Audit Report

OIG-15-018

Audit of the Exchange Stabilization Fund's Fiscal Years 2014 and 2013 Financial Statements

December 8, 2014

Office of Inspector General

Department of the Treasury

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

OFFICE OF
INSPECTOR GENERAL

December 8, 2014

MEMORANDUM FOR MARK SOBEL
DEPUTY ASSISTANT SECRETARY FOR INTERNATIONAL MONETARY AND FINANCIAL POLICY

FROM: Michael Fitzgerald
Director, Financial Audit

SUBJECT: Audit of the Exchange Stabilization Fund's Fiscal Years 2014 and 2013 Financial Statements

I am pleased to transmit the attached audited Exchange Stabilization Fund (ESF) financial statements for fiscal years 2014 and 2013. Under a contract monitored by the Office of Inspector General, KPMG LLP (KPMG), an independent certified public accounting firm, performed an audit of the financial statements of ESF as of September 30, 2014 and 2013 and for the years then ended. The contract required that the audit be performed in accordance with generally accepted government auditing standards and Office of Management and Budget (OMB) Bulletin No. 14-02, *Audit Requirements for Federal Financial Statements*.

The following reports, prepared by KPMG, are incorporated in the attachment:

- Independent Auditors' Report;
- Independent Auditors' Report on Internal Control Over Financial Reporting; and
- Independent Auditors' Report on Compliance and Other Matters.

In its audit, KPMG found that the financial statements were fairly presented, in all material respects, in accordance with U.S. generally accepted accounting principles. However, KPMG identified a significant deficiency related to management's review of its financial statements. Further, KPMG found no instances of reportable noncompliance with laws and regulations tested.

In connection with the contract, we reviewed KPMG's reports and related documentation and inquired of its representatives. Our review, as differentiated from an audit performed in accordance with generally accepted government auditing standards, was not intended to enable us to express, and we do not express, an opinion on the financial statements or conclusions about the effectiveness of internal control or compliance with laws and regulations. KPMG is responsible for the attached auditors' reports dated December 5, 2014, and the conclusions expressed therein. However, our review disclosed no instances where KPMG did not comply, in all material respects, with generally accepted government auditing standards and OMB Bulletin No. 14-02.

Should you have any questions, please contact me at (202) 927-5789, or a member of your staff may contact Catherine Yi, Manager, Financial Audit at (202) 927-5591.

Attachment

EXCHANGE STABILIZATION FUND

Financial Statements

September 30, 2014

EXCHANGE STABILIZATION FUND

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POLICY AND OPERATIONS STATEMENTS
FISCAL YEAR 2014

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 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, October 19, 1976) 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." This amendment became effective on April 1, 1978, the date of entry into force of the Second Amendment of the IMF Articles of Agreement. In 1977, P.L. 95-147 further amended Section 10 of the Gold Reserve Act. Following codification, Section 10 now provides in relevant part:

> 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), 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.

I. Foreign Currency Operations

a. Euros and Japanese Yen

The ESF had a net valuation loss of $970 million on its holdings of euros and yen. The ESF had investment income of $85.1 million equivalent on its euro and yen assets.

b. Mexico

In December 2013, the Treasury and Federal Reserve Bank of New York, acting as Treasury's fiscal agent, renewed the Exchange Stabilization Agreement with Mexico for another year to December 2014.

II. SDR Operations

As of September 30, 2014, U.S. holdings (assets) of SDRs totaled SDR 35.8 billion ($53.1 billion equivalent), a net change of 0 SDR during Fiscal Year 2013. However, as the SDR depreciated against the dollar in this period, there was a net valuation loss of $1.8 billion on U.S. holdings of SDRs. The ESF reimbursed the Treasury's General Fund $28.1 million for SDRs received from the IMF as remuneration on the U.S. reserve position in the IMF. The ESF earned interest of $54.1 million equivalent on its SDR holdings.

As of September 30, 2014, cumulative allocations to (liabilities of) the United States totaled SDR 35.3 billion ($52.4 billion equivalent). 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.

