FINANCIAL MANAGEMENT:
Audit of the Exchange Stabilization Fund's Fiscal Years 2000 and 1999 Financial Statements

OIG-01-061

March 30, 2001

Office of Inspector General

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The Department of the Treasury

Contents

OIG

Report of the Office of Inspector General

The Department of the Treasury
Office of Inspector General

March 30, 2001

To the Assistant Secretary for International Affairs:

We audited the Exchange Stabilization Fund's (ESF) Statements of Financial Position as of September 30, 2000 and 1999, and the related Statements of Income and Retained Earnings, and Cash Flows for the years then ended.

Results in Brief

Our opinion on ESF's Fiscal Years 2000 and 1999 financial statements is unqualified. Our Fiscal Year 2000 audit disclosed the following matters involving the internal control and its operation that we consider to be reportable conditions, as defined on page 4 of this report:

- Supervisory Review and Approval of Transactions Recorded in the General Ledger Need to be Consistently Performed (see page 5).

- Detailed Written Procedures Documenting Accounting Operations and the Financial Statement Preparation Process Need to be Established (see page 6).

Our audit disclosed no reportable instances of noncompliance with laws and regulations.

Management's Responsibilities

Management is responsible for:

- Preparing the financial statements in conformity with generally accepted accounting principles as published by the Financial Accounting Standards Board and for preparing the Policy and Operations Statements of ESF.
- Establishing and maintaining internal control. In fulfilling this responsibility, estimates and judgments by management are required to assess the benefits and related costs of internal accounting policies and procedures.
- Complying with laws and regulations applicable to ESF.

Scope of Audits

We conducted our audits in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements* (OMB Bulletin No. 01-02). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. Our responsibility is to express an opinion on the financial statements based on our audits. We believe that our audits provide a reasonable basis for our opinion.

In planning and conducting our audit of ESF's financial statements for the year ended September 30, 2000, we considered its internal control over financial reporting and compliance with laws and regulations. Specifically, we obtained an understanding of the design of ESF's internal controls, determined whether these internal controls had been placed in operation, assessed control risk, and performed tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting and compliance with laws and regulations. Consequently, we do not provide an opinion on such controls.

As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of ESF's compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. Providing an opinion on compliance with laws and regulations was not an objective of our audit and, accordingly, we do not express such an opinion.

We have read the information in the Policy and Operations Statements and assessed whether such information, or the manner of its presentation, is materially inconsistent with the information, or the manner of its presentation, in the financial statements.

Results of Audits

Opinion on the Financial Statements

In our opinion, the financial statements present fairly, in all material respects the financial position of ESF as of September 30, 2000 and 1999, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

Other Information

Our audits were conducted for the purpose of expressing an opinion on ESF's Fiscal Years 2000 and 1999 financial statements referred to above. The information contained in the Policy and Operations Statements of ESF is presented for the purpose of additional analysis and is not a required part of the financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the financial statements, and accordingly, we express no opinion on it. However, we compared this information for consistency with the financial statements and, based on this limited work, we found no material inconsistencies.

Internal Control

Internal control is a process, effected by management and other personnel, designed to provide reasonable assurance that the following objectives are met:

- Reliability of financial reporting - transactions are properly recorded, processed, and summarized to permit the preparation of the financial statements in accordance with generally accepted accounting principles as published by the Financial Accounting Standards Board, and the safeguarding of assets against loss from unauthorized acquisition, use, or disposition; and

- Compliance with applicable laws and regulations that could have a direct and material effect on the financial statements.

Because of limitations inherent in any internal control, errors or fraud may occur and not be detected. Also, projection of any evaluation of internal control to future periods is subject to the risk that internal control may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

As defined in OMB Bulletin No. 01-02, reportable conditions are matters coming to our attention that, in our judgment, should be communicated because they represent significant deficiencies in the design or operation of the internal control, that could adversely affect ESF management's ability to meet the internal control objectives as defined above. Material weaknesses are reportable conditions in which the design or operation of the internal control does not reduce to a relatively low level the risk that errors, fraud, or noncompliance in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

We identified the following matters involving the internal control and its operation that we consider to be reportable conditions as defined above.

<u>Reportable Conditions</u>

1. **Supervisory Review and Approval of Transactions Recorded in the General Ledger Need to be Consistently Performed**

   ESF management requires supervisory review and approval of batch runs of transactions before they are posted to the general ledger, to prevent mispostings. We noted in our audit that the batch runs of October 1999 through July 2000 transactions were not reviewed or approved. This lack of review allowed a number of inaccurate entries to be recorded in the general ledger without detection. Specifically, we noted errors in calculations of monthly interest revenue accruals and monthly revaluations of foreign currency denominated assets due to the use of incorrect interest rates, holding periods, and exchange rates. We also noted adjustments to the general ledger to correct errors made in prior periods which could not be explained or supported. ESF performed review and approval of transaction batch runs and adjustments for the months of August and September 2000.

