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America's Community Bankers

September 21, 2001

Letter of Comment No: 32
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Mr. Timothy Lucas
Director of Research and Technical Activities
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856-5116

RE: Disclosure of Information About Intangible Assets Not Recognized in Financial Statements

Dear Mr. Lucas:

America's Community Bankers[1] is pleased to offer comments to the Financial Accounting Standards Board's (FASB or the Board) Proposal for New Agenda Project – Disclosure of Information About Intangible Assets Not Recognized in Financial Statements, dated August 17, 2001.

We understand the challenges that the accounting profession faces in developing financial reporting that is representationally faithful to the economics of business enterprise, and we commend FASB for its sponsorship of the Special Report, *Business and Financial Reporting, Challenges from the New Economy*. New thinking is obviously called for regarding some aspects of business' balance sheets.

In answer to your central question, there is a role for FASB to play in addressing reporting the intangibles of a business enterprise. This role, however, should be narrowly cast. We suggest that FASB's proposed project scope address only those intangible assets that are not recognized in statements of financial position but would have been recognized if acquired either separately or in a business combination, *and, that the scope include separate recognition for and measurement of embedded financial assets and liabilities such as banks' core deposit and customer relationship intangibles*.

Your proposal indicates that the Board does not propose to include core deposit intangibles (CDI) and similar matters in this potential project but welcomes comments on this conclusion. We strongly urge the Board to address treatment of CDIs in the scope. Unlike many more

[1] ACB represents the nation's community banks of all charter types and sizes. ACB members, whose aggregate assets exceed $1 trillion, pursue progressive, entrepreneurial and service-oriented strategies in providing financial services to benefit their customers and communities.

intangibles that could serve as the subject for this proposal, we suggest that assets that are exchanged with the frequency and predictability of CDI would make prime candidates for inclusion in this project. We understand that FASB (and the IASC) have indicated that customer-related intangibles be included within fair value accounting. We have shared our views with the Board, and IASC, on several occasions about the unsuitability of fair value accounting, which would be particularly unsuitable for accounting for intangibles. Obviously, CDIs do not trade with the liquidity and frequency of securities, but they are a form of semi-liquid financial instrument, and would be recorded under Generally Acceptable Accounting Principles (GAAP) if sold separately or in a business combination.

Current GAAP guidance for treatment of intangibles is at present incomplete. The recently issued Statement 142 retains paragraphs 4-7 of FAS 72 *Accounting for Certain Acquisitions of Banking and Thrift Institutions*. FAS 72, issued in 1983, creates "unidentifiable intangible assets" related to acquisitions that are not goodwill, but should be treated as goodwill. We urge the Board to consider whether current accounting guidance is adequate, clear, and consistent with regard to intangibles – even for those intangibles that are currently required to be recognized in acquisitions or business combinations.

Internally generated CDIs are real assets that are, for example, disclosed to regulators in some risk reporting and also are important "off-book" assets for analysts. If there is any type of intangible that makes sense to include in this proposed study, it would be internally generated intangibles related to customer and relationship-based activities.

Regarding other possible scopes of the project, we urge great caution in addressing an expansive list of possible intangibles. As we stated in our simultaneously submitted letter on the proposal on *Reporting Information About Financial Performance*, there should be a demarcation between what is the boundary of GAAP financial reporting and what is merely communicating information about strategy, quality, or management's analysis of the firm's prospects. Investors should ultimately make up their own minds comparing GAAP results against other information they receive. For example, in-process research and development assets may have value or may prove worthless. To the extent that a company is acquired and acquirers are willing to pay for this R&D investment, guidance from FASB may be useful for complying with Statements 141 and 142. The proper role of GAAP accounting is to record these assets in a representationaly faithful way. The fact that stock investors may be, by inference, willing to place a similarly high value of these R&D assets is quite different in character. Stock prices may be driven by only a small "free float" of the firm's equity capital. As recent history has shown us, high stock prices do not necessarily indicate that there are valuable underlying intangible assets.

As we stated in our *Reporting Information About Financial Performance* comments, it is not within the purview of GAAP financial reporting to communicate what are key value drivers of a business. If a reader of a reporting entity's annual report, or other reports such as 10-Ks, cannot figure out what a particular company does to make money, it is not necessarily the accountant's responsibility to tell them. The firm's "value proposition", as it is often called, is something that management should impart to investors through Management's Discussion and Analysis, investor conferences, and non-GAAP financial statements. If this value proposition is not self-evident in a firm's GAAP earnings, it is questionable whether recognizing new and innovative classes of intangible assets will more successfully inform investors than would standard GAAP results. Having simple, clear-cut GAAP serves as a check on management making unrealistic claims about financial performance or sources of value.

In summary, we support FASB in its efforts to study and further clarify how intangible assets are to be recognized. FASB should further develop and clarify existing guidance so as to create a sound and consistent approach to recognizing intangibles that are currently sold in arm's length transactions, as well as those currently unrecognized intangibles that would otherwise be recognized for accounting purposes in a business combination or other acquisition. This would undoubtedly include a better approach to recognizing CDIs and similar intangibles embedded in certain financial assets or liabilities.

ACB appreciates the opportunity to comment on this important matter. Please contact the undersigned at 202-857-3125 regarding questions or clarification of our views.

Sincerely,

/s/Joseph Blalock

Joseph Blalock
Director, Financial and Technology Policy