There were $5.2 billion of SDR certificates that had been issued to the Federal Reserve System prior to fiscal year 2014.

III. Income and Expense

Interest revenue totaled $147.2 million, consisting of $8.0 million in interest on dollar holdings invested in U.S. Government securities, $54.1 million equivalent in interest on SDR holdings, and $85.1 million equivalent in interest on foreign currency investments.

Interest expense totaled $53.3 million, primarily representing interest charges on SDR Allocations.

KPMG LLP
Suite 12000
1801 K Street, NW
Washington, DC 20006

Independent Auditors' Report

Inspector General
U.S. Department of the Treasury:

Report on the Financial Statements

We have audited the accompanying financial statements of the U.S. Department of the Treasury's Exchange Stabilization Fund (ESF), which comprise the statements of financial position as of September 30, 2014 and 2013, and the related statements of operations, comprehensive operations and retained earnings, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 14-02, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin No. 14-02, require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

KPMG

Opinion on the Financial Statements

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the U.S. Department of the Treasury's Exchange Stabilization Fund as of September 30, 2014 and 2013, and the results of its operations and its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

Other Matters

Other Information

Our audits were conducted for the purpose of forming an opinion on the basic financial statements as a whole. The Policy and Operations Statements section is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 5, 2014 on our consideration of the ESF's internal control over financial reporting and our report dated December 5, 2014 on our tests of its compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* in considering ESF's internal control over financial reporting and compliance.

KPMG LLP

December 5, 2014

KPMG LLP
Suite 12000
1801 K Street, NW
Washington, DC 20006

Independent Auditors' Report on Internal Control Over Financial Reporting

Inspector General
U.S. Department of the Treasury

We have audited, in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 14-02, *Audit Requirements for Federal Financial Statements*, the financial statements of U.S. Department of the Treasury's Exchange Stabilization Fund (ESF), which comprise the statements of financial position as of September 30, 2014 and 2013, and the related statements of operations, comprehensive operations and retained earnings, and cash flows for the years then ended, and the related notes to the financial statements, and have issued our report thereon dated December 5, 2014.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements as of and for the year ended September 30, 2014, we considered the ESF's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the ESF's internal control. Accordingly, we do not express an opinion on the effectiveness of the ESF's internal control. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, we did identify a certain deficiency in internal control, described below titled as item "Management Review of Financial Statements", that we consider to be a significant deficiency.

2014-01 Management Review of Financial Statements

Management, during the course of its reviews of the financial statements, did not identify mistakes in the supporting records that eventually flowed to the notes to the financial statements that related to other-than-temporary impairment (OTTI) of investments and cash and cash equivalents.

The manual process of tracking certain investment data needed for the financial statement note disclosures is performed outside of the general ledger utilizing several spreadsheets. Accordingly, the review of this information and the notes to the financial statement requires management to have specific knowledge of the on-ledger and manual components as well as specifically relevant accounting rules and interpretations that are relevant to those financial investment transactions.

This deficiency caused the disclosures in the notes to the financial statements to be initially misstated. Specifically, the amortized cost basis and gross unrealized losses related to the Japanese bond portfolio was overstated by $491 million related to the OTTI recognized in the current year, and the the Euro-denominated cash and cash equivalents was overstated by $677 million, conversely understating the Yen cash and cash equivalents balances. Such amounts were corrected in the financial statements.

Recommendations

We recommend that ESF management:

1. Prepare an accounting policy and procedures document detailing applicable accounting standards, the preparation of financial statement support schedules, and suitable review procedures and controls.

2. Consider tracking investment cost adjustment information in the general ledger at the transaction level and enhancing the automation in the financial statement preparation process.

3. Consider enhancing existing procedures to ensure accounting personnel are appropriately knowledgeable of applicable accounting standards requirements specific to investment impairment and their impact on the financial statements through internal training or consultation with appropriate resources.

4. Ensure those performing financial statement reviews are appropriately trained and knowledgeable of such processes over investment impairment so that their review is performed at a level of precision sufficient to prevent and detect significant misstatements.

