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**ECONOMIC POLICY BOARD
EXECUTIVE COMMITTEE**

March 24, 1976
8:30 a.m.
Roosevelt Room

STRICTLY PRINCIPALS ONLY

1. Review of the Current Economic Outlook

Troika II

MEMORANDUM
OF CALL

TO:

Pat

YOU WERE CALLED BY—

YOU WERE VISITED BY—

Paul Leach

OF (Organization)

PLEASE CALL →

PHONE NO.
CODE/EXT. _____

WILL CALL AGAIN

IS WAITING TO SEE YOU

RETURNED YOUR CALL

WISHES AN APPOINTMENT

MESSAGE

"I have no problem with the
Bill Simon letter to Henry Royce
which was just delivered here."

*Relayed to Seidman's
Office 3:00 p.m. / pm*

RECEIVED BY

CV

DATE

tues

TIME

2:42

STANDARD FORM 63

REVISED AUGUST 1967

GSA FPMR (41 CFR) 101-11.6

GPO : 1969-048-10-80241-1 222-829

63-108

100-218

THE WHITE HOUSE

WASHINGTON

March 23, 1976

MEMORANDUM FOR ECONOMIC POLICY BOARD
EXECUTIVE COMMITTEE MEMBERS

FROM: ROGER B. PORTER *RBP*

SUBJECT: Letter to Chairman Ruess on Banking Regulation

A letter to Chairman Ruess on banking regulation, prepared for Secretary Simon's signature is attached. He has requested that it be circulated to Executive Committee members for their comments by 4:00 p.m. today. Please provide your comments on this letter to Mr. Seidman's office no later than 3:30 p.m. today.

Attachment



THE SECRETARY OF THE TREASURY

WASHINGTON 20220

Dear Mr. Chairman:

While I was abroad, Deputy Secretary Dixon testified for the Administration on the omnibus bill entitled the Financial Reform Act. I would like to support his testimony and add my own views about the proposed changes in the Federal Reserve System.

As the chief financial officer of the Administration, I believe it would be unwise to remove the Federal Reserve from direct regulation, examination and supervisory contact with our domestic and international financial institutions. Since monetary policy cannot be conducted in a vacuum, the Federal Reserve's supervisory powers are invaluable in maintaining a close and continuous dialogue with the banking system, the international monetary authorities and the central banks of the western trading nations.

In order to implement monetary policy and effectively assess the impact of its actions, the Federal Reserve must have the best first-hand information from the domestic and international financial markets and institutions. Daily, hourly, and sometimes minute-by-minute knowledge are absolute requirements in conducting these very sensitive activities. As you know, when we talk about the processes of determining appropriate monetary policy, we are really talking about loan rates and the volume of available credit, security prices and yields, currency exchange rates, international currency and capital flows, and the condition of bank reserves and the federal funds market. The general public may think that the Federal Reserve is working with obscure esoteric concepts like M_1 , M_2 , etc., but these calculations, like the balance of payments computation, only tell us what happened yesterday. What the Federal Reserve needs to know is what is happening now and only direct contact with financial institutions can tell them that.

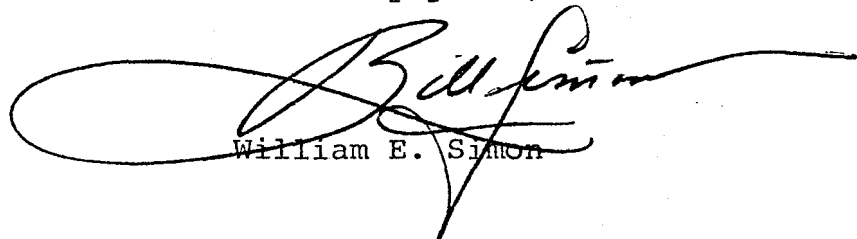


We cannot ask the Governors and experts of the Federal Reserve System, however eminently qualified, to take on the awesome responsibility for monetary policy without giving them the tools for this critical mission. When a central bank having supervisory responsibility asks questions, it gets answers and attention. When it has a background of extensive studies and examinations of banks and bank holding companies and has at its disposal a corps of professional bank supervisors, it can quickly spot changes in the intricate mechanisms of payment and credit transactions that affect monetary aggregates. With its regulatory and supervisory powers it can stop or control practices which affect our monetary system and the stability of our currency. I fear that to transfer the supervisory mission to a Federal Banking Commission would deny the Federal Reserve an instrument it has relied on for decades, and would frustrate the execution of monetary policy.

The value of the direct interrelationship of supervisory and monetary policy roles has most recently been apparent at such times as the bankruptcy of the Penn Central Railroad, the failure of the Franklin National Bank, and the New York City financial crisis. During these periods, as always, I maintained direct and close liaison with the Federal Reserve not only because the operational missions of the Treasury and the Federal Reserve are so closely interrelated, but also because their eyes and ears are sharp and sensitive. I am convinced that without a supervisory role this capability would wane.

Those responsible for monetary policy need every aid to conduct it effectively. Under the proposed Financial Reform Act we could be rushing into ill-advised experimentation with this delicate process. That, in my opinion, would be an unnecessary and dangerous course.