Recommendation

The Director, Office of Financial Management should ensure that batch runs of transactions and adjustments are consistently reviewed and approved by a supervisor before they are posted to the general ledger. This review should include examining supporting documentation and calculations to support these entries.

2. **Detailed Written Procedures Documenting Accounting Operations and the Financial Statement Preparation Process Need to be Established**

   ESF does not have written procedures detailing how to process transactions or prepare its financial statements. During FY 2000, ESF experienced turnover of its accounting staff and supervisor. As a result of no written procedures, certain transactions were not processed accurately, consistently, or timely. Also, staff did not have procedures to prepare year-end accruals, adjustments, closing entries, and the financial statements. As a result, it was necessary for us to provide management with significant assistance to complete the year-end close and prepare the financial statements.

   Recommendation:

   The Director, Office of Financial Management should ensure that ESF's management establishes written procedures detailing the process for recording all transactions, performing year-end closing, and preparing financial statements.

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Our consideration of the internal control would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we do not believe the reportable conditions described above are material weaknesses.

Compliance with Laws and Regulations

The results of our tests of compliance in Fiscal Year 2000 with laws and regulations disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards,* and OMB Bulletin No. 01-02.

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We have reviewed our findings and recommendations with ESF's financial management and have incorporated their comments as appropriate. The response to our audit report from the Deputy Chief Financial Officer, Departmental Offices is included in Appendix 1 to this report. In accordance with Department of the Treasury Directive No. 40-01, we request a corrective action plan be provided to us within 30 days of the date of this report. We recognize that certain corrective actions have already been undertaken. We encourage these efforts and will continue to provide advice and assistance to you in this regard.

Should you or you staff have any questions, you may contact me at (202) 927 5430 or a member of your staff may contact Mike Fitzgerald, Director, Financial Audits, at (202) 927-5789. We appreciate the corporation and the courtesies extended to our staff.

This report is intended solely for the information and use of the management of ESF, the Department of the Treasury, OMB, and the Congress, and is not intended to be and should not be used by anyone other than these specified parties.

William H. Pugh

William H. Pugh
Deputy Assistant Inspector General for Financial Management
and Information Technology Audits
December 22, 2000

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

March 21, 2001

MEMORANDUM FOR: WILLIAM H. PUGH
DEPUTY ASSISTANT INSPECTOR GENERAL FOR FINANCIAL MANAGEMENT AND INFORMATION TECHNOLOGY AUDITS

FROM: Barry Hudson,
Deputy Chief Financial Officer, Departmental Offices

SUBJECT: Draft Audit Report on the Department of the Treasury Exchange Stabilization Fund FY 2000 Financial Statements

We have reviewed your office's draft audit report on the Department of the Treasury Exchange Stabilization Fund FY 2000 financial statements. We have no comments on the report. I appreciate the efforts of you and your staff in the audit and we look forward to working with you again on the FY 2001 audit.

Financial Audits Division

Mike Fitzgerald, Director
Marie Maguire, Audit Manager
Ade Bankole, Lead Auditor
Alex Biggs, Auditor
Catherine Yi, Auditor

The Department of the Treasury

The Secretary of the Treasury
Office of International Affairs
Office of Management
Office of Accounting and Internal Control
Office of Financial Management

SECTION II

EXCHANGE STABILIZATION FUND
FISCAL YEARS 2000 AND 1999
FINANCIAL STATEMENTS

Exchange Stabilization Fund
Policy and Operations Statements
Fiscal Year 2000

The Nature and Function of the Exchange Stabilization Act

The Gold Reserve Act of 1934 established a fund to be operated by the Secretary of the Treasury, with the approval of the President. Section 10 of the Act provided that "For the purpose of stabilizing the exchange value of the dollar, the Secretary of the Treasury, with the approval of the President, directly or through such agencies as he may designate, is authorized, for the account of the fund established in this section, to deal in gold and foreign exchange and such other instruments of credit and securities as he may deem necessary to carry out the purpose of this section." To this end, the Congress, in 1934, appropriated to the Exchange Stabilization Fund (ESF) the sum of $2 billion out of the increment resulting from the reduction in the "weight of the gold dollar." Subsequent amendments to the Gold Reserve Act approved the operation of the ESF through June 30, 1945. Section 7 of the Bretton Woods Agreements Acts, approved July 31, 1945, continued its operations permanently.

