professional accounting gave me the tool to cut through the complexity of financial accounting created since Luca Pacioli and his "Rules of Double-Entry Bookkeeping" (1494), on whose shoulders we stand to this day.

The difference between a banker and an accountant is a small one. I found that a bank is effectively a glorified accounting office.

John Law of Lauriston, the son of a wealthy goldsmith and money lender from Scotland, taught us the art of modern money creation and banking. His Banque Royale de France (1716-1722) was a victim of the avarice of the Regent of France and his misconception that money was so good that more money must be better. Then came the Bank of Amsterdam that failed on priciples that are now accepted — the creation of bank deposits and bank notes without backing in anything. The UK *Bank Act of 1844* put a stop to that, but "bankers immediately set themselves to recover the economy and elasticity, which the Act of 1844 banished from the English system, by other means;

and with the development of the cheque system to its present state of perfection they have magnificently succeeded." (John Maynard Keynes (1913), "Indian Currency and Finance.")

The creation of money has generally been a taboo subject at the universities. John Kenneth Galbraith's (1975) explanation is on point in his book, "Money: Whence it came, where it went":

> Much discussion of money involves a heavy overlay of priestly incantation… Those who talk of money and teach about it and make their living by it gain prestige, esteem and pecuniary return, as does a doctor or a witch doctor from cultivating the belief that they are in privileged association with the occult — that they have insights that are not available to the ordinary person. Though professionally rewarding and on occasion profitable, this too is a well-established form of fraud. There is nothing about money that cannot be understood by the person of reasonable curiosity, diligence and intelligence.

Bankers don't face imprisonment; their employers pay the state billions in fines for promoting bogus subprime asset backed securities or manipulating LIBOR, while their accountants hide behind the veil of GAAP and, if taken to court following a Lehman Brothers type of failure, presumably settle for the professional malpractice insured amount.

The IFRS Conceptual Framework defines an asset as**:**

- a resource controlled by the entity
- as a result of a past event
- from which future economic benefits are expected to flow to the entity.

An asset is recognised when**:**

- it is probable that any future economic benefit associated with the item will flow to the entity; and
- the item has a cost or value that can be measured with reliability.

The focus on the expected inbound or outbound flow of benefits alone does not make the item an asset or a liability. James Leisenring (2004) said in his video "Conceptual Framework," London: IASB, 2004 (see Michael Schemmann (2017), "Deplorable Revelations of the German Bundesbank," p.22):

> It is absolutely clear to me that you cannot focus on the probability of the inbound or the outbound flow. If you focus exclusively on that, you can't possibly be talking about assets and liabilities, because I assure you General Motors will have inbound cash flow next year. Positive they will. I don't know how much, but let's give them fifty billion. I don't think that's an asset now. I think they have dead flat certain inbound cash flows, but it's clearly not yet an asset if it's not a claim or benefit based on a past transaction or event.
>
> The same with liabilities. I am dead flat certain General Motors will pay salaries next year, but that doesn't mean they have a liability for them now.
>
> So the focus is got to be first on whether you have the right and the obligation, secondarily what the result of having that right and that obligation is going to be. It is not necessarily the other way around.

Now comes the Bank of England (Q1, 2014) and the Deutsche Bundesbank (April 2017 Monthly Report) to promote John Law's (1716) and the Bank of Amsterdam's (1763) system of creating bank deposits by way of Luca Pacioli's double entry bookkeeing out of nothing, admitting the falsehood of economic thought to this day that banks are merely intermediates lending out pre-existing money of the saving public. The central banks advocate higher risk capital and more regulations.

Basel I of 1988, mandating capital adequacy requirements, did not prevent the bank failures of the 1990s, and Basel II did not prevent the Global Financial Crisis of 2007.

Prof. Mervyn King of the Bank of England (11 November 2010) agreed with me that Basel III didn't go far enough in requiring higher liquidity standards. Prof. King writes on ring fencing (see IICPA.com "Articles & Open Letters"):

> "I also agree that there is no reason why there should not be serious consideration of banking functions being separated, with deposits being 100% backed by liquid money."

