AUDITED FISCAL YEARS 1999 AND 1998 FINANCIAL STATEMENTS OF THE EXCHANGE STABILIZATION FUND

OIG-00-021 JANUARY 5, 2000

Office of Inspector General

United States Department of the Treasury

OFFICE OF
INSPECTOR GENERAL

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

January 5, 2000

MEMORANDUM FOR EDWIN M. TRUMAN, ASSISTANT SECRETARY
INTERNATIONAL AFFAIRS

FROM: Dennis S. Schindel
Assistant Inspector General for Audit

SUBJECT: Report on the Exchange Stabilization Fund's Fiscal Years 1999 and 1998 Financial Statements

Attached is our report on the Exchange Stabilization Fund's (ESF) Statements of Financial Position as of September 30, 1999 and 1998, and the related Statements of Income and Retained Earnings, and Cash Flows for the years then ended.

Our report includes an unqualified opinion on ESF's financial statements as of September 30, 1999 and 1998, and for the years then ended. Our report contains no reportable conditions related to internal control. In addition, no reportable instances of noncompliance with laws and regulations that could have a direct and material effect on the financial statements were noted.

We conducted our audits of ESF's financial statements in accordance with *Government Auditing Standards*, as amended, issued by the Comptroller General of the United States, and Office of Management and Budget Bulletin No. 98-08, *Audit Requirements for Federal Financial Statements*, as amended. In accordance with these standards, our report is dated December 3, 1999, the last date of our audit field work.

Should you or you staff have any questions, please contact me on (202) 927-5400, or William H. Pugh, Deputy Assistant Inspector General for Audit (Financial Management) on (202) 927-5430.

Attachment

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SECTION I -

REPORT OF THE OFFICE OF INSPECTOR GENERAL

REPORT OF THE OFFICE OF INSPECTOR GENERAL

To the Assistant Secretary for International Affairs

We audited the Exchange Stabilization Fund's (ESF) Statements of Financial Position as of September 30, 1999 and 1998, and the related Statements of Income and Retained Earnings, and Cash Flows for the years then ended. This report presents our unqualified opinion on these financial statements.

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 (FASB) 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, regulations, and government-wide requirements applicable to ESF.

SCOPE OF AUDITS

We conducted our audits in accordance with *Government Auditing Standards*, as amended, issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No. 98-08, *Audit Requirements for Federal Financial Statements*, as amended, (OMB Bulletin No. 98-08). 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. 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, 1999, 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, 1999 and 1998, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles as published by FASB.

OTHER INFORMATION

Our audits were conducted for the purpose of expressing an opinion on ESF's Fiscal Years 1999 and 1998 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 audits 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 ESF's 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 FASB, 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.

Our consideration of the internal control in place on September 30, 1999 would not necessarily disclose all matters in the internal control that might be material weaknesses as defined by OMB Bulletin No. 98-08. Material weaknesses in internal control are 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. However, we noted no matters involving the internal control and its operation that we consider to be material weaknesses.

COMPLIANCE WITH LAWS AND REGULATIONS

The results of our tests of compliance in Fiscal Year 1999 with laws and regulations disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*, as amended, or OMB Bulletin No. 98-08.

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REPORT OF THE OFFICE OF INSPECTOR GENERAL

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

William H. Pugh

William H. Pugh
Deputy Assistant Inspector General for Audit
(Financial Management)

December 3, 1999

SECTION II -

EXCHANGE STABILIZATION FUND
FISCAL YEARS 1999 AND 1998
FINANCIAL STATEMENTS

Exchange Stabilization Fund
Policy and Operations Statements
Fiscal Year 1999

The Nature and Function of the Exchange Stabilization Fund

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 Act, 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 1999, the ESF engaged in no market transactions. However, the ESF sold euros to the Treasury General Account in return for dollars ($3.7 billion). The euros were used by the United States in paying the reserve asset portion of the increase in its quota in the IMF in February. Subsequently, the ESF purchased euros ($4.8 billion) from and sold yen ($1.4 billion) to the Federal Reserve System in transactions to balance the holdings of euro and yen evenly between the portfolios of the ESF and the Federal Reserve System's Open Market Account in March.

a. European Euros

During fiscal year 1999, the ESF had a net unrealized loss of $423.4 million on its euro holdings and interest earnings of $192.6 million equivalent on investment of euro assets.

b. Japanese Yen

During fiscal year 1999, the ESF had a net unrealized gain of $1.9 billion on its yen holdings and interest earnings of $8.4 million equivalent on investment in yen assets.

c. German Swap Line

In December 1998, the ESF's $1 billion swap line with the German Bundesbank expired and was not renewed. No drawings were made under this swap line during fiscal year 1999.