The Bretton Woods Agreements Act also directed the Secretary of the Treasury to pay $1.8 billion from the ESF to the International Monetary Fund (IMF), for the initial U.S. quota subscription in the IMF, thereby reducing the ESF's appropriated capital to $200 million.

Reflecting termination of the fixed exchange rate system, legislation enacted in 1976 (P.L. 94-564, effective April 1, 1978, the date of entry into force of the Second Amendment of the IMF Articles of Agreement) amended the language of Section 10 of the Gold Reserve Act to specify that the ESF is to be utilized as the Secretary "may deem necessary to and consistent with the United States obligations in the International Monetary Fund." In 1977, P.L. 95-147 further amended Section 10 of the Gold Reserve Act. Following codification, Section 10 now provides as follows:

> Consistent with the obligations of the Government in the International Monetary Fund on orderly exchange arrangements and a stable system of exchange rates, the Secretary or an agency designated by the Secretary, with the approval of the President, may deal in gold, foreign exchange, and other instruments of credit and securities the Secretary considers necessary. However, a loan or credit to a foreign entity or government of a foreign country may be made for more than 6 months in a 12-month period only if the President gives Congress a written statement that unique or emergency circumstances require the loan or credit be for more than 6 months (31 U.S.C. 5302 (b)).

Pursuant to the Special Drawing Rights Act of 1968 (P.L. 90-349, amended by P.L. 94-564, which was approved October 18, 1976 and became effective April 1, 1978), Special Drawing Rights (SDRs) allocated by the IMF to the United States or otherwise acquired by the United States are resources of the ESF.

Section 286p of Title 22 of the United States Code allows for SDRs to be monetized/demonetized through the issuance/redemption by the Secretary of the Treasury of SDR certificates to the Federal Reserve Banks in exchange for dollars. The total amount of SDR certificates outstanding cannot exceed the dollar equivalent of ESF (i.e., U.S.) holdings of SDRs; such certificates are a liability of the ESF.

Foreign Currency Operations

During fiscal year 2000, the ESF engaged in a single market transaction. On September 22, 2000, the ESF bought $669.7 million equivalent of euros in an operation coordinated with the European Central Bank, the Bank of Japan, and other G-7 monetary authorities.

a. Euros

During fiscal year 2000, the ESF had a net unrealized loss of $1.259 billion on its euro holdings and investment income of $239.6 million equivalent on investment of euro assets.

b. Japanese yen

During fiscal year 2000 the ESF had a net unrealized loss of $84.4 million on its yen holdings and interest earnings of $2.0 million equivalent on investment of yen assets.

c. Brazil

In October 1999, December 1999 and April 2000, the ESF received commissions of $43.8 million, $30.9 million and $30.1 million respectively from the Bank for International Settlements (BIS) when Brazil completed the repayments of its two drawings on a credit arrangement provided by the BIS. The United States, through the ESF, participated in a multilateral guarantee of this credit arrangement, which was established in December 1998. The ESF earned a total of $140.3 million in commissions under this guarantee, of which $104.8 million was in connection with repayments by Brazil to the BIS during fiscal year 2000 and $35.5 million was in connection with repayments in fiscal year 1999.

d. Mexico

After the end of fiscal year 2000, in December 2000, the Treasury and Federal Reserve Bank of New York renewed the Exchange Stabilization Agreement with Mexico for another year to December 2001.

SDR Operations

ESF holdings of SDRs increased by SDR 537.9 million during fiscal year 2000 to SDR 7.95 billion. The dollar value of these SDR holdings increased by $32.7 million, a difference that is due both to the net change in SDRs and a change in the value of the SDR in dollars, a figure calculated by the IMF. The ESF reimbursed the Treasury's General Fund $444.2 million for SDRs received from the IMF as remuneration on the U.S. reserve position in the IMF. The ESF earned interest of $438.5 million on its SDR holdings.

As of September 30, 2000, cumulative allocations to (liabilities of) the United States totaled SDR 4.9 billion ($6.4 billion). These liabilities would come due only in the event of liquidation of, or U.S. withdrawal from, the SDR Department of the IMF, or cancellation of SDRs. As of September 30, 2000, U.S. holdings (assets) of SDRs exceeded cumulative allocations and totaled SDR 7.9 billion ($10.3 billion).

The ESF redeemed $4 billion of SDR certificates from the Federal Reserve in fiscal year 2000, leaving $3.2 billion of SDR certificates outstanding at the end of the fiscal year. Subsequent to the end of the fiscal year, the ESF redeemed a further $1 billion of SDR certificates.