The UK has reform legislation in place. The Banking Reform Act 2013 mandates ring-fencing by the 1st of January 2019, separating deposit taking from lending activities, just in case the Global Financial Crisis happens again. HSBC, Europe's largest bank, is informing it's customers of the change. (HSBC: "UK Ring-fencing. Why are we changing our structure?")

The misconceptions of the Basel Committee on Banking Supervision's Basel I, II and III capital adequacy requirements rest on the fact that equity capital is not a buffer for illiquidity, and therefore is not a backup protector of demand deposits. As we all know, equity is on the wrong side of the balance sheet because liquid assets are required to pay off depositors during a Lehman Brothers' run on the bank (or any systemically important financial institution); they cannot be satisfied by a bank's tender of shares of capital stock. In the minds of many economicsts, who are notoriously short on accounting, the vague notion of capital is "money;" and the notion is firmly held.

I have not audited a bank's financial statements, and if I did, for example, I would recommend to write down Deutsche Bank's 2016 year end €274 billion carrying amount of loans receivable created out of nothing with a corresponding charge to equity, turning the bank's € 46 billion equity into a deficit of €228 billion. I would do so on the rationale that customer deposits, created in the so called lending process out of nothing, have been disposed of, while the € 270 billion deposits reported on the balance sheet belong to third party customers, are *bona fide*, remain on the balance sheet and cannot be touched. Deutsche Bank would be insolvent at an instant, though not necessarily "illiquid" if it could continue, on what basis ever, with the usual knitting stitches, 'two left, two right' — althoug I would have difficulty to see how. (Michael Schemmann, "Deplorable Revelations of the German Bundesbank. The Role of Banks, Non-banks and the Central Bank in the Money Creation Process." IICPA Publications, 2017, pp. 16-17.)

To provide a true and fair view of the financial position of a bank, I would recommend that all customer demand deposits not be shown "broad" on the liability side, but net, ie, as a deduction from “liquid money” to use the term of Mervyn King above (namely, vault cash, balances at the clearing house or central bank) on the asset side, the net amount of which may not be negative.

The banks’ money creation monopoly is only possible with the cooperation by the accounting profession, which has the trust of the public and can quickly lose it when the public and parliaments determine that for a good hundred years CAs, CPAs, WPs and all of us licensed public accountants have betrayed the nations, have caused the never-ending financiual crises by allowing money bubbles to be created by the banks by an accounting fraud, forcing nations (that have the constitutional money power) into trillion dollar debtors to the banks and their double-entry-bookkeeing-created money out of nothing, while half the populations’ young people in the Southern European countries are unemployed, austerity programs and old-age poverty abounds as preconditions for rescue packages of bankrupt governments at tax payer expense.

John Kenneth Galbraith writes in his last book, “The Economies of Innocent Fraud” (2006:x):

> **“**As I was working on these pages, there came the great breakout in corporate power and theft with the unanticipated support of cooperative and corrupt accounting.**”**

Public accounting is an honourable profession and partners of the Big4 rely on their million dollar pay and pensions. That may be history. The risk: Accounting firms are not systemically important institutions, and therefor not too big to fail. Enron took down the best of them: Arthur Andersen.

Switzerland is scheduled to hold a referendum on the initiative of putting a stop to bank-book-money creation out of nothing in favour of 100-percent central bank money. The German Bundesbank’s article in its Monthly Report of April 2017 may be intended to come in aid of the two multinational Swiss banks and their troubled past, though the article is flawed, written by economists in the ivory tower without a foundation in accounting, let alone practical commercial banking’s critical treasury function.

The backlash against our profession, if found to be in collusion with a corrupt banking system, could be a revolution. The populist political landslides in North America and in Europe, that surprise us, may be the canaries in the coal mines, if only we want to notice.

I recommend that you take my current booklet (2017), “Deplorable Revelations of the German Bundesbank,” available at Amazon, to the summer beaches or wherever you have the pleasure to read.

With all best wishes,

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Managing Director of the IICPA