SDR Operations

ESF holdings of SDRs increased by SDR 41.4 million during fiscal year 1999 to SDR 7.4 billion ($10.3 billion). The dollar value of these SDR holdings increased by $178.1 million, a difference that is due both to the net change in SDRs, resulting from purchases and sales and a change in the value of the SDR in dollars, a figure calculated by the IMF. In addition, the ESF reimbursed the Treasury's General Fund $707.2 million for SDRs received from the IMF as remuneration on the U.S. reserve position in the IMF. The ESF earned interest of $349 million on its SDR holdings.

In fiscal year 1999, the ESF sold and purchased SDR 884 million ($1.2 billion) and SDR 327 million ($444 million), respectively, equivalent of SDRs with IMF participating members.

As of September 30, 1999, cumulative allocations to (liabilities of) the United States totaled SDR 4.9 billion ($6.8 billion). These liabilities will come due only in the event of liquidation of, or U.S. withdrawal from, the SDR Department of the IMF, or cancellation of SDRs. Also, outstanding were $7.2 billion of SDR certificates issued to the Federal Reserve Banks.

Income and Expense

Interest revenue totaled $1.3 billion, consisting of $802.9 million in interest on dollar holdings invested in U.S. Government securities, $349 million equivalent in interest on SDR holdings, $153.8 million in interest on foreign currency investments, and $47.1 million in interest on investment securities.

Interest expense totaled $236.9 million, of which $233.2 million was in charges on SDR allocations and $3.7 million was 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. The ESF was charged $967 thousand in an annual assessment by the IMF for operating expenses.

Statement of Financial Position
Department of the Treasury
Exchange Stabilization Fund

September 30 (In Thousands)		1999		1998
Assets				
Cash and Cash Equivalents (Note 2)				
U.S. Government Securities	$	15,232,198	$	15,980,577
Foreign Currency Denominated Assets		9,001,271		8,710,718
Total Cash and Cash Equivalents		24,233,469		24,691,295
Other Foreign Currency Denominated Assets (Note 3)		2,513,215		2,094,253
Special Drawing Right Holdings (Note 4)		10,283,763		10,105,705
Investment Securities, Held to Maturity (Note 5)		4,521,171		3,724,029
Accrued Interest Receivable		112,668		122,469
Total Assets	$	41,664,286	$	40,737,751
Liabilities and Equity				
Liabilities				
Certificates Issued to Federal Reserve Banks (Note 6)	$	7,200,000	$	9,200,000
Special Drawing Right Allocations (Note 4)		6,799,029		6,718,836
Unearned Income and Advances		13,283		-
Accrued Expenses		39,491		48,488
Total Liabilities		14,051,803		15,967,324
Equity				
Appropriated Capital		200,000		200,000
Retained Earnings		27,412,483		24,570,427
Total Equity		27,612,483		24,770,427
Total Liabilities and Equity	$	41,664,286	$	40,737,751

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

Statement of Income and Retained Earnings
Department of the Treasury
Exchange Stabilization Fund

Years Ended September 30 (In Thousands)		1999		1998
Interest Revenue				
Interest on U.S. Government Securities	$	802,860	$	864,169
Interest on Foreign Currency Denominated Assets		153,777		186,053
Interest on Special Drawing Right Holdings		348,990		428,313
Interest on Investment Securities		47,197		44,737
Total Interest Revenue		1,352,824		1,523,272
Interest Expense				
Interest on Special Drawing Right Allocations		233,262		280,188
Interest on Special Drawing Rights Received as Remuneration by the U.S. Treasury		3,680		4,142
Total Interest Expense		236,942		284,330
Net Interest Revenue		1,115,882		1,238,942
Other Revenue				
Commissions		35,547		-
Total Other Revenue		35,547		-
Net Gains and Losses				
Unrealized Gain on Valuation of Special Drawing Rights		54,197		8,519
Net Realized Gain on Sales of Foreign Currency Denominated Assets		151,598		-
Unrealized Gain (Loss) on Valuation of Foreign Currency Denominated Assets		1,485,799		(645,924)
Total Net Gain (Loss)		1,691,594		(637,405)
Other Expenses				
International Monetary Fund Annual Assessment		967		1,389
Total Other Expenses		967		1,389
Net Income	$	2,842,056	$	600,148
Retained Earnings, Beginning of Year		24,570,427		23,970,279
Retained Earnings, End of Year	$	27,412,483	$	24,570,427