Sincerely yours,



William E. Simon

The Honorable
Henry S. Reuss
Chairman, Committee on Banking,
Currency and Housing
House of Representatives
Washington, D. C. 20515

March 19, 1976

ECONOMIC POLICY BOARD
EXECUTIVE COMMITTEE

Proposed Agenda

Monday, March 22, 1976

- | | |
|---|----------|
| 1. Monthly Status Report on Trade Policy | STR |
| 2. New York City Financial Condition | Treasury |
| 3. Report of Task Force on Banking Regulation | Treasury |

Tuesday, March 23, 1976

- | | |
|---|----------|
| 1. Administration Policy on the Use of Government Sponsored Loans in Leveraged Leases | OMB |
| 2. Task Force Proposal for Improving Agency Regulations | Schmults |
| 3. Report on International Monetary Situation | Treasury |

~~X~~ Wednesday, March 24, 1976 - Principals Only

- | | |
|---|-----------|
| 1. Review of the Current Economic Outlook | Troika II |
|---|-----------|

Thursday, March 25, 1976

- | | |
|---|--|
| 1. Meeting of Council on Wage and Price Stability | |
|---|--|

Friday, March 26, 1976

- | | |
|--|---------|
| 1. Report of Labor Negotiations Committee | Labor |
| 2. Pension Plans and the Employment Retirement Income Security Act of 1974 | Labor |
| 3. Small Business | Seidman |



THE SECRETARY OF THE TREASURY

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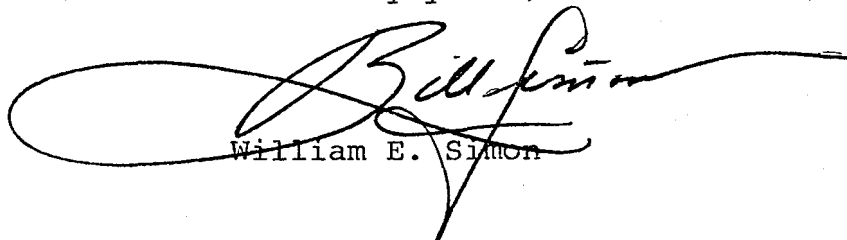
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William E. Simon

The Honorable
Henry S. Reuss
Chairman, Committee on Banking,
Currency and Housing
House of Representatives
Washington, D. C. 20515

THE WHITE HOUSE

WASHINGTON

March 23, 1976

MEMORANDUM FOR ECONOMIC POLICY BOARD
EXECUTIVE COMMITTEE MEMBERS

FROM: L. WILLIAM SEIDMAN *lws*
SUBJECT: Replacement Cost Accounting

The involvement of several Executive Committee members at a GOP Leadership meeting with the President this morning prompted the cancellation of this morning's regular Executive Committee meeting.

One agenda item scheduled for this morning was a presentation by the Securities and Exchange Commission on their adoption of a new rule that will require large companies to disclose information about the impact of changing costs on their business. The announcement is scheduled for public release Wednesday morning.

Three documents, prepared by the SEC, explaining the new rule are attached for your information. The new rule is generally in line with our previous discussions on this subject and may merit a statement in support of the concept.

Attachments

The Securities and Exchange Commission today announced the adoption of a new rule which will require large companies to disclose information about the impact of changing costs on their business.

The rule, an amendment to Regulation S-X which sets forth the form and content of financial statements filed with the Commission, provides that all registrants with inventories and gross plant aggregating more than \$100 million and amounting to more than 10% of their total assets must disclose, either in a footnote or in a separate section of the financial statements, the current cost of replacing inventories and productive capacity and the amount of cost of sales and depreciation if they had been computed on the basis of replacement costs. The rule is applicable to annual financial statements covering periods beginning after December 25, 1975, and thus will require the disclosures in 1976 statements.

While the Commission noted that it was not requiring a change in the face of the basic financial statements which are prepared on the basis of historical costs, it did recognize that the new rule would require companies subject to it to produce on a supplemental basis significantly different data than are currently available.

These data, based on current replacement costs, may represent the first step toward a revised system of accounting based on current values. The Commission specifically stated that it did not intend to require fundamental changes in basic financial statements beyond requiring the disclosures set forth in the rule, since it believed that any such change should be initiated by the Financial Accounting Standards Board which is currently studying the conceptual framework of financial

statements. The data required based on current replacement cost should provide useful input to the Board as it considers this matter.

Because the required data will require many estimates and subjective judgments, the Commission rules will permit them to be labeled "unaudited" even though they must be part of the financial statements filed with the Commission. The rule also calls for disclosure of the methods of preparing the data and the presentation of such additional information as management believes necessary to communicate the meaning of the data to investors.

The Commission issued the new rule for comment in August 1975 and received over 350 letters of comment, most of which urged delay. In rejecting these arguments, the Commission said that the data are presently needed by investors and that it was not necessary to develop detailed procedural techniques for implementing the rules prior to adoption. It noted that the rules would encourage experimentation with varying techniques and it found this a beneficial result when the data were supplemented by disclosure of the methods used in their preparation.

In recognition of the imprecision and subjectivity of the required data, the Commission proposed a "safe harbor" rule which would provide registrants with some protection from liabilities where the data were prepared with care and good faith and where the basis of calculation was set forth.

In addition, the Commission indicated that it would soon appoint an advisory committee to work with the staff in assisting registrants with the problems of implementation as the year progresses.

At the same time as the new rule was adopted, the staff issued Staff Accounting Bulletin No. 7 which provided a number of interpretations of the rule, based on comments received on the proposal and on pilot studies observed by the staff.