Income and Expense

Interest revenue totaled $1.49 billion, consisting of $807.5 million in interest on dollar holdings invested in U.S. Government securities, $438.5 million equivalent in interest on SDR holdings, and $241.6 million in interest on foreign currency investment.

The ESF earned $104.8 million in commission for its role in guaranteeing the BIS credit facility for Brazil.

Interest expense totaled $281.1 million, of which $275.1 million was in charges on SDR allocations and $6.0 million was interest paid by the ESF to the Treasury General Fund on the dollar counterpart of SDRs received as remuneration on the U.S. reserve position in the IMF.

Department of the Treasury
Exchange Stabilization Fund
Statement of Financial Position
(In Thousands)

September 30	2000	1999
Assets		
Cash and Cash Equivalents (Note 2)		
U.S. Government Securities	$ 11,028,570	$ 15,232,198
Foreign Currency Denominated Assets	8,504,370	9,001,271
Total Cash and Cash Equivalents	19,532,940	24,233,469
Other Foreign Currency Denominated Assets (Note 3)	2,404,450	2,513,215
Special Drawing Right Holdings (Note 4)	10,316,415	10,283,763
Investment Securities, Held to Maturity (Note 5)	4,666,854	4,521,171
Accrued Interest Receivable	146,839	112,668
Total Assets	$ 37,067,498	$ 41,664,286
Liabilities and Equity		
Liabilities		
Certificiates Issued to Federal Reserve Banks (Note 6)	$ 3,200,000	$ 7,200,000
Special Drawing Right Allocations (Note 4)	6,359,054	6,799,029
Unearned Income and Advances	87	13,283
Accrued Expenses	188,037	39,491
Total Liabilities	9,747,178	14,051,803
Equity		
Appropriated Capital	200,000	200,000
Retained Earnings	27,120,320	27,412,483
Total Equity	27,320,320	27,612,483
Total Liabilities and Equity	$ 37,067,498	$ 41,664,286

The accompanying notes are an integral part of the financial statements

Department of the Treasury
Exchange Stabilization Fund
Statement of Income and Retained Earnings
(In Thousands)

Years Ended September 30	2000	1999
Interest Revenue		
Interest on U. S. Government Securities	$ 807,535	$ 802,860
Interest on Foreign Currency Denominated Assets	186,377	153,777
Interest on Special Drawing Right Holdings	438,494	348,990
Interest on Investment Securities	55,247	47,197
Total Interest Revenue	1,487,653	1,352,824
Interest Expense		
Interest on Special Drawing Right Allocations	275,153	233,262
Interest on Special Drawing Right Received as Remuneration by the U.S. Treasury	5,961	3,680
Total Interest Expense	281,114	236,942
Net Interest Revenue	1,206,539	1,115,882
Other Revenue		
Commissions	104,773	35,547
Total Other Revenue	104,773	35,547
Net Gains and Losses		
Unrealized (Loss) Gain on Valuation of Special Drawing Rights	(255,181)	54,197
Net Realized Gain on Sales of Foreign Currency Denominated Assets	-	151,598
Unrealized (Loss) Gain on Valuation of Foreign Currency Denominated Assets	(1,347,761)	1,485,799
Total Net (Loss) Gain	(1,602,942)	1,691,594
Other Expenses		
International Monetary Fund Annual Assessment	533	967
Total Other Expenses	533	967
Net (Loss) Income	$ (292,163)	$ 2,842,056
Retained Earnings, Beginning of Year	27,412,483	24,570,427
Retained Earnings, End of Year	$ 27,120,320	$ 27,412,483

The accompanying notes are an integral part of the financial statements.

Department of the Treasury
Exchange Stabilization Fund
Statement of Cash Flows
(In Thousands)