ESF's Response to Finding

Management concurs with the finding and recommendations.

Treasury management will assess the possibility of implementing KPMG's recommendations for improvements in ESF's internal controls. We aggressively address control weaknesses and, in FY 2014, management made significant improvements in this area, including strengthening our review process. However, we acknowledge further efforts are required to address the causes of these errors.

ESF's response to the significant deficiency identified in our audit is described previously. ESF's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on the response.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and the result of that testing, and not to provide an opinion on the effectiveness of the ESF's internal control. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the ESF's internal control. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

December 5, 2014

KPMG LLP
Suite 12000
1801 K Street, NW
Washington, DC 20006

Independent Auditors' Report on Compliance and Other Matters

Inspector General
U.S. Department of the Treasury:

We have audited, in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 14-02, *Audit Requirements for Federal Financial Statements*, the financial statements of the U.S. Department of the Treasury's Exchange Stabilization Fund (ESF), which comprise the statements of financial position as of September 30, 2014 and 2013, and the related statements of operations, comprehensive operations and retained earnings, and cash flows for the years then ended, and the related notes to the financial statements, and have issued our report thereon dated December 5, 2014.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the ESF's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 14-02. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests of compliance disclosed no instances of noncompliance or other matters that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 14-02.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of compliance and the result of that testing, and not to provide an opinion on the ESF's compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the ESF's compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

December 5, 2014

DEPARTMENT OF THE TREASURY
EXCHANGE STABILIZATION FUND
STATEMENTS OF FINANCIAL POSITION
(In Thousands)

As of September 30		**2014**		**2013**
Assets				
Cash and Cash Equivalents (Note 2)	$	27,087,365	$	30,561,249
Securities Purchased Under Agreement to Resell (Note 3)		0		2,233,275
Investment Securities and Other Foreign Currency Denominated Assets, at fair value (Note 5)		17,835,201		14,016,912
Special Drawing Right Holdings (Note 4)		53,148,237		54,966,034
Interest Receivable		69,204		79,133
Interest Receivable on Special Drawing Right Holdings		5,359		6,430
Total Assets	$	98,145,366	$	101,863,033
Liabilities and Equity				
Liabilities:				
Special Drawing Rights Certificates Issued to Federal Reserve Banks (Note 7)	$	5,200,000	$	5,200,000
Special Drawing Right Allocations (Note 4)		52,358,322		54,177,080
Interest Payable on Special Drawing Right Allocations		5,279		6,338
Other		153		124
Total Liabilities		57,563,754		59,383,542
Commitments and Contingencies (Note 9)				
Equity:				
Appropriated Capital		200,000		200,000
Retained Earnings		41,562,620		42,467,000
Accumulated Other Comprehensive Loss (Notes 1 and 6)		(1,181,008)		(187,509)
Total Equity		40,581,612		42,479,491
Total Liabilities and Equity	$	98,145,366	$	101,863,033

See accompanying notes to financial statements.

DEPARTMENT OF THE TREASURY
EXCHANGE STABILIZATION FUND
STATEMENTS OF OPERATIONS, COMPREHENSIVE OPERATIONS AND RETAINED EARNINGS
(In Thousands)