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

SECURITIES ACT OF 1933
Rel. No. /March 23, 1976

SECURITIES EXCHANGE ACT OF 1933
Rel. No. /March 23, 1976

PUBLIC UTILITY HOLDING COMPANY ACT OF 1935
Rel. No. /March 23, 1976

NOTICE OF PROPOSED AMENDMENTS UNDER REGULATION S-X
WITH RESPECT TO DISCLOSURE OF CERTAIN REPLACEMENT
COST DATA IN NOTES TO FINANCIAL STATEMENTS (S7-623)

Comment Deadline: May 31, 1976

File No.

The Securities and Exchange Commission today published for comment an amendment to Rule 3-17 of Regulation S-X, the adoption of which was recently announced in Securities Act Release No. (March , 1976). The proposed amendment would make clear that persons complying with the provisions of Rule 3-17 in disclosing current replacement cost information would not be deemed to have made an "untrue statement of a material fact" or a statement "false or misleading with respect to any material fact," or to have engaged in or employed a "manipulative, deceptive, deceitful or fraudulent device, contrivance, scheme, course of business transaction, act or practice" as those terms are used in the Securities Act, Securities Exchange Act ("Exchange Act"), or the Public Utility Holding Company Act (the "Holding Company Act") or rules and regulations thereunder.

The Commission has proposed this amendment because of the imprecise nature of replacement cost information and its desire to encourage the development and disclosure of such information in good faith. In effect, the amendment would create a "safe harbor," insulating persons from liability under the federal securities laws if, at the time they disclosed current replacement cost information in compliance with the provisions of Rule 3-17 of Regulation S-X, such information (1) had been

prepared with reasonable care, (2) had a reasonable factual basis and represented management's good faith judgment, and (3) was accompanied by a statement which disclosed the basis upon which such information was calculated and the imprecisions inherent therein. Of course, unless management had disclosed all information of which it was aware and which it believed was necessary to prevent current replacement cost information from being misleading, the requirements of Rule 3-17(f) of Regulation S-X would not be satisfied, and the "safe harbor" would not be available. If the rule is adopted, the Commission would evaluate the desirability of the safe harbor from time-to-time as its experience under Rule 3-17 increases.

The text of the proposed amendment is as follows:

PROPOSED AMENDMENT TO RULE 3-17 OF REGULATION S-X

Rule 3-17 of Regulation S-X shall be amended by adding:

* * *

(g) Current replacement cost information disclosed in accordance with the requirements of this rule shall be deemed not to be an "untrue statement of a material fact," a statement "false or misleading with respect to any material fact" or a "manipulative, deceptive or fraudulent device, contrivance, scheme, course of business, transaction, act or practice, as those terms are used in the Securities Act of 1933, the Securities Exchange Act of 1934, or the Public Utility Holding Company Act of 1935, or rules and regulations thereunder, if such information, at the time disclosed --

- (1) Had been prepared with reasonable care;
- (2) Had a reasonable factual basis and represented management's good faith judgment; and
- (3) Was accompanied by a statement which disclosed the basis upon which it was calculated and the imprecisions inherent therein.

* * *

The Commission has proposed the foregoing amendment pursuant to its authority under Section 19(a) of the Securities Act, Sections 3(b) and 23(a)(1) of the Exchange Act, and Section 20 of the Holding Company Act. In addition to the definitional authority provided therein, Section 19(a) of the Securities Act, Section 23(a)(1) of the Exchange Act, and Section 20(d) of the Holding Company Act specifically provide that no liability under those Acts "shall apply to any act done or omitted in good faith in conformity" with any rule or regulation of the Commission.

Pursuant to Section 23(a)(2) of the Exchange Act, the Commission has considered the effect that the proposed amendment would have on competition and is not aware, at this time, of any burden that such amendment, if adopted, would impose on competition not necessary or appropriate in furtherance of the purposes of that Act. However, the Commission specifically invites comment as to the anticompetitive effects, if any, the proposal likely would engender.

All interested persons are invited to submit their views and comments on the foregoing proposal, in writing, to George A. Fitzsimmons, Secretary, Securities and Exchange Commission, Washington, D.C. 20549, on or before May 31, 1976. Such communications should refer to File No. S7-623 and will be available for public inspection.

By the Commission.

George A. Fitzsimmons
Secretary

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

SECURITIES ACT OF 1933
Rel. No. /March 23, 1976

SECURITIES EXCHANGE ACT OF 1934
Rel. No. /March 23, 1976

PUBLIC UTILITIES HOLDING COMPANY ACT OF 1935
Rel. No. /March 23, 1976

ACCOUNTING SERIES
Rel. No. /March 23, 1976

NOTICE OF ADOPTION OF AMENDMENTS TO REGULATION S-X
REQUIRING DISCLOSURE OF CERTAIN REPLACEMENT COST DATA

A. General Statement

In Securities Act Release No. 5608 issued August 21, 1975, the Commission proposed for comment amendments to Regulation S-X which would require footnote disclosure of certain financial data regarding current replacement cost. These proposals were designed to enable investors to obtain more relevant information about the current economics of a business enterprise in an inflationary economy than that provided solely by financial statements prepared on the basis of historical cost. More than 350 letters of comment have been received on the proposals and after giving these comments careful consideration, the Commission has determined to adopt the proposals in somewhat revised form. In addition, the Commission has decided to create an advisory committee to assist its staff in providing guidance to registrants in the problems of implementing this new rule.

