International Institute of
Certified Public Accountants
Incorporated under the laws of the State of Delaware

1st May 2013

Open Letter

TO the FASB —

Russell G. Golden
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Financial Accounting Standards Board
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AND TO the IASB —

Hans Hoogervorst
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AND TO

IFAC —

The Members,
International Accounting Bodies

Dear Sirs, dear Madams:

ACCOUNTING STANDARDS — REQUEST FOR RECONSIDERATION:
Accounting Perversion in Bank Financial Statements —
Demand Deposits Do NOT comply with IFRS (GAAP)

I am of the opinion that underlying the ongoing Global Financial Crisis is continuing accounting malpractice based on faulty accounting standards, or their false interpretation. The effects are devastating. I request you to reconsider and, if you agree, to act.

As public accountants we cannot continue to watch banks fail only a month after we have certified their financial statements as going concerns when they are clearly not. We cannot continue to hide behind the assertion that in the conduct of our audits we have complied with IFRS (GAAP) attesting, for example:

> "In our opinion, the financial statements... present fairly, in all material respects, the **financial position** of the Company as of ... , and the results of its operations and its **cash** flows... in accordance **with generally accepted accounting principals** in (the country where the report is issued)."

when the standards are misconceived and patently false, and we know that they are.

Demand deposits referred to by the public as "cash in bank" is recorded and reported by monetary financial institutions (MFI) in units of account by double-entry bookkeeping in a process which the MFIs call "lending " — but which is effectively a nullity — by debiting loans receivable and crediting demand deposits.

These so created units of account are then denominated at will in dollars, pound sterling, euros, etc., depending on the terms of the documentation or underlying promissory note, or whatever is the legal document giving rise to this type of "lending," using whatever is the name of the currency in the jurisdiction in which it takes place, but legal tender the "demand deposits" are not.

Banks do not have pre-existing funds in the form of legal tender to lend, except in miniscule amounts relative to the size of their loan portfolios.[1] In other words, banks create demand deposits out of nothing, and it therefore remains a nothing. The malpractice continues because public accountants as auditors sanctify the aforementioned practice by "certifying" the banks' financial statements, provoking credit expansion, moral hazard, asset bubbles, liquidity-stressed financial markets, bank runs, and eventually global financial crises.

By our inaction, we, the public accountants and their standard setters, are the enablers of the MFIs and responsible, in part at least, and not a small one, of the Global Financial Crisis that started in August 2007 when BNP Paribas refused to redeem certain sub-prime mortgage funds for inability to determine their value. The GFC is ongoing, continued in the form of a sovereign debt crisis, haircuts of bank deposits to "recapitalize" failed banks, and so on. The horror stories resulting from our oversight and malpractice are enormous. Yet, we remain quiet, we hide behind our complicated standards, are therefore not yet in issue, so it may appear.

The creation of units of account by MFIs that are masquerading as demand deposits defined by the FASB's ASC 305-10-20 as "cash in bank" do not comply with GAAP or IFRS. These socalled "loans receivable" that give rise to these socalled "demand deposits"

- are not assets within the meaning of economic resources,
- do not have the capacity to eventually result in cash inflows (cash being legal tender or central bank money, so called federal funds),
- are created bank-internally and therefore in violation of self-dealing,
- have no cost basis,

[1] For example, the total money U.S. supply in 2010 was about $10.9 trillion of which central bank money was only $2.7 trillion; the total Eurozone's money supply in 2010 was about €12.3 trillion of which the central bank money was less than only €1 trillion.

- have no market value except by way of assignment against like-kind-nullities to or from other MFIs never settled in legal tender or central bank money.

Such internally created units of account are not transferable among banks because they are unique to the MFI that created the units of account in their books of account, and can only be offset in what MFIs call their “payment clearing,” which means: incoming units of account are offset against outgoing units of account and the balance, if adverse, MUST be settled in legal tender meaning central bank money, so called federal funds in the United States. Other countries have their own mechanisms, but they are all based on non-legal-tender offsets of accounting units against each other — incoming vs. outgoing. If nothing comes in, as in stress situations, nothing can go out, markets freeze and financial assets cannot be liquidated... Contagion sets in. Déja vue... [2]

The Financial Accounting Standards Board’s (FASB) **Accounting Standards Codification** (1 July 2009) is misconceived stating:

> “**Cash**
>
> “Consistent with common usage,[3] cash includes not only legal tender bills and coins on hand but demand deposits at banks or other financial institutions. Cash also includes other kinds of accounts that have the general characteristics of demand deposits permitting the entity to deposit and withdraw funds at any time without prior notice or penalty.
>
> “All charges and credits to those accounts are cash receipts or payments to both the entity owning the account and the bank holding it. **For example, a bank's granting of a loan by crediting the proceeds to a customer's demand deposit account is a cash payment by the bank and a cash receipt of the customer when the entry is made.** [ASC 305-10-20] ” [Emphasis added.]

and should urgently be redrafted.

<u>Regulatory capital requirement misconception</u>

If and when by way of a proper definition of “demand deposits” as being legal tender actually held by the MFI (eg, as vault cash or balances at the central bank), requiring monetary reform which is currently underway — albeit on the basis of another misconception that regulatory capital serves as a resource to protect MFIs’ demand deposits, but “capital” is on the wrong side of the balance sheet when a **liquid asset** is required — then the so called regulatory capital requirements of the Basel Capital Accords,

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[2] Central Bankers Ben Bernanke, Mervyn King, Jean-Claude Trichet, as he then was,... came and helped out with cash, ***real*** **cash** like legal tender, central bank money. Lehman Brothers bankruptcy, Monday 15 September 2008 ... the line in the sand... drawn by US Sec. Treas. Hank Paulson, his grudge against his former rival Dick Fuld, but NEVER again. See “Quantitative Easing,” “Outright Monetary Transactions”...

[3] Yes, “common usage,” but if THAT constitutes and justifies Generally Accepted Accounting Principles, so might all kinds of things people do, and the end must also be generally accepted, including the GFC. For professional accountants, “common usage” is another nullity.

which have never prevented any of the ongoing bank failures and crises, become superfluous.

No end to the GFC until we act

Until the accounting standard setters act by correcting their own misconceptions and malpractices, there is no end to the ongoing Global Financial Crisis, and the central banks are forced to continue to plug the holes to save the world's payment system from collapsing.

The Americans call this exercise "Quantitative Easing," the Europeans "Outright Monetary Actions," which is all the same, namely band-aids to keep banks funded with real money because we, the public accountants, are aiding and abetting the bankers' common practice of creating non-transferable units of account NOT money, violating our own conceptual framework as the basis for our standards. [4]

With best professional regards,

Michael Schemmann, PhD, CPA, CMA
Director

[4] The IICPA's core standards require the disclosure of bank deposits as a deduction of balances held at the central bank, and the net amount may not be negative. SuperGAAP promotes the presentation of foreward-looking dynamic financial statements super-imposed on GAAP/IFRS. I wish to direct you to my various publications, listed at IICPA's website www.iicpa.com "Publications," in particular to "Accounting Perversion in Bank Financial Statements." My books are available for order online, but if you experience any difficulties, I will be pleased to send you a free copy.