Years Ended September 30	2000	1999
Cash Flows from Operating Activities		
Interest Received on U.S. Government Securities	$ 805,597	$ 804,237
Interest Received on Foreign Currency Denominated Assets	171,876	159,316
Interest Received on Investment Securities	50,507	37,631
Commissions Received on Credit Facility	104,773	35,547
Net Realized Gain on Sale of Foreign Currency Denominated Assets	-	151,598
Net Unrealized (Loss) Gain on Valuation of Foreign Currency Denominated Assets	(1,334,759)	1,486,828
Other	(17,365)	13,283
Net Cash (Used in) Provided by Operating Activities	(219,371)	2,688,440
Cash Flows from Investing Activities		
Net Decrease (Increase) in Foreign Currency Denominated Assets	108,766	(418,962)
Net Increase in Investment Securities	(145,683)	(797,142)
Purchases of Special Drawings Rights Received as Remuneration by the U.S. Treasury and Related Interest	(444,241)	(710,974)
Purchases of Special Drawings Rights	-	(443,708)
Sales of Special Drawing Rights	-	1,225,269
Net Cash Used in Investing Activities	(481,158)	(1,145,517)
Cash Flows from Financing Activities		
Certificates Redeemed from Federal Reserve Banks	(4,000,000)	(2,000,000)
Other	-	(749)
Net Cash Used in Financing Activities	(4,000,000)	(2,000,749)
Net Decrease in Cash and Cash Equivalents	(4,700,529)	(457,826)
Cash and Cash Equivalents at Beginning of Year	24,233,469	24,691,295
Cash and Cash Equivalents at End of Year	$ 19,532,940	$ 24,233,469

Reconciliation of Net (Loss) Income to Net Cash (Used in) Provided by Operating Activities

	2000	1999
Net (Loss) Income	$ (292,163)	$ 2,842,056
Adjustments to Reconcile Net (Loss) Income to Net Cash (Used in) Provided by Operating Activities:		
Decrease (Increase) in Special Drawing Right Holdings Due to Valuation	411,588	(247,896)
(Increase) Decrease in Accrued Interest Receivable	(34,171)	9,801
(Decrease) Increase in Special Drawing Right Allocations Due to Valuation	(439,975)	80,193
Increase (Decrease) in Accrued Expenses	148,546	(8,997)
(Decrease) Increase in Unearned Income and Advances	(13,196)	13,283
Total Adjustments	72,792	(153,616)
Net Cash (Used in) Provided by Operating Activities	$ (219,371)	$ 2,688,440

The accompanying notes are an integral part of the financial statements.

NOTES TO THE FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies

The Exchange Stabilization Fund (ESF) was established as a result of the Gold Reserve Act of 1934, as amended, to be operated by the Secretary of the Treasury, with the approval of the President, consistent with the obligations of the U.S. Government in the International Monetary Fund (IMF) on orderly exchange arrangements and a stable system of exchange rates. To this end, the Secretary of the Treasury may deal in gold, foreign exchange, and other instrument of credit and securities.

A. Basis of Accounting & Presentation

The ESF has historically prepared its financial statements in accordance with generally accepted accounting principles, based on accounting standards issued by the Financial Accounting Standards Board (FASB), the private-sector standards-setting body. In October 1999, the Federal Accounting Standards Advisory Board (FASAB) was designated by the American Institute of Certified Public Accountants (AICPA) as the standards-setting body for financial statements of federal government entities, with respect to the establishment of generally accepted accounting principles. FASAB has indicated, however, that financial statements prepared based upon accounting standards published by the FASB may also be regarded as in accordance with generally accepted accounting principles for those federal entities, such as the ESF, that have issued financial statements based upon FASB accounting standards in the past. Accordingly, consistent with historical reporting, the ESF financial statements are presented in accordance with accounting standards published by the FASB.

In accordance with generally accepted accounting principles, the preparation of financial statements requires the use of management estimates. Certain immaterial reclassifications have been made to the 1999 financial statements to conform to the presentation used in 2000.

B. Fair Values of Financial Instruments

Cash and Cash Equivalents, which consist of U.S. Government securities and Foreign Currency Denominated Assets (FCDA), are reported in the Statement of Financial Position at amounts that approximate their fair values. The fair value of Investment Securities is based upon quoted market prices (See Note 5). FCDAs, Other FCDAs, Special Drawing Right (SDR) Holdings, and SDR Allocations have been revalued in the Statement of Financial Position, using current exchange rates, to amounts which approximate fair value. The SDR Certificates issued to Federal Reserve Banks (FRB) are reflected on the Statement of Financial Position at their face value. It is not practicable to estimate the fair value of these Certificates issued to FRBs since these Certificates contain no specific terms of repayment.

Note 1. Summary of Significant Accounting Policies (continued)

ESF enters into guarantee agreements which represent commitments by Treasury with lenders and/or investors that provide for repayment of all or part of the principal and/or interest on certain debt obligations of a borrower and/or issuer. The ESF is exposed to credit risk on guarantees in the event that it has to honor a guarantee and is unable to recover from the borrower the amounts advanced under the guarantee. It is not practicable to estimate the fair value of these guarantee agreements because no similar agreements that have comparable credit risk could be readily identified. Therefore, excessive costs would be incurred to estimate the fair value of these guarantee agreements.