For the years-ended September 30	2014	2013
Interest Income		
Interest on Cash and Cash Equivalents	$ 10,705	$ 14,107
Interest on Securities Purchased Under Agreement to Resell	2,116	159
Interest on Investment Securities and Other Foreign Currency Denominated Assets	80,305	101,558
Interest on Special Drawing Right Holdings	54,055	40,183
Total Interest Income	147,181	156,007
Interest Expense		
Interest on Special Drawing Right Allocations	(53,265)	(39,614)
Interest on Special Drawing Right - Remuneration due to the U.S. Treasury	(1)	(1)
Total Interest Expense	(53,266)	(39,615)
Net Interest Income	93,915	116,392
Net Gains/(Losses)		
Gain/(Loss) on Foreign Currency Valuation of:		
Special Drawing Rights Holdings	(1,846,456)	(290,222)
Special Drawing Rights Allocations	1,818,927	286,312
Investment Securities and Other Foreign Currency Denominated Assets, net (Notes 1 and 5) (Includes net gain of $68,249 and $175,539 in fiscal years 2014 and 2013, respectively, in accumulated other comprehensive income reclassifications for previously unrealized net gains on available-for-sale securities)	(477,914)	(841,198)
Other-Than-Temporary Losses on Investment Securities	(491,256)	(527,727)
Securities Purchased Under Agreement to Resell	(1,200)	89,278
Total Net Losses	(997,899)	(1,283,557)
Other Expenses		
International Monetary Fund Annual Assessment	(396)	(156)
Total Other Expenses	(396)	(156)
Net Loss	(904,380)	(1,167,321)
Other Comprehensive Loss		
Unrealized Holding Loss, net (Notes 1 and 6)	(993,499)	(542,406)
Comprehensive Loss	$ (1,897,879)	$ (1,709,727)
Retained Earnings, Beginning of Year	$ 42,467,000	$ 43,634,321
Net Loss	(904,380)	(1,167,321)
Retained Earnings, End of Year	$ 41,562,620	$ 42,467,000

See accompanying notes to financial statements.

DEPARTMENT OF THE TREASURY
EXCHANGE STABILIZATION FUND
STATEMENTS OF CASH FLOWS
(In Thousands)

For the years-ended September 30		2014		2013
Cash Flows from Operating Activities:				
Interest Received on:				
Cash and Cash Equivalents	$	10,312	$	14,123
Securities Purchased Under Agreement to Resell		2,151		179
Investment Securities and Other Foreign Currency Denominated Assets		158,273		183,326
Other		(7,326)		(11,664)
Net Cash Provided by Operating Activities		163,410		185,964
Cash Flows from Investing Activities:				
Net (Purchases)/Maturities of Securities Purchased Under Agreement to Resell		2,232,075		(1,372,637)
Purchases of Investment Securities and Foreign Currency Denominated Assets		(14,733,840)		(9,728,406)
Maturities of Investment Securities and Foreign Currency Denominated Assets		9,317,318		9,624,858
Reimbursement for Remuneration Received		(28,056)		(23,586)
Other		367		298
Net Cash Used in Investing Activities		(3,212,136)		(1,499,473)
Effect of Exchange Rate on Cash		(425,158)		(558,433)
Net Decrease in Cash and Cash Equivalents		(3,473,884)		(1,871,942)
Cash and Cash Equivalents, Beginning of Year		30,561,249		32,433,191
Cash and Cash Equivalents, End of Year	$	27,087,365	$	30,561,249
Reconciliation of Net Loss to Net Cash Provided by Operating Activities				
Net Loss	$	(904,380)	$	(1,167,321)
Adjustments to Reconcile Net Loss to Net Cash Provided by Operating Activities:				
Net Exchange Rate Loss on Repos, FCDAs, and Investment Securities		479,114		751,920
Decrease in Special Drawing Right Holdings Due to Valuation		1,846,285		290,321
Net Increase in Special Drawing Rights Holdings		(799)		(577)
Decrease in Accrued Interest Receivable		11,001		11,379
Amortization of Bond Premium/(Discount) (net)		60,721		59,752
Decrease in Special Drawing Right Allocations Due to Valuation		(1,818,758)		(286,410)
Decrease in Accrued Interest Payable and Other		(1,030)		(827)
Other-Than-Temporary Losses on Investment Securities		491,256		527,727
Total Adjustments		1,067,790		1,353,285
Net Cash Provided by Operating Activities	$	163,410	$	185,964

See accompanying notes to financial statements.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Entity

The Exchange Stablization Fund (ESF) was originally established pursuant to section 10 of the Gold Reserve Act of 1934 for the purpose of stabilizing the exchange value of the dollar. Section 10 has been amended several times since 1934. This section currently authorizes the Secretary, with the approval of the President, to deal in gold, foreign exchange, and instruments of credit and securities consistent with US obligations in the International Monetary Fund on orderly exchange arrangements and a stable system of exchange rates. 31 U.S.C. 5302(b).