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

Statement of Cash Flows
Department of the Treasury
Exchange Stabilization Fund

Years Ended September 30 (In Thousands)	1999	1998
Cash Flows from Operating Activities:		
Interest Received on U.S. Government Securities	$ 804,237	$ 864,427
Interest Received on Foreign Currency Denominated Assets	159,316	183,252
Interest Received on Investment Securities	37,631	36,229
Commissions Received on Credit Facility	35,547	-
Net Realized Gain on Sale of Foreign Currency Denominated Assets	151,598	-
Net Unrealized Gain (Loss) on Valuation of Foreign Currency Denominated Assets	1,486,828	(647,776)
Other	13,283	-
Net Cash Provided by Operating Activities	2,688,440	436,132
Cash Flows from Investing Activities:		
Net (Increase) Decrease in Foreign Currency Denominated Assets	(418,962)	4,786
Net Increase in Investment Securities	(797,142)	(68,840)
Purchases of Special Drawing Rights Received as Remuneration by the U.S. Treasury and Related Interest	(710,974)	(594,129)
Purchases of Special Drawing Rights	(443,708)	-
Sales of Special Drawing Rights	1,225,269	666,522
Net Cash (Used in) Provided by Investing Activities	(1,145,517)	8,339
Cash Flows from Financing Activities:		
Certificates Redeemed from Federal Reserve Banks	(2,000,000)	-
Other	(749)	620
Net Cash (Used in) Provided by Financing Activities	(2,000,749)	620
Net (Decrease) Increase in Cash and Cash Equivalents	(457,826)	445,091
Cash and Cash Equivalents at Beginning of Year	24,691,295	24,246,204
Cash and Cash Equivalents at End of Year	$ 24,233,469	$ 24,691,295

Reconciliation of Net Income to Net Cash Provided by Operating Activities

Net Income	$ 2,842,056	$ 600,148
Adjustments to reconcile net income to net cash provided by operating activities:		
Increase in Special Drawing Right Holdings Due to Valuation	(247,896)	(181,457)
Decrease (Increase) in Accrued Interest Receivable	9,801	(14,464)
Increase in Special Drawing Right Allocations Due to Valuation	80,193	29,939
(Decrease) Increase in Accrued Expenses	(8,997)	1,966
Increase in Unearned Income and Advances	13,283	-
Total Adjustments	(153,616)	(164,016)
Net Cash Provided by Operating Activities	$ 2,688,440	$ 436,132

The accompanying notes are an integral part of 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 instruments of credit and securities.

The ESF's accounting policies conform with generally accepted accounting principles as published by the Financial Accounting Standards Board and the accrual method of accounting. In addition, 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 1998 financial statements to conform to the presentation used in 1999.

Translation of Foreign Currency Denominated Assets and Liabilities

In accordance with 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.

U.S. Government Securities

The 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.

Fair Values of Financial Instruments

Cash and Cash Equivalents, which consist of U.S. Government securities and FCDAs, 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). Other FCDAs, Special Drawing Right (SDR) Holdings,

Note 1. Summary of Significant Accounting Policies (continued)

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.

The 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 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.

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 foreign currency 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, 1999 and September 30, 1998, the amounts of repurchase agreements outstanding were $1.2 billion and $1.1 billion, respectively. These repurchase agreements are considered to be FCDA with original maturities of three months or

Note 2. Cash and Cash Equivalents (continued)

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 related to these investments.

September 30 (In Thousands)	1999	1998
Cash and Cash Equivalents:		
U.S. Government Securities	$15,232,198	$15,980,577
FCDAs:		
European Euro	3,173,695	-
German Mark	-	3,367,476
Japanese Yen	5,827,576	5,343,242
Total Foreign Currency Denominated Assets	9,001,271	8,710,718
Total Cash and Cash Equivalents	$24,233,469	$24,691,295

Note 3. Other FCDAs

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 foreign currency denominated assets are assets with maturities greater than three months, and include foreign currencies acquired under swap agreements with various countries (See Note 7).

Note 3. Other FCDAs (continued)

September 30 (In Thousands)	1999	1998
Other FCDAs:		
European Euro	$ 2,513,215	-
German Mark	-	$ 2,094,253
Total Other FCDAs	$ 2,513,215	$ 2,094,253

Note 4. Special Drawing Rights (SDR)

The SDR is an international reserve asset created by the IMF. It was created as a supplement to existing reserve assets and is allocated by the IMF to members participating in the 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.

Pursuant to the Special Drawing Rights Act of 1968, as amended, SDRs allocated to or otherwise acquired by the United States are resources of the 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 liability related to SDR allocations is conditional on the 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

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

allocations of SDRs. As of September 30, 1999 and September 30, 1998, the amounts of SDR allocations were $6.8 billion and $6.7 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 five currencies are the U.S. dollar, the European euro, 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 1999 and 1998, the ESF purchased from the Treasury General Fund, at prevailing rates, $707.2 million and $590.5 million, respectively, equivalent of SDRs received from the IMF by Treasury as remuneration (interest) on the U.S. reserve position in the IMF. The ESF paid the Treasury's General Fund $3.7 million and $4.1 million in fiscal years 1999 and 1998, respectively, in interest on dollars due the General Fund in return for SDRs, received as remuneration. In addition, during fiscal year 1999, the ESF sold and purchased $1.2 billion and $444 million, respectively, equivalent of SDRs with participating members. During 1998, the ESF sold $666 million equivalent of SDRs.