C. Translation of Foreign Currency Denominated Assets and Liabilities

In accordance with Statement of Financial Accounting Standards (SFAS) No. 52, "Foreign Currency Translation," foreign currency denominated assets (FCDA) and liabilities are revalued monthly to reflect current exchange rates in effect as of the reporting date. The unrealized gains or losses resulting from changes in exchange rates are reported separately in the Statement of Income and Retained Earnings.

D. U.S. Government Securities

ESF invests dollars in excess of its immediate needs in overnight, non-marketable U.S. Government securities issued by the Treasury. The interest rate paid on the investments is the overnight repurchase agreement rate as established by the Bureau of Public Debt.

Note 2. Cash and Cash Equivalents

Cash equivalents are short-term, highly liquid investments that are both readily convertible to known amounts of cash, and so near their maturity that they present insignificant risk of change in value due to changes in interest rates. Generally, only investments with original maturities of three months or less qualify under that definition. U.S. Government securities and FCDAs with original maturities of three months or less, except for foreign currencies acquired under swap agreements with developing countries, are treated as cash equivalents.

The ESF invests a portion of its European Euro holdings through repurchase agreements in securities issued by, and backed by the full faith and credit of, the Federal Republic of Germany. As of September 30, 2000 and September 30, 1999, the amounts of repurchase agreements were approximately $1.2 billion. These repurchase agreements are considered to be FCDA with original maturities of three months or less, which are treated as cash equivalents, as discussed above. Such investments are made by the Federal Reserve Bank of New York (FRBNY), as fiscal agent of the Treasury, in connection with the ESF's participation in such repurchase agreements. In this capacity, FRBNY enters into agreements under which German government securities are purchased from, and subsequently resold to, private counterparties. Such transactions are settled through a tri-party agent, Deutsche Bank. The securities are held by Deutsche Bank for FRBNY pending resale and are not transferred back to a private counterparty upon resale until cash has been received. The FRBNY instructs the tri-party agent on matters

Note 2. Cash and Cash Equivalents (continued)

related to these investments. The amounts held as of September 30, 2000 and September 30, 1999 were as follows:

September 30	2000	1999
Cash and Cash Equivalents (In Thousands):		
U. S. Government Securities	$11,028,570	$15,232,198
FCDAs		
European Euro	$ 3,205,979	$ 3,173,695
Japanese Yen	$ 5,298,391	$ 5,827,576
Total Foreign Currency Denominated Assets	$ 8,504,370	$ 9,001,271
Total Cash and Cash Equivalents	$19,532,940	$24,233,469

Note 3. Other Foreign Currency Denominated Assets

Operations of the ESF result in the holding of various foreign currencies. The ESF normally invests its foreign currency holdings in interest bearing assets issued by or held through foreign governments or monetary authorities. Other FCDAs are assets with maturities greater than three months, and include foreign currencies acquired under swap agreements with various countries (See Note 7).

September 30	2000	1999
Other FCDAs (In Thousands):		
European Euro	$ 2,404,450	$ 2,513,215
Total Other FCDAs	$ 2,404,450	$ 2,513,215

Note 4. Special Drawing Rights (SDR)

The SDR is an international reserve asset created by the International Monetary Fund (IMF). It was created as a supplement to existing reserve assets, and on several occasions SDRs have been allocated by the IMF to members participating in the IMF's SDR department. Its value as a reserve asset derives, essentially, from the commitments of participants to hold and accept SDRs and to honor various obligations connected with its proper functioning as a reserve asset.

Note 4. Special Drawing Rights (SDR) (continued)

Pursuant to the Special Drawing Rights Act of 1968, as amended, SDRs allocated to or otherwise acquired by the United States are resources of ESF. SDRs, once allocated, are permanent resources unless:

a. they are canceled by an 85 percent majority decision of the total voting power of the Board of Governors of the IMF;

b. the SDR Department of the IMF is liquidated;

c. the IMF is liquidated; or

d. the United States chooses to withdraw from the IMF or terminate its participation in the SDR Department.

Except for the payment of interest and charges on SDR allocations to the United States, the payment of the ESF's liability related to the SDR allocations is conditional on events listed above, in which the United States has a substantial or controlling voice. Allocations of SDRs were made on January 1, 1970, 1971, 1972, 1979, 1980 and 1981. Since 1981, the IMF has made no further allocations of SDRs. As of September 30, 2000 and September 30, 1999, the amounts of SDR allocations was the equivalent of $6.4 billion and $6.8 billion, respectively.