The new rule as adopted requires registrants who have inventories and gross property, plant and equipment which aggregate more than \$100 million and which comprise more than 10% of total assets to disclose the estimated current replacement cost of inventories and productive capacity at the end of each fiscal year for which a balance sheet is required and the approximate amount of cost of sales and depreciation based on replacement cost for the two most recent full fiscal years. In addition, registrants are required to disclose the methods used in determining these amounts and to furnish any additional information of which management is aware and believes is necessary to prevent the information from being misleading. This

information may be presented either in a footnote to the financial statements or in a separate section of the financial statements following the notes. In either place, the information may be designated as "unaudited."

In requiring these data, the Commission is aware that it is requiring companies to make disclosures of costs which cannot be calculated with precision. They must be estimated on the basis of numerous assumptions which may vary over time and from company to company and through the use of techniques which are not so fully developed that they can be standardized at the present time, if ever. This is because estimates of current replacement cost must be made within the framework of each registrant's economic situation and because there are difficult conceptual and empirical judgments which must be made in the light of different specific factual circumstances in developing the data. Nevertheless, the Commission believes that such data are important and useful to investors and are not otherwise obtainable. It feels that imprecision, if properly explained, will not make the data misleading. The Commission encourages registrants to supplement the required disclosures with information which management believes will be helpful to investors in understanding the impact of price changes and other current economic conditions on reported results.

In recognition of the imprecise nature of the data, the Commission is proposing for comment a "safe harbor" rule designed to recognize in a rule the Commission's view that if such data have a reasonable basis, are prepared with reasonable care and in good faith and are presented with adequate disclosure the data do not constitute an "untrue statement of a material fact" or a "manipulative, deceptive or fraudulent device."

Decision not to Delay

The Commission was urged by many commentators to delay the adoption of rules (or at least the effective date) until the means of compliance with the rules could be spelled out with precision. The Commission has concluded that such delay is not appropriate in general, although it has permitted a one year delay in effectiveness of the rule for mineral resources in the extractive industries. This was done in recognition of the particularly severe implementation problems for such assets and in the light of the expressed willingness of a leading trade association in the largest of these industries to undertake a major research effort within this year to resolve such problems. In addition, a one year delay

has been permitted in effectiveness for foreign assets located outside the North American continent and the European Economic Community if certain specific disclosures relating to such assets are made.

The Commission's judgment that delay is not appropriate is based on a number of factors. First, it believes that under current economic conditions, data about the impact of changes in the prices of specific goods and services on business firms is of great significance to investors in developing an understanding of the current operations of any firm. While the current general rate of inflation has been reduced from 1974 levels, it is still at a level such that unsupplemented historical cost based data do not adequately reflect current business economics. Further, in an inflationary economy specific costs and prices which may affect a business change more rapidly than the general price level. These factors make the impact of delay more severe than would be the case in a time of price stability.

In addition, as a practical matter, it would never be possible for the Commission to anticipate every possible circumstance that may be faced in the application of this new disclosure rule. This is particularly true since the rule covers new ground and requires subjective judgments in its application. Accordingly, the Commission believes that various approaches taken in implementing the rule should be viewed as experimental, and that alternative approaches will be acceptable as long as the methods used are fully described and are applied in good faith and with reasonable care. There does not seem to be any persuasive reason, therefore, to deny these data to investors while experimentation in alternative techniques takes place.

By requiring full disclosure of the approaches used and permitting considerable flexibility in the way in which the data are displayed, the Commission is confident that it has provided sufficient latitude so that registrants will be able to communicate effectively the meaning of the data to investors. Registrants may, for example, present the data in supplemental financial statements, show estimates in terms of ranges rather than single figures, and discuss the imprecisions inherent in the data. They may describe historical relationships between costs and selling prices, point out the cost savings and any incremental costs and changed economic lives associated with new equipment, indicate their plans for the

replacement or non-replacement of assets, and present any other information which they believe will assist investors in understanding the impact of changing prices and inflation in general on the registrant. This may include a discussion of possible favorable effects of inflation on the firm, such as the benefits from repaying debt in less valuable dollars and the possible benefits of operating leverage in an inflationary environment.

While certain standards and guidelines for application of this rule may be developed after experimentation has taken place, it is highly unlikely that a totally uniform set of procedures can ever be developed which will make the implementation of the rule a mechanical process.

Creation of Advisory Committee to Assist in Implementation

Nevertheless, the Commission recognizes that it is important that registrants receive guidance on implementation problems and that experience in this regard is shared. Accordingly, it has determined to appoint an advisory committee composed of persons working with the problems of implementation to meet on a regular basis with the staff of the Commission to consider problems raised by registrants in complying with the rule. The composition and procedures of this committee will be announced shortly. From these meetings and from its other experiences in dealing with registrants, the staff will publish staff accounting bulletins which set forth its judgments. The first staff accounting bulletin on this subject which responds to questions raised in letters of comment on the proposal and to problems arising from the staff's experience in participating in pilot programs by business firms is being published simultaneously with the issuance of this release.

In addition to its own efforts, the Commission believes that it would be useful for industry groups and associations to consider specialized problems in the application of replacement cost concepts to their areas of interest. In this connection, such groups may undertake to develop specific price indices applicable to particular classes of assets and suggest uniform industry-wide reporting approaches. The Commission staff would be willing to lend such assistance as it can to such efforts.