The Federal Reserve Bank of New York (FRBNY) acts as the fiscal agent for the ESF, as permitted by the Federal Reserve Act. As the fiscal agent, the FRBNY plays a significant role in the processing of foreign currency transactions that the Secretary of the Treasury authorizes. The manager of the ESF foreign currency portfolio at the FRBNY consults regularly with the Federal Open Market Committee and the U.S. Department of the Treasury (Treasury) about the disposition of investments and the status of the portfolio. The level and currency composition of the ESF foreign currency portfolio are the products of Treasury policy determinations. The ESF management is responsible for the record keeping and investment decisions for foreign currency transaction activity carried out by the FRBNY.

By law, the ESF is not available to pay administrative expenses. Instead, the Treasury's Office of International Affairs has responsibility for managing ESF operations, and Treasury's Office of the Deputy Chief Financial Officer provides the recordkeeping and financial reporting services for the ESF. These Treasury offices bear all administrative expenses of the ESF. Accordingly, there are no administrative expenses reported in the financial statements.

B. Basis of Accounting and 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.

C. Risks and Uncertainties

The ESF faces certain risks and uncertainties as a result of holding foreign currency securities. The price of ESF's holdings of such securities may widely fluctuate as a result of volatility in foreign currency markets and changes in real and perceived credit of ESF's counterparties.

Credit risk related to its holdings, is the potential, no matter how remote, for financial loss from a failure of a borrower or counterparty to perform in accordance with underlying contractual obligations.

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates are used in the preparation of amounts related to the valuation of investments and contingent liabilities. Actual results could differ from those estimates.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

D. 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. Cash and Cash Equivalents consist of the following:

- U.S. Government Securities, and
- Short-term Foreign Currency Denominated Assets (FCDAs) – including deposits and securities denominated in both euro and yen.

E. Investments

Held-to-maturity securities are those securities in which the entity has the ability and intent to hold the security until maturity. Held-to-maturity securities are recorded at amortized cost, adjusted for the amortization and accretion of premiums or discounts.

Available-for-sale securities are those which are neither trading nor held-to-maturity. ESF's Other FCDAs and Investment Securities are classified as available-for-sale. Available-for-sale securities are recorded at fair value. Unrealized holding gains and losses on available-for-sale securities, including amounts related to foreign currency valuation, are excluded from earnings and are reported as a separate component of accumulated other comprehensive income until realized or deemed to be other than temporary. Realized gains and losses from the sale of available-for-sale securities are determined on a specific-identification basis.

Interest on investments, amortization of premiums, and accretion of discounts are reported in Interest Income and are recognized on an accrual basis. Premiums and discounts are amortized or accreted over the life of the related investment security as an adjustment to yield using the effective–interest method.

Foreign currency assets (FCA) include interest-bearing foreign deposit accounts and investments in foreign government securities.

FCAs also include FCDAs reported as Cash and Cash Equivalents, Other FCDAs, and Investment Securities. These categorizations are based on maturity. FCDAs have terms of 3 months or less. Other FCDAs have terms of less than or equal to a year but greater than 3 months and Investment Securities have terms greater than a year.

F. Securities Purchased Under Agreement to Resell

Securities Purchased Under Agreement to Resell generally have agreement terms that do not exceed 90 days. These securities are generally treated as collateralized financial transactions and are carried at amounts at which the securities were acquired, adjusted for translation gains/losses if such agreements pertained to FCAs.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

G. Foreign Currency Valuations

In accordance with Foreign Currency Matters (FASB ASC 830), FCAs as well as Special Drawing Rights and related accrued interest receivable or payable, discussed below, are revalued to reflect exchange rates in effect as of the reporting date. Such gains or losses, recognized in the period of the fluctuations, are reported on the Statements of Operations, Comprehensive Operations and Retained Earnings as Gains (Losses) on Foreign Currency Valuation. Gains and losses related to foreign currency valuations of Investment Securities and Other FCDAs are excluded from earnings and are reported as a component of Other Comprehensive Income until realized.