The following charts reflect the actual activity (i.e. amounts paid and received) related to SDRs during fiscal years 1999 and 1998.

September 30,1999 (In Thousands)	SDR	Dollar Equivalent
Special Drawings Rights		
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 on Holdings	-	132,938
Ending Balance:	7,410,706	$10,283,763

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

September 30, 1998 (In Thousands)	SDR	Dollar Equivalent
Special Drawings Rights		
Beginning Balance:	7,322,864	$ 9,997,262
Interest Received on Holdings	317,065	428,272
Interest Paid on Allocations	(207,602)	(280,471)
Remunerations	437,995	590,550
Sales of SDRs	(500,000)	(666,522)
IMF Annual Assessment	(1,009)	(1,359)
Net Gain on Valuation on Holdings	-	37,973
Ending Balance:	7,369,313	$10,105,705

Note 5. Investment Securities

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 and amortization of premiums and accretion of discounts are reported in interest on investment securities.

September 30 (In Thousands)	1999	1998
Securities, Held to Maturity:		
Maturity Within 1 Year		
Fair Value:		
German Bonds	$1,256,294	$ 782,240
German BUBILLS	262,898	205,412
Japanese T-Bills	3,004,812	2,766,482
Total Fair Value	$4,524,004	$3,754,134

Note 5. Investment Securities (continued)

Amortized Cost:		
German Bonds	$1,253,613	$ 753,300
German BUBILLS	262,833	205,350
Japanese T-Bills	3,004,725	2,765,379
Total Amortized Cost	$4,521,171	$3,724,029
Gross Unrealized Holding Gains(Loss):		
German Bonds	$ 2,681	$ 28,940
German BUBILLS	65	62
Japanese T-Bills	87	1,103
Total Gross Unrealized Holding Gains	$ 2,833	$ 30,105

Note 6. Certificates Issued to Federal Reserve Banks

The Special Drawing Rights Act of 1968 also authorized the Secretary of the Treasury to issue certificates, not to exceed the value of SDR holdings, to FRB 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 or for financing exchange stabilization operations. Certificates issued are to be redeemed by the ESF at such times and in such amounts as the Secretary of the Treasury may determine (SDR demonetization).

As of September 30, 1999 and September 30, 1998, the amount of certificates outstanding were $7.2 billion and $9.2 billion, while the value of SDR holdings were $10.3 billion and $10.1 billion, respectively, for a difference of $3.1 billion and $906 million, respectively. During both fiscal years 1999 and 1998 ESF transacted no SDR monetizations.

Also, during fiscal year 1999, demonetizations (redemptions) of SDR certificates occurred as follows: $1 billion in March 1999 and $1 billion in September 1999. No demonetizations of SDR certificates occurred in fiscal year 1998.

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.

The 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 it has to honor a guarantee and is unable to recover from the borrower amounts advanced under the guarantee.

The ESF's foreign currency agreements and guarantees consisted of the following at September 30, 1999 and September 30, 1998:

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, 1999 and 1998. On December 14, 1999, both agreements were renewed for another year.

Note 7. Foreign Currency Agreements and Guarantees (continued)

b. A 1978 $1 billion swap line with Germany was permitted to expire in December 1998 in light of the formation of the European Central Bank on January 1, 1999. No drawings were made under this agreement during fiscal years 1999 and 1998.

c. 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 Settlements (BIS) Credit Facility for Brazil. The termination date for the BIS credit facility is the later of (1) December 14, 1999 or (2) the date on which each drawing or rollover under the agreement has been repaid in full. Any drawing or rollover by Brazil under the BIS Credit Facility shall mature not later than the date of Brazil's final repurchase under the IMF's Supplemental Reserve Facility.

During fiscal year 1999, Brazil made two drawings on the BIS Credit Facility. These drawings were on December 18, 1998 and April 9, 1999 for $4.15 billion and $4.5 billion, respectively, in which the ESF's 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 the 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 percent of the December 1998 drawing and the BIS paid the United States a $35.5 million commission. On September 30, 1999, ESF's share of the guarantee under the BIS Credit Facility totaled $2.8 billion.

Subsequent to fiscal year end, on December 20, 1999, Brazil repaid the remaining balance of the December 1998 drawing. On October 12, 1999, Brazil also repaid approximately 30 percent of the April 1999 drawing reducing ESF's share of the guarantee of this drawing to $1.2 billion. The BIS paid the United States a total of $82.7 million in commissions.