

February 18, 2010

The Honorable Christopher J. Dodd
Chairman
Committee on Banking, Housing and Urban Affairs
United States Senate
534 Dirksen Senate Office Building
Washington, D.C. 20510

The Honorable Richard C. Shelby
Ranking Member
Committee on Banking, Housing and Urban Affairs
United States Senate
534 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Chairman Dodd and Ranking Member Shelby:

The American Institute of Certified Public Accountants strongly believes that independent, unbiased standard setting of private sector accounting principles is critical to capital markets and investor interests. As a result, the AICPA unequivocally supports the independence of the accounting standard setting process, and we appreciate the support you have shown for the same in your leadership roles on the Senate Committee on Banking.

Accounting standards are designed to present investors and other users of financial statements with transparent information in which they can be confident, thus serving as an essential foundation of capital markets.

A recent letter from various financial services organizations to the Committee suggests that accounting standards can cause systemic risk and thus should be subject to particular input from systemic risk authorities under financial regulatory reform legislation that Congress is considering. The writers “urge you to address potential systemic risks associated with accounting policy.” We believe this suggestion wrongly confuses the roles of accounting standard setters and the Securities and Exchange Commission with the role of prudential supervisors of financial institutions such as the Federal Deposit Insurance Corporation.

The primary objective of accounting standards is to identify and capture the essence and substance of what has already occurred in order to meet the public reporting obligations and needs of investors and capital markets. Fostering the safety and soundness of financial institutions and stability of financial markets is rightly the primary objective of prudential regulatory oversight agencies.

Illustrating the confusion we see in the current public debate, fair value accounting, in and of itself, has been targeted by some as contributing to the global financial crisis by impacting bank capital requirements

which in turn affect the ability of a bank to lend money in support of economic activity. Some even take the argument further and suggest that accounting standards can cause potential systemic risks in the financial system. What is missing in such a debate and such arguments is the distinction between accounting standards used for public reporting purposes and the application of such standards for prudential supervisory purposes.

Accounting standards for public reporting purposes should be seen solely as part of a wider disclosure regime that focuses on past financial performance. As SEC Chair Mary Schapiro stated in a November 5, 2009 letter: “I fear the potential consequences for our capital markets if investors come to believe that accounting standards serve any purpose other than to present the unvarnished truth.”

The reality is that business decisions and economic cycles lead to systemic risk – not accounting standards. Accounting standards merely capture business decisions and transactions in a way that investors can understand and utilize. We believe that statutory authority to address bank capital and lending capacity is already properly vested with financial regulatory authorities, and it would be a mistake to conflate accounting standards for public reporting purposes with systemic risk.

To be clear, recent disruptions in the U.S. financial system were caused by a number of factors, including poor underwriting in securitized debt markets, excessive leverage and use of derivative instruments, coupled with bad investment decisions by major financial institutions. In fact, by requiring the current market value of securitized assets to be disclosed, fair value accounting rules, where required, appropriately highlighted problems in banking companies instead of masking those problems. As former Treasury Secretary Henry Paulson said recently, critics of fair value accounting simply want to use historical cost accounting “to hide and cover up losses.”

In light of the recent letter to the Committee from various financial service organizations, we want to express our concern with any construct that would allow bank regulatory authorities or a systemic risk oversight authority to intervene or have undue influence over the setting of accounting standards for purposes of public financial reporting. We believe it may be quite appropriate, however, for bank regulatory authorities to assess if accounting standards used for public financial reporting purposes should be automatically applied for prudential regulatory purposes. Such authority resides today with prudential supervisors of financial institutions. Systemic risk authorities, if established, conceivably could provide appropriate input and direction to such prudential regulators regarding the use of accounting standards for prudential supervisory purposes.

As evidenced by the December 16, 2009 action by banking authorities with respect to FAS 166/167 – standards that require companies to bring off-balance sheet securitization vehicles on their balance sheet – there is no need to disrupt financial reporting to the public in order to utilize prudential authority. In the announcement by bank regulators easing the impact of these accounting standards on bank capital, FDIC Chair Sheila Bair stated: “The capital relief we are offering banks for the transition period should ease the impact of this accounting change on banks’ regulatory capital requirements, and enable banks to maintain consumer lending and credit availability as they adjust their business practices to the new accounting rules.”

There are a number of important wider implications in this debate. Generally accepted accounting principles are applicable to all companies. Focusing solely on any one industry effectively ignores the needs of the users of financial reporting for all other companies that may engage in similar transactions.

Tailoring accounting standards for any specific industry would mean that financial reporting for everyone else may not be as useful and transparent.

Further, from an international perspective, political intervention in the accounting standard-setting process could undermine U.S. leadership as the world moves toward adoption of a single set of high-quality, globally accepted accounting standards – strong standards which are needed to facilitate capital formation in an increasingly global economy. In our view, any step back from the bedrock principle of independent standard setting should be avoided.

Comments by any member of the public, including regulatory authorities, on existing and proposed accounting standards should always be welcomed. Financial regulatory authorities already have standing to play an important role in that process. We are deeply concerned, however, with recently made suggestions that Congress should assume and assert that accounting standards used for public reporting purposes can create “systemic risk” – as opposed to merely describing the financial condition of a company.

Again, we support the input of all interested parties into the independent accounting standard setting process. As the Committee considers moving forward on financial regulatory reform legislation, we hope it will strive to protect the investor-oriented public reporting purpose underlying the development of accounting standards and avoid proposals that confuse the role of accounting standard setters and the SEC with the role of prudential supervisors of financial institutions. We urge any consideration by a systemic risk authority regarding the effect of accounting standards on financial institutions and economic systemic risk be directed to prudential regulatory authorities as appropriate.

I appreciate your consideration of this issue.

Sincerely,

A handwritten signature in black ink, appearing to read "Barry C. Melancon". The signature is fluid and cursive, with a long horizontal stroke at the end.

Barry C. Melancon, CPA
President and CEO

cc: Senate Committee on Banking, Housing and Urban Affairs Members