H. Other-Than-Temporary Impairment

A decline in the market value (either due to credit, price or currency) of any investment below cost that is deemed to be other-than-temporary is accounted for as an impairment and the carrying value is reduced to fair value for financial statement reporting purposes. The impairment is charged to earnings and the charge establishes a new cost basis for the investment. To determine whether impairment is other-than-temporary, the ESF considers whether it has the ability and intent to hold the investment until a market price recovery and considers whether evidence indicating the cost of the investment is recoverable outweighs evidence to the contrary. Evidence considered in this assessment includes the reasons for the impairment, the severity and duration of the impairment, changes in value subsequent to year-end, forecasted performance of the investee, remaining maturity of the investment and the general market condition in the geographic area or industry in which the investee operates. ESF regularly evaluates whether unrealized losses on investment securities indicate other-than-temporary impairment that would require recognition in the financial statements.

I. Fair Values of Financial Instruments

Fair Value Measurements and Disclosures (FASB ASC 820-10) establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

- Level 1 Inputs: Unadjusted quoted prices in active markets for identical assets or liabilities accessible to the reporting entity at the measurement date.

- Level 2 Inputs: Other than quoted prices included in Level 1 inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the asset or liability.

- Level 3 Inputs: Unobservable inputs for the asset or liability used to measure fair value to the extent that observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at measurement date.

All of the ESF's investments and other foreign currency denominated assets are Level 1 measurements since these financial assets are traded in active markets where quotable values are readily available.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

J. Special Drawing Right Certificates Issued to Federal Reserve Banks

Special Drawing Right Certificates issued to Federal Reserve Banks (FRB) are reflected on the Statements of Financial Position at their face value. Under the terms of the agreement, there is no set repayment date and no interest accrued while certificates remain outstanding. As a result, the carrying amount represents the face value.

K. U.S. Government Securities

The ESF invests dollars in excess of its immediate needs in overnight, nonmarketable U.S. government securities issued by the Treasury. The interest rate earned on the investments is equal to the overnight repurchase agreement rate as established by the Treasury's Bureau of the Fiscal Service.

L. Other Comprehensive Income/(Loss)

Accumulated Other Comprehensive Income/(Loss) is made up of changes in the fair value of investments classified as available-for-sale. Unrealized gains and losses, if any, are subsequently reclassified into income in the same period the underlying investment is either sold, deemed to be other than temporary or transferred to the Trading classification.

M. Tax-Exempt Status

As a component of the Treasury, which is a federal agency, the ESF is not subject to federal, state, or local income taxes, and accordingly, no provision for income taxes is recorded.

NOTE 2 – CASH AND CASH EQUIVALENTS

Cash and cash equivalent amounts held as of September 30, 2014 and 2013 are as follows:

September 30 (In Thousands)	2014	2013
Cash and cash equivalents:		
U. S. government securities	$ 22,649,209	$ 22,669,271
Short-term FCDAs:		
European euro	1,626,653	4,759,250
Japanese yen	2,811,503	3,132,728
Total short-term FCDAs	4,438,156	7,891,978
Total cash and cash equivalents	$ 27,087,365	$ 30,561,249

NOTE 2 – CASH AND CASH EQUIVALENTS (Continued)

As of September 30, 2014 and 2013, $0 and $2.4 billion, respectively of the Japanese yen short-term FCDA's were part of the Bank of Japan's Automatic Investment Facility, investing funds overnight in short-term Japanese government financing bills and/or treasury bills.

NOTE 3 – SECURITIES PURCHASED UNDER AGREEMENT TO RESELL

The FRBNY, on behalf of the ESF, enters into transactions to purchase foreign-currency-denominated government-debt securities under agreements to resell for which the accepted collateral is the debt instruments, denominated in euro, and issued or guaranteed in full by European governments. These agreements are subject to daily margining requirements.