Analysis of Costs and Benefits

The release which accompanied the proposed rules specifically requested data as to the cost of compliance. Many respondents expressed concern about costs, but only a small number made specific estimates. Those estimates varied widely, and in general the cost estimates supplied by companies which had implemented replacement cost systems or undertaken pilot studies were substantially below those which had not. This suggests that as companies take steps to implement the rules adopted herein, they will find that the cost of compliance will be less than that estimated. Nevertheless, the Commission recognizes that the cost of implementing this rule will be significant, particularly in the first year of preparing the necessary data. It also seems clear that the cost will be proportionately higher for small companies with less sophisticated accounting systems.

The Commission has carefully considered the cost of implementation and weighed it against the need of investors for replacement cost information. It has concluded that in the case of companies of large size which generally have the largest public investor interest, the data are of such importance that the benefits of disclosure clearly outweigh the costs of data preparation. In the case of smaller companies where the cost burden is proportionately greater and the extent of public investor interest is proportionately less, the balance between economic costs and benefits is less clear. Accordingly, the Commission has determined initially to exempt from the rule companies whose inventories and gross property, plant and equipment aggregate less than \$100 million. While it urges such companies to make appropriate disclosure of the effect of specific price changes and inflation in general on their operations, it is not at this time requiring them to make the specific disclosure required by this rule. As experience is gained with the costs of implementing the rule and the benefit of the information to investors, the Commission will consider the desirability of eliminating or amending the exemption.

In addition, the Commission has concluded that companies whose inventories and gross properties comprise less than 10% of total assets need not make the disclosure since in the case of such companies the effects of such disclosure on financial statements would generally be immaterial.

Inclusion of Data in Financial Statements and Auditor Responsibility

The Commission also asked for specific comment on whether the required data should be audited. Most commentators suggested that due to both cost considerations and the lack of articulated standards, it would be undesirable to require the replacement cost information to be audited. Many advocated that the data be removed from the financial statements and included elsewhere in annual reports and filings.

In response to these comments, the Commission has concluded that the required data need not be audited and it accordingly will permit the required information to be labeled "unaudited." It does not believe, however, that the information should be removed from the financial statements. As it has previously stated, 1/ it believes that significant financial disclosures about business operations during a period should generally be included in the financial statements for that period, and it does not see any compelling reasons for excluding this information. In a business world characterized by uncertainty, it is necessary to recognize that many estimates based on subjective judgments must be included in financial statements and that appropriate means of describing the uncertainties and the lack of precision in the data must be found. 2/

While the original proposal required that the data be displayed in a footnote, the Commission recognizes that in some circumstances the required data when supplemented by additional disclosures explaining the basis for its preparation and other information deemed appropriate by management may be of considerable length and include substantial data. Both because of its length and its nature registrants may feel that it should not be included in the notes to the financial statements. Accordingly, the adopted rule permits the disclosures either in the footnote or in a separate section of the financial statements which follows the notes and is appropriately labeled. If such a separate section is used, a brief cross reference in the notes (such as in the note on accounting policies) would be appropriate.

1/ Accounting Series Release No. 177

2/ Accounting Series Release No. 166

The unaudited footnote or separate section of the financial statements containing the data will be a part of financial statements reported on by independent accountants. Accordingly, the independent accountant will be associated with the replacement cost information even though it is unaudited. The Commission urges the Auditing Standards Executive Committee of the American Institute of Certified Public Accountants to develop appropriate standards applicable to the auditor in the case of such association.

Non-Preemption of Financial Accounting Standards Board

A number of those commenting upon the proposal expressed concern that the rules if adopted would preempt the Financial Accounting Standards Board (FASB) and possibly the conclusions of the Commission's general study of financial disclosure now under way. The Commission does not believe that these concerns are merited.

In December 1974, the FASB issued an exposure draft of a statement which would require financial statements to include supplemental data in which historical costs were adjusted for changes in the general price level. In the Commission's proposal, it noted that general price level adjustments might be used either with historical cost or current replacement cost financial data. Accordingly, it did not and does not view its proposal as competitive with that of the FASB. In fact, in implementing the Commission's rule, some registrants may wish to use data regarding changes in the general price level as part of the analysis of reasons for changes in replacement costs. At the present time, however, the Commission does not propose to require the presentation of data restated for changes in the general purchasing power of the monetary unit.

Similarly, the Commission does not believe its new requirements prejudice any conclusions which may arise from the FASB's study of the conceptual framework of financial statements. As it noted in its original proposal, the Commission believes that fundamental changes in the basic accounting model should come about only after careful study by the FASB. It believes that experimentation with replacement cost information of the sort that will result from the

implementation of this rule will materially assist the FASB in its study as well as providing meaningful supplemental disclosure to investors in the interim.

Finally, the Commission does not feel that adoption of this rule will have any adverse effect on its own broad study of financial disclosure. One of the reasons for the study was the concern expressed by some that the Commission's requirements emphasized objective disclosure to the exclusion of relevant information. Certainly this rule will give the study group the opportunity to observe the response of registrants and investors to a requirement for non-precise subjective disclosure. The rule will of course be part of the total framework studied and its adoption at this time does not exclude it from consideration in the study.

Non-inclusion of Other Current Cost and Value Data

Some commentators on the proposed rule objected to its partial approach. They suggested that data be required concerning the current value of other assets and liabilities and the effect of inflation on monetary items held by the company. The Commission recognizes that its rule is a limited one and does not deal either with all effects of inflation on financial position and operations, or with the current value of all assets and liabilities. Its primary objective, as articulated in the adopted rule, is to provide investors with meaningful additional information not otherwise available about the current economics of a business as a supplement to historical cost data. A secondary objective is to provide data about the current cost of inventories and productive capacity at the balance sheet date. These are the principal operating assets of many businesses. It is recognized that replacement cost does not always measure the current economic value of such assets, but in most cases it is a reasonable approximation.

