



Office of the General Counsel

B-276130

February 25, 1997

The Honorable Alfonse M. D'Amato
Chairman
The Honorable Paul S. Sarbanes
Ranking Minority Member
Committee on Banking, Housing, and Urban Affairs
United States Senate

The Honorable Thomas J. Bliley, Jr.
Chairman
The Honorable John D. Dingell
Ranking Minority Member
Committee on Commerce
House of Representatives

Subject: Securities and Exchange Commission: Disclosure of Accounting Policies
for Derivative Financial Instruments and Derivative Commodity
Instruments

Pursuant to section 801(a)(2)(A) of title 5, United States Code, this is our report on a major rule promulgated by the Securities and Exchange Commission (SEC), entitled "Disclosure of Accounting Policies for Derivative Financial Instruments and Derivative Commodity Instruments" (RIN: 3235-AG42/RIN: 3235-AG77). We received the rule on February 3, 1997. It was published in the Federal Register as a final rule on February 10, 1997. 62 Fed. Reg. 6044.

This rule amends existing rules and forms for domestic and foreign issuers to clarify and expand disclosure requirements for market risk sensitive instruments. The amendments also require enhanced disclosure of accounting policies for derivative financial instruments and derivative commodity instruments in the footnotes to the financial statements. The amendments expand existing disclosure requirements to include quantitative and qualitative information about market risk inherent in market risk sensitive instruments and provide safe harbor protection to this information. In the aggregate, these amendments are designed to provide

additional information about market risk sensitive instruments, which investors can use to better understand and evaluate the market risk exposures of a registrant.

Enclosed is our assessment of the SEC's compliance with the procedural steps required by section 801(a)(1)(B)(i) through (iv) of title 5 with respect to the rule. Our review indicates that the SEC complied with the applicable requirements.

If you have any questions about this report, please contact Kathleen E. Wannisky, Associate General Counsel for Operations, at (202) 512-5207. The officials responsible for GAO evaluation work relating to the Securities and Exchange Commission are Jean Gleason Stromberg, Director of Financial Institutions and Markets Issues (telephone 202-512-8678), and Robert W. Gramling, Director of Corporate Audits and Standards (telephone 202-512-9406).

Robert P. Murphy
General Counsel

Enclosure

cc: The Honorable Jonathan G. Katz
Secretary
Securities and Exchange Commission

ANALYSIS UNDER 5 U.S.C. § 801(a)(1)(B)(i)-(iv) OF A MAJOR RULE
ISSUED BY
THE SECURITIES AND EXCHANGE COMMISSION
ENTITLED
"DISCLOSURE OF ACCOUNTING POLICIES FOR DERIVATIVE FINANCIAL
INSTRUMENTS AND DERIVATIVE COMMODITY INSTRUMENTS"
(RIN: 3235-AG42/RIN: 3235-AG77)

(i) Cost-benefit analysis

The Commission stated in its report to us that there is no statutory mandate for it to prepare a cost-benefit analysis of a rule. However, section 23(a)(2) of the Securities Exchange Act of 1934 directs the Commission to consider the impact that any rule will have on competition. The Commission states that it is adopting these amendments and disclosure items in response to requests from investors and others to provide more meaningful information about various financial and commodity instruments. According to the Commission, the expected benefits of these amendments are to provide more complete information about market risk sensitive instruments to investors and others. This more complete disclosure is expected to result in the markets operating more efficiently. The Commission believes that the benefits from the more complete disclosure and increased market efficiency are expected to outweigh the related costs. The Commission also believes that the rule will not impose any unnecessary or inappropriate burden on competition.

(ii) Agency actions relevant to the Regulatory Flexibility Act, 5 U.S.C. §§ 603-605, 607 and 609

Section 603: Initial Regulatory Flexibility Analysis

The proposed rulemaking, 61 Fed. Reg. 578 (January 8, 1996) incorporated an initial regulatory flexibility analysis of the expected impact on small entities.

The analysis provides the information required by paragraphs 603(b)(1) through (b)(3). It describes the reasons for the proposed action, and its objectives and legal basis. It describes the small entities (small business issuers) to which the rule will apply. It states that the proposed rule does not conflict or overlap with existing requirements, but rather tailors them for specific purposes. The analysis further points out that it has reduced the impact of the proposed amendments on small businesses by determining not to amend Regulation S-B to incorporate an item similar to proposed Item 305 of Regulation S-K.

Section 604: Final Regulatory Flexibility Analysis

The preamble to the final rule contains a summary of the Final Regulatory Flexibility Analysis. 62 Fed. Reg. 6062 (February 10, 1997). The agency submitted the entire analysis to us for our review when it submitted its report on the rule.

As required by section 604(a)(1), the Commission provided a succinct statement of the need for, and the objectives of, the rule.

Although no comments were filed that addressed the Initial Regulatory Flexibility Analysis, comments were received from 97 entities. The analysis discusses the changes made to the proposed rule as a result of the comments, including (1) extending the safe harbor to any Item 305 disclosure that is voluntarily provided by a small business issuer and (2) several changes that the Commission believes should reduce the cost for all registrants preparing the disclosures of quantitative information about market risk.

The Commission also describes how excluding small business issuers from all but the accounting policy disclosures required by the rule limits substantially the application of the amendments to small entities. It also states that the accounting policies required by the new rule are clarifications of existing requirements and should not require any additional recordkeeping or bookkeeping.

(iii) Agency actions relevant to sections 202-205 of the Unfunded Mandates Reform Act of 1995, 2 U.S.C. §§ 1532-1535

As an independent regulatory agency, the Commission is not subject to title II of the Unfunded Mandates Reform Act of 1995.

(iv) Other relevant information or requirements under Acts and Executive orders

Administrative Procedure Act, 5 U.S.C. §§ 551 *et seq.*

The final rule was promulgated using the notice and comment procedures of 5 U.S.C. § 553. The notice of proposed rulemaking was published in the Federal Register on January 8, 1996. 61 Fed. Reg. 578.

The SEC received 97 comments to the proposed rulemaking. The commenters raised concerns relating to (1) accounting policy, (2) quantitative disclosures about market risk, (3) qualitative disclosures about market risk, and (4) implementation issues. The Commission discusses its reaction to these concerns, and changes made because of the comments, in the preamble to the rule published in the Federal Register. 62 Fed. Reg. 6062 (February 10, 1997).

Paperwork Reduction Act, 44 U.S.C. §§ 3501-3520

According to the SEC, the amendments and disclosure items were submitted for review to the Office of Management and Budget in accordance with the Paperwork Reduction Act and were approved by OMB in accordance with the clearance procedures of that act (44 U.S.C. 3507). Because the various regulations, forms, and rules that are being amended by this rulemaking already possessed OMB control numbers, OMB did not assign new control numbers.

The Commission stated that it also solicited comments on the compliance burdens associated with the proposals but received no public comment in response.

Statutory authorization for the rule

The final rule is authorized by sections 7, 10, 19, and 27a of the Securities Act of 1933 (15 U.S.C. 77g, 77j, 77s, and 77z-1) and sections 12, 13, 14, 21E, and 23 of the Securities Exchange Act of 1934 (15 U.S.C. 78l, 78m, 78q, 79u, and 79w).

Executive Order No. 12866

This rule, promulgated by an independent regulatory agency, is not subject to the review requirements of Executive Order 12866.

The Commission did not identify any other statutes or executive orders imposing requirements relevant to the rule.