On a daily basis, the IMF calculates the value of the SDR using the market value, in terms of the U.S. dollar, of each of the five freely usable weighted currencies, as defined by the IMF. These currencies are the U.S. dollar, the European Euro, Deutsche Mark, the Japanese yen, the French franc, and the pound sterling. The ESF's SDR holdings and allocations are revalued monthly based on the SDR valuation rate calculated by the IMF, and an unrealized gain or loss on revaluation is recognized.

During Fiscal Years (FY) 2000 and 1999, the ESF purchased, at the prevailing rates, $577.6 million and $707.2 million, respectively, equivalent of SDRs received from the IMF by the General Fund of the U.S. Government as remuneration (interest) on the U.S. reserve position in the IMF, and paid the General Fund $6.0 million and $3.7 million in FYs 2000 and 1999, respectively, in interest on dollars due the General Fund in return for SDRs received as remuneration. ESF did not directly sell SDRs to or purchase SDRs from participating members during FY 2000. During FY 1999, ESF sold and purchased $1.2 billion and $444 million, respectively, equivalent of SDRs with participating members.

The following charts reflect the actual activity (i.e. amounts paid and received) related to SDRs during FYs 2000 and 1999.

Note 4. Special Drawing Rights (SDR) (continued)

September 30, 2000	SDR	Dollar Equivalent
Special Drawing Rights (In Thousands):		
Beginning Balance:	7,410,706	$ 10,283,763
Interest Received on Holdings	302,670	405,182
Interest Paid on Allocations	(194,569)	(260,567)
Remunerations	430,550	577,587
IMF Annual Assessment	(755)	(1,016)
Net Loss on Valuation of Holdings	-	(688,534)
Ending Balance:	7,948,602	$ 10,316,415

September 30, 1999	SDR	Dollar Equivalent
Special Drawing Rights (In Thousands):		
Beginning Balance:	7,369,313	$ 10,105,705
Interest Received on Holdings	263,705	364,030
Interest Paid on Allocations	(176,415)	(243,468)
Remunerations	512,357	707,200
Sales of SDRs	(884,000)	(1,225,269)
Purchases of SDRs	326,546	443,708
IMF Annual Assessment	(800)	(1,081)
Net Gain on Valuation of Holdings	-	132,938
Ending Balance:	7,410,706	$ 10,283,763

Note 5. Investment Securities, Held to Maturity

In accordance with SFAS 115, "Accounting for Certain Investments in Debt and Equity Securities", securities that the ESF has both the positive intent and ability to hold to maturity are classified as investment securities held to maturity and carried at historical cost, adjusted for amortization of premiums and accretion of discounts. Interest on investment securities, amortization of premiums, and accretion of discounts are reported in interest on investment securities.

The following schedule shows investment securities at their amortized cost and by year of maturity as of September 30, 2000 and September 30, 1999. The only investment securities maturing after one year are the German bonds. There are no securities maturing after 10 years.

Note 5. Investments and Related Interest (continued)

September 30	2000	1999
Securities, Held to Maturity (In Thousands):		
All Securities (at Amortized Cost)		
German Bonds	$ 1,016,089	$ 1,253,613
German Bubills	215,398	262,833
Japanese T- Bills	3,000,155	3,004,725
Japanese Financing Bills	435,212	-
Total Amortized Cost	$4,666,854	$ 4,521,171
Maturing Within 1 Year		
Fair Value:		
German Bonds	$ 100,064	$ 122,536
German Bubills	218,523	262,898
Japanese T-Bills	3,000,298	3,004,812
Japanese Financing Bills	435,265	0
Total Fair Value	$3,754,150	$3,390,246
Amortized Cost:		
German Bonds	$ 97,737	118,850
German Bubills	215,398	262,833
Japanese T- Bills	3,000,155	3,004,725
Japanese Financing Bills	435,212	0
Total Amortized Cost	$3,748,502	$3,386,408
Gross Unrealized Holdings Gain:		
German Bonds	$ 2,327	$ 3,686
German Bubills	3,125	65
Japanese T-Bills	143	87
Japanese Financing Bills	53	0
Total Gross Unrealized Holdings Gain	$ 5,648	$ 3,838

Note 5. Investments and Related Interest (continued)

September 30	2000	1999
Maturing after 1 Year through 5 Years (German Bonds only)		
Total Fair Value	$ 421,006	$ 521,269
Total Amortized Cost	$ 421,985	$ 514,425
Total Gross Unrealized Holdings (Loss) Gain	($ 979)	$ 6,844
Maturing after 5 Years through 10 Years (German Bonds only)		
Total Fair Value	$ 494,421	$ 612,489
Total Amortized Cost	$ 496,367	$ 620,338
Total Gross Unrealized Holdings Loss	($ 1,946)	($ 7,849)

Note 6. Certificates Issued to Federal Reserve Banks

The Special Drawing Rights Act of 1968 authorized the Secretary of the Treasury to issue certificates, not to exceed the value of SDR holdings, to the Federal Reserve Bank in return for interest free dollar amounts equal to the face value of certificates issued (SDR monetization). The certificates may be issued for the purpose of financing the acquisition of SDRs from other countries or to provide resources for financing other ESF operations. Certificates issued are to be redeemed by ESF at such times and in such amounts as the Secretary of the Treasury may determine (SDR demonetization).