The Commission views its rule as a first step in a process of providing more meaningful disclosure about current economic costs and values to investors. It believes that the rule will encourage meaningful experimentation with the various approaches to providing such information, and as noted above it will assist the FASB in addressing the broad conceptual and practical issues involved.

The Commission also believes that the rule will provide investors with significant data now unavailable about the effect of current economic conditions on the business. The effect of inflation on monetary assets and liabilities can be approximated from data now publicly available, and the current market value of marketable securities portfolios is required to be disclosed. With the additional data provided as a result of this rule, analysts and investors should be able to develop a number of different methods of analyzing economic results, such as estimating the return on new investment, calculating rates of return on capital based on varying assumptions and developing alternative measures of economic results.

The Commission cautions investors and analysts against simplistic use of the data presented. It intentionally determined not to require the disclosure of the effect on net income of calculating cost of sales and depreciation on a current replacement cost basis, both because there are substantial theoretical problems in determining an income effect and because it did not believe that users should be encouraged to convert the data into a single revised net income figure. The data are not designed to be a simple road map to the determination of "true income." In addition, investors must understand that due to the subjective judgments and the many different specific factual circumstances involved, the data will not be fully comparable among companies and will be subject to errors of estimation.

Legal Exposure of Registrants

Finally, commentators expressed concern about the possible legal liabilities to which they would be exposed as a result of including data based on subjective judgments and estimates. While the Commission believes that registrants are protected under the law as it now exists if such data have a reasonable basis, are prepared with reasonable care and in good faith and are accompanied by disclosure of the basis of their calculation and the imprecisions inherent therein, it has determined to propose an amendment to Rule 3-17 to make this clear. This proposal is being issued for comment (in Securities Act Release No.) simultaneously with the adoption of these amendments to Regulation S-X.

Effect on Competition

The Commission has considered the impact which the foregoing amendments to Regulation S-X would have upon competition and has concluded that the preparation and disclosure of replacement cost information of the type in question to the public, including registrants' competitors, will not significantly burden competition. In addition, the Commission has concluded that requiring these disclosures only by those companies whose inventories and gross property, plant and equipment aggregate \$100 million or more, and whose total inventories and gross property, plant and equipment are 10% or more of its total assets, will not significantly burden the ability of such companies to compete with those which do not meet these criteria. In any event, the Commission has determined that any possible resulting burden will be far outweighed by, and is necessary and appropriate to achieve, the important benefits to investors discussed herein.

Effective Date of Regulation S-X Amendments

The Commission has determined to make Rule 3-17 of Regulation S-X effective for financial statements covering fiscal years ending on or after December 25, 1976, with the exception that it shall not apply to the mineral resource assets of companies engaged in the extractive industries prior to fiscal years ending on or after December 25, 1977, nor shall it apply to the assets located outside the North American continent and the countries of the European Economic Community prior to fiscal years ending on or after December 25, 1977, provided that the historical cost and a description of any such assets excluded from the supplemental replacement cost data are disclosed.

B. Amendments Adopted

Regulation S-X.

* * * * *

Rule 3-17. Current Replacement Cost Information. (New rule)

Statement of Objectives.

The purpose of this rule is to provide information to investors which will assist them in obtaining an understanding of the current costs of operating the

business which cannot be obtained from historical cost financial statements taken alone. Such information will necessarily include subjective estimates and it may be supplemented by additional disclosures to assist investors in understanding the meaning of the data in particular company situations. A secondary purpose is to provide information which will enable investors to determine the current cost of inventories and productive capacity as a measure of the current economic investment in these assets existing at the balance sheet date.

Exemption. This rule shall not apply to any person where the total of inventories and gross property, plant and equipment (i.e., before deducting accumulated depreciation, depletion and amortization) as shown in the consolidated balance sheet at the beginning of the most recently completed fiscal year is less than \$100 million or where the total of inventories and gross property, plant and equipment is less than 10 percent of the total assets of the person as shown in the consolidated balance sheet at the beginning of the most recently completed fiscal year.

The information set forth below shall be shown in a note to the financial statements or as part of a separate section of the financial statements following the notes. The note or the separate section may be designated "unaudited."

(a) The current replacement cost of inventories at each fiscal year end for which a balance sheet is required shall be stated. If current replacement cost exceeds net realizable value at that date, that fact shall be stated and the amount of the excess disclosed.

(b) For the two most recent fiscal years, state the approximate amount which cost of sales would have been if it had been calculated by estimating the current replacement cost of goods and services sold at the times when the sales were made.

(c) State the estimated current cost of replacing (new) the productive capacity together with the current depreciated replacement cost of the productive capacity on hand at the end of each fiscal year for which a balance sheet is required. For purposes of this rule, assets held under financing leases as defined in Rule 3-16(q) shall be included in productive capacity. In the case

of any major business segments which the company does not intend to maintain beyond the economic lives of existing assets, the disclosures set forth in Rules 3-17(c) and (d) are not required provided full disclosure of the facts, amounts and circumstances is made.