NOTE 4 – SPECIAL DRAWING RIGHTS

The SDR is an international reserve asset created by the International Monetary Fund (IMF) in 1969 to supplement the existing reserve assets of IMF member countries, including the United States. In addition to its role as a supplementary reserve asset, the SDR serves as a means of payment within the IMF, as well as the unit of account for the IMF and several other international organizations. SDRs may be held only by the official sector – IMF member countries and certain institutions designated by the IMF as prescribed holders. On several occasions SDRs have been allocated by the IMF to members participating in the IMF's SDR Department, including the United States. SDR transactions by the United States require the explicit authorization of the Secretary of the Treasury.

The SDR's value is based on a weighted average of a basket of key international reserve currencies issued by IMF members (or monetary unions that include IMF members) which have been determined by the IMF to be freely usable currencies. These currencies are the U.S. dollar, the Euro, the Japanese yen, and the pound sterling. The SDR carries a variable interest rate, calculated weekly as a weighted average of representative interest rates on short-term debt in the money markets of the SDR basket currencies. The ESF's SDR Allocations and Holdings (see below) are revalued monthly, based on the SDR valuation rate calculated by the IMF, and unrealized gains or losses on revaluation are recognized. SDR Holdings and SDR Allocations are reported as an asset and liability respectively in the financial statements of the ESF.

SDR Allocations

SDRs, once allocated to the United States, 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.

Due to the fact that the SDRs are able to be withdrawn, the ESF carries a liability related to such allocations.

NOTE 4 – SPECIAL DRAWING RIGHTS (Continued)

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 controlling voice. Allocations of SDRs were made during 1970, 1971, 1972, 1979, 1980, 1981, and 2009. As of September 30, 2014 and 2013, the value of SDR allocations to the United States was the equivalent of $52.4 billion and $54.2 billion, respectively.

SDR Holdings

Pursuant to the Special Drawing Rights Act of 1968, as amended, SDRs allocated by the IMF to, or otherwise acquired by the United States, are also resources (holdings) of the ESF. SDR Holdings represent transactions resulting from these SDR activities, primarily the result of IMF allocations. Other transactions reported in this account are recorded as they are incurred and include any SDR acquisitions and sales, interest received on SDR Holdings, interest charges on SDR Allocations, and other SDR related activities, as well as valuation adjustments.

Other SDR Activities

The U.S. Government receives remuneration in SDRs from the IMF on the U.S. claim on the IMF, represented by the U.S. Reserve Position. The ESF is the only agency within Treasury permitted to transact in SDRs. SDRs received become the resources of the ESF, as required by law, and the ESF pays the dollar equivalent to the U. S. Government's Treasury General Account (TGA). The ESF's receipt of the SDRs and payment of the dollar equivalent to the TGA are not simultaneous. Typically, the payment is several weeks after the receipt of SDRs from the IMF. Therefore, the ESF must reimburse the TGA the interest it earned on the dollar equivalent of the SDRs held on behalf of the TGA during the period which elapsed between the receipt of the SDRs and the dollar payment to the TGA.

The ESF paid to the TGA $565 and $980 in fiscal years 2014 and 2013, respectively, in interest due on the transferred dollars. The ESF did not transact to buy or sell SDRs to any participating members during fiscal year 2014 or 2013.

The following schedule reflects the activity related to SDR Holdings during fiscal years 2014 and 2013 in SDR and dollar equivalent.

September 30 (SDRs In Thousands)	**2014**	**2013**
Beginning balance	35,829,965	35,814,322
Interest credits on holdings	35,710	26,859
Interest charges on allocations	(35,190)	(26,481)
Remuneration	18,231	15,464
IMF annual assessment	(238)	(199)
Total SDR - Holdings	35,848,478	35,829,965

NOTE 4 – SPECIAL DRAWING RIGHTS (Continued)

September 30 (Dollar Equivalent In Thousands)	2014	2013
Beginning balance	$ 54,966,034	$ 55,232,490
Interest credits on holdings	54,955	40,975
Interest charges on allocations	(54,155)	(40,398)
Remuneration	28,055	23,586
IMF annual assessment	(367)	(298)
Net loss on valuation of holdings	(1,846,285)	(290,321)
Total Dollar Equivalent – Holdings	$ 53,148,237	$ 54,966,034

The table above reflects the actual dollar equivalent amount of SDRs received or transferred by the ESF. Amounts within the financial statements computed on an accrual basis will thus differ due to changes in foreign exchange rates since actual SDR movements occur shortly after the balance sheet date.