As of September 30, 2000 and September 30, 1999 the amounts of SDR certificates outstanding were $3.2 billion and $7.2 billion respectively, while the value of SDR holdings was $10.3 billion on both dates, for a difference of $7.1 billion and $3.1 billion respectively. During FYs 2000 and 1999, ESF transacted no monetizations. Also, during FYs 2000 and 1999, ESF transacted $4.0 billion and $1.0 billion demonetizations respectively.

Note 7. Foreign Currency Agreements and Guarantees

Foreign Currency Agreements represent swap agreements between Treasury and various countries that provide for drawings of dollars by those countries and/or drawings of foreign currencies by Treasury. The Treasury enters into these agreements through the ESF. Any balances the ESF may hold under such agreements are held for other than trading purposes and are reflected as Other Foreign Currency Denominated Assets in the Statement of Financial Position (See Note 3). The ESF is exposed to credit risk on foreign currency agreements in the event of default by counterparties to the extent of any amounts that have been recorded in the Statement of Financial Position. Market risk occurs as a result of fluctuations in currency exchange rates. The ESF is not exposed to market risk on foreign currency agreements that could occur as a result of fluctuations in currency exchange rates. Under these agreements, the ESF will receive an agreed upon amount in dollars upon maturity regardless of currency fluctuations.

ESF enters into guarantee agreements which represent commitments by Treasury with lenders and/or investors that provide for repayment of all or part of the principal and/or interest on certain debt obligations of a borrower and/or issuer. ESF is exposed to credit risk on guarantees in the event it has to honor a guarantee and is unable to recover from the borrower amounts advanced under the guarantee.

ESF's foreign currency agreements and guarantees consisted of the following at September 30, 2000 and September 30, 1999:

a. In April 1994, Treasury signed the North American Framework Agreement, which includes an Exchange Stabilization Agreement (ESA), with Mexico. The ESA provides for a $3 billion standing swap line. The amounts and terms (including the assured source of repayment) of any new borrowings under the North American Framework Agreement would need to be negotiated. There were no drawings outstanding on these agreements as of September 30, 2000 and 1999. In December 2000, the Treasury and FRB renewed this agreement for another year to December 2001.

b. On November 6, 1998, Secretary Rubin agreed the United States would commit to guarantee up to $5 billion from the ESF to participate in a multilateral guarantee of a $13.2 billion Bank for International Settlement (BIS) Credit Facility for Brazil. The termination date for the BIS facility is the later of (1) December 14, 1999 or (2) the date on which each drawing or rollover under the agreement is repaid in full. Any drawing or rollover by Brazil under the BIS Credit Facility shall mature no later than the date of Brazil's final repurchase under the IMF's Supplemental Reserve Facility. Under the terms of the BIS Credit Facility, Brazil can seek drawings or renew drawings until December 14, 1999, one year after the effective date of the credit facility.

   During FY 1999, Brazil made two drawings on the BIS' credit facility partially guaranteed by ESF. These drawings were made in December 1998 and April 1999 for $4.2 billion and $4.5 billion respectively and the ESF' shares of the guarantee were $1.6 billion and 1.7 billion respectively. In this regard, the Treasury Department authorized the Federal Reserve Bank of New York to invest ESF's share of the guarantee in Treasury non-marketable securities on behalf of ESF on those dates. On June 18, 1999, Brazil repaid approximately 30% of the December 1998 drawing and ESF was paid a commission of $35.5 million. On October 12, 1999 Brazil also repaid approximately 30 % of the April 1999 drawing and ESF received a commission of $43.8 million. The balance of the December 1998 drawing was repaid in December 1999 and ESF received a commission of $30.9 million. Also, in April 2000, Brazil repaid the balance of its April 1999 drawings and ESF received a commission of $30.1 million. With this last payment, the credit facility granted to Brazil by BIS and partially guaranteed by ESF was terminated. Accordingly, ESF had no loan guarantee obligations on the BIS credit facility to Brazil as of September 30, 2000.