(d) For the two most recent fiscal years, state the approximate amount of depreciation, depletion and amortization which would have been recorded if it were estimated on the basis of average current replacement cost of productive capacity. For purposes of this calculation, economic lives and salvage values currently used in calculating historical cost depreciation, depletion or amortization shall generally be used. For assets being depreciated, depleted or amortized on a time expired basis, the straight-line method shall be used in making this calculation. For assets depreciated, depleted or amortized on any other basis (such as use), that basis shall be used for this calculation.

(e) Describe the methods used in determining the amounts disclosed in items (a) through (d) above. Describe what consideration, if any, was given in responding to items (a) and (b) to the related effects on direct labor costs, repairs and maintenance, utility and other indirect costs as a result of the assumed replacement of productive capacity. Where the economic lives or salvage values currently used in historical cost financial statements are not used in (d) above, an explanation of other bases used and the reasons therefor shall be disclosed. If depreciation, depletion or amortization expense is a component of inventory costs or cost of sales, indicate that fact and cross-reference the answer for this item in item (b) in order to avoid potential duplication in the use of these data.

(f) Furnish any additional information--such as the historical customary relationships between cost changes and changes in selling prices, the difficulty and related costs (such as those related to environmental regulations) which might be experienced in replacing productive capacity--of which management is aware and which it believes is necessary to prevent the above information from being misleading.

* * * * *

This amendment to Regulation S-X is adopted pursuant to Sections 6, 7, 8, 10 and 19(a) of the Securities Act of 1933; Sections 12, 13, 15(d) and 23(a) of the Securities Exchange Act of 1934; and Sections 5(b), 14 and 20(a) of the Public Utility Holding Company Act of 1935.

Rule 3-17 of Regulation S-X is effective for financial statements for fiscal years ending on or after December 25, 1976, except that the rule shall be initially applicable to the mineral resource assets of registrants engaged in the extractive industries and to registrants' assets located outside the North American continent and the countries of the European Economic Community in financial statements for fiscal years ending on or after December 25, 1977; provided that the historical cost and a description of any such assets excluded from the supplemental replacement cost data are disclosed.

By the Commission.

George A. Fitzsimmons
Secretary

ECONOMIC POLICY BOARD
EXECUTIVE COMMITTEE

March 23, 1976
8:30 a.m.
Roosevelt Room

- Cancelled*
1. Replacement Cost Accounting SEC
 2. Administration Policy on the Use of
Government-Sponsored Loans in Leveraged
Leases OMB



MINUTES OF THE
ECONOMIC POLICY BOARD
EXECUTIVE COMMITTEE MEETING

March 22, 1976

Attendees: Messrs. Simon, Seidman, Lynn, Robinson, Dent, Baker, Cannon, Malkiel, Dixon, Gorog, Gerard, Porter, Perritt, Glitman, Hormats, Wolff, Arena, Rosenblatt, Hughes

1. Monthly Status Report on Trade Policy

The Executive Committee reviewed a memorandum prepared by the Special Representative for Trade Negotiations outlining Trade Act remedies and trade policy issues likely to require consideration during the next six months. The discussion focused on the Jackson-Vanik waiver, the reporting of trade figures by the Department of Commerce, and the advisability of holding public hearings on our overall trade policy.

Decisions

The Executive Committee approved a recommendation that the Administration seek a year's extension of the Jackson-Vanik waiver which expires on July 4, 1976.

Ambassador Dent will prepare a letter for the President's signature recommending extension of the Jackson-Vanik waiver and will also prepare a cover memorandum outlining the reasons for this recommendation.

Ambassador Dent will prepare a discussion paper on the issue of whether the Administration should hold public hearings on overall U.S. trade policy. The paper will include alternative formats for such public hearings.

The Executive Committee approved forwarding to the President the STR memorandum on "Trade Policy -- Six Months Projection." Ambassador Dent will revise the memorandum for submission to the President.

The Department of Commerce will report trade figures on a CIF basis as well as on a FAS basis.

2. New York Financial Condition

The Executive Committee reviewed a memorandum outlining the current financial situation of New York City and New York State which is attached at Tab A. The discussion focused on the City University, the current status of the bankruptcy legislation, the New York City Transit negotiations, and the likelihood of New York City pulling out of the Social Security system.

Decision

Mr. Gerard will prepare a memorandum on the outlook for state and local governments terminating their participation in the Social Security system.

3. Report of Task Force on Banking Regulation

The Executive Committee reviewed a report from the Task Force on Banking Regulation. The discussion focused on the Administration's testimony on congressional proposals for consideration of the Comptroller of the Currency and the bank regulation and supervision functions of the Federal Reserve Board into a new independent agency called the Federal Banking Commission; the legislative status of the Financial Reform Act; and the work plan for the Task Force.

Decision

The Executive Committee requested the Task Force to prepare a report on alternatives for improved banking regulation, including the proposals of the Federal Reserve Board.

COUNCIL OF ECONOMIC ADVISERS
WASHINGTON

ALAN GREENSPAN, CHAIRMAN
PAUL W. MACAVOY
BURTON G. MALKIEL

March 22, 1976

MEMORANDUM FOR THE AGRICULTURAL POLICY COMMITTEE

FROM: Paul W. MacAvoy *Paul MacAvoy*
SUBJECT: Report No. 1 of the Agricultural Policy Working Group

1. Grain Exports

Forecasts of wheat exports have been placed in the range from 34.7 to 36.1 million metric tons, a decline of 1.4 million tons at the midpoint of the range. But if no further sales for export to the Soviet Union by July 1, 1976 occur, this would likely put wheat exports just above the lower end of the range.

Projected corn exports for 1975/76 have been increased 2.5 million metric tons, placing them in the range from 38.1 to 40.6 million metric tons. This increase is due to additional world demand for U.S. feed grains, much of it accounted for by more livestock feeding and less use of wheat in Western Europe.

U.S. carryover stocks of wheat are now forecast at 12.7 to 13.4 million metric tons, a 1.4 million ton increase from the January estimate, reflecting the reduction in estimated exports. This would put 1975/76 ending stocks 4.2 million tons above a year earlier. The forecast ending stocks of feed grains have been reduced 1 million tons since January, with increased exports being partially offset by a decline in projected domestic feeding due to lower fed cattle prices.

2. The Outlook for Additional Soviet Sales

USDA expects that damage to the Soviet winter grain crop has been greater than normal, although this should be offset in part by larger planted acreage. Spring barley is likely to be the principal crop used to reseed winter-killed areas.



USDA and State have different understandings concerning Soviet purchases of 1976 crop wheat. Assistant Secretary Bell has stated that up to 4 million metric tons of 1976 crop wheat shipped before October 1, 1976 may be purchased by the Soviets without further consultation with the USG even if such shipments would lead to additional exports above the 7 million ton hold put into effect at the time U.S. sales to the Soviets were reopened last fall. Under Secretary Robinson has stated that any Soviet purchases for shipment before October 1, 1976 in excess of the 7 million ton hold would require further Soviet consultation with the USG. The difference between these two positions is that Mr. Bell's view could allow 4 million metric tons of grain shipments more than Mr. Robinson's before October 1, 1976 without further Soviet consultation with the USG.

3. Palm Oil Imports and Potential Effects on U.S. Soybean Producers

An interagency working group chaired by CIEP was requested to study issues posed by increasing imports of palm oil and options for dealing with these imports. The working group is to report to the Agricultural Policy Working Group in two or four weeks.

4. Meat Import Negotiations

Australia and New Zealand have been dissatisfied with the existence of the 1976 voluntary meat export restraint program and the level of restraint proposed for imports into the United States for 1976. It is considered important that the negotiations be completed soon, hopefully by March 31 so that the Secretary of Agriculture can announce completion along with his quarterly estimate of imports subject to the Meat Import Law. Delay could have political costs among livestock farmers, especially if fed cattle prices continue to decline or even remain at current levels which are on the order of 5 to 10 percent below levels of last December.



DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

DEPUTY ASSISTANT SECRETARY

March 17, 1976

MEMORANDUM FOR THE EXECUTIVE COMMITTEE ECONOMIC POLICY BOARD

SUBJECT: Up-Date on New York City

I. March 15 Monthly Report

The March 15 monthly report, covering the period ending January 31, shows continued steady budget reductions roughly in accordance with the financial plan for fiscal 1976. It should be noted that the plan still calls for annualized expenditure reductions of only \$200 million in fiscal 1976, notwithstanding the \$300 million increase in the deficit estimates. What remains of most concern is the fact that no concrete plans have yet been announced to cover the \$400-\$500 million reductions required in each of the next two fiscal years.

II. Other New York City Matters

The transit workers' contract expires on March 31 and negotiations are currently underway. The Union is demanding a substantial wage and benefit increase and is taking the position that since the Transit Authority is technically a State agency, its employees are not covered by the city employee wage freeze. Needless to say, whether or not this position is factually correct, as a practical matter a substantial wage and/or benefit increase will make it extremely difficult to hold the line on other city contracts which will be negotiated this spring.

Last week, Governor Carey announced the removal of Herbert Elish as Executive Director of the Emergency Financial Control Board, and appointed Stephen Berger, currently State Welfare Commissioner, to the position. Berger is extremely familiar with the finances of New York City since he served as Executive Director of the Rockefeller-created Scott Commission which raised some key warning signals in 1973 and 1974. Berger has a reputation as an honest and tough, if somewhat abrasive, administrator. If, notwithstanding the Governor's public pronouncements regarding stretching

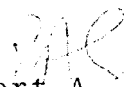
out the financial plan and similar comments by Felix Rohatyn, the Control Board is committed to carrying out the plan, Berger can be an effective force.

In April, New York City will return to the front burner in Congress. Proxmire will hold oversight hearings beginning on April 1. Secretary Simon will be the lead-off witness; Mayor Beame, other City and State officials, and GAO representatives will also testify. On April 6, both the Senate and House Appropriations Subcommittees will hold hearings on the issue in connection with our fiscal 1977 administrative expenses appropriation. Congressman Ashley's Subcommittee of House Banking is expected to hold oversight hearings on or about April 20 (the date the first loan repayment is due).

III. New York State

There is room for optimism with respect to the financing requirements of New York State. The \$2.6 billion State Agency financing package appears to be firmly in place.

With respect to the State's own financing requirements, considerable progress has been made. The legislature is expected to adopt a conservatively balanced FY-77 budget sometime this week. The New York clearing house banks have agreed to provide approximately \$1 billion of the \$2.75 billion to be raised from the private sector. The principal question mark is the \$700 million scheduled to be provided by commercial banks outside of New York State. No formal approaches have been made to these institutions, pending adoption of the budget and the issuance of a State prospectus regarding the offering. An informal contact with the institution expected to take the largest share provides basis for hope, but it is still too early to tell.


Robert A. Gerard
Deputy Assistant Secretary
Financial Resources Policy Coordination