NOTE 5 – INVESTMENT SECURITIES AND OTHER FOREIGN CURRENCY DENOMINATED ASSETS

The amortized cost, gross unrealized holding gains and losses, and fair value of available-for-sale and held-to-maturity debt securities by major security type and class of security at September 30, 2014 and 2013 were as follows:

September 30, 2014 (In Thousands)	Amortized Cost	Gross Unrealized Holdings Gains	Gross Unrealized Holding (Losses)	Fair Value
Available for sale:				
FIXBIS	$ 1,123,626	$ -	$ (87,803)	$ 1,035,823
French Time Deposits	6,013,196		(423,816)	5,589,380
German Bonds	2,452,794	3,766	(96,262)	2,360,298
French Bonds	1,840,349	8,042	(73,724)	1,774,667
French Notes	1,406,436	7,964	(37,553)	1,376,847
Japanese Bonds	6,179,808	-	(481,622)	5,698,186
Total	$ 19,016,209	$ 19,772	$ (1,200,780)	$ 17,835,201

NOTE 5 – INVESTMENT SECURITIES AND OTHER FOREIGN CURRENCY DENOMINATED ASSETS (Continued)

September 30, 2013 (In Thousands)	Amortized Cost	Gross Unrealized Holdings Gains	Gross Unrealized Holding (Losses)	Fair Value
Available for sale:				
FIXBIS	$ 2,795,604	$ 88,384	$ -	$ 2,883,988
German Bonds	2,342,698	71,892	(22,550)	2,392,040
French Bonds	1,153,122	56,661	(10,102)	1,199,681
French Notes	1,145,669	57,304	(11,092)	1,191,881
Japanese Bonds	6,767,327	13,860	(431,865)	6,349,322
Total	$ 14,204,420	$ 288,101	$ (475,609)	$ 14,016,912

Other FCDAs represents Euro denominated instruments issued by the Bank of International Settlements, which typically mature within one year, and Bank of France Time Deposits with terms greater than three months, but less than one year.

Gross unrealized losses in which other-than-temporary impairments have not been recognized and the fair value of those securities as of September 30, 2014:

September 30, 2014 (In Thousands)	Unrealized Losses Greater Than 1 Year	Fair Value
Available-for-sale		
FIXBIS	$ -	$ -
French Time Deposits	-	-
German Bonds	50,353	464,277
French Bonds	8,013	45,568
French Notes	1,921	18,893
Japanese Bonds	302,938	871,999
Total	$ 363,225	$ 1,400,737

NOTE 5 – INVESTMENT SECURITIES AND OTHER FOREIGN CURRENCY DENOMINATED ASSETS (Continued)

September 30, 2014 (In Thousands)	**Unrealized Losses Less Than 1 Year**		**Fair Value**	
Available-for-sale				
FIXBIS	$	87,803	$	1,035,823
French Time Deposit		423,816		5,589,380
German Bonds		45,909		1,516,946
French Bonds		65,711		1,363,457
French Notes		35,632		904,704
Japanese Bonds		178,684		2,444,145
Total	$	837,555	$	12,854,455

Maturities of debt securities classified as available for sale were as follows at September 30, 2014:

September 30, 2014 (In Thousands)	**Amortized Cost**		**Fair Value**	
Available-for-sale:				
Due within one year	$	10,644,643	$	10,082,856
Due after one year but before five years		8,371,566		7,752,345
Total	$	19,016,209	$	17,835,201

Impairment Assessment

As of each balance sheet date, the ESF evaluates securities holdings in an unrealized loss position. For debt securities, the ESF considers whether it has the ability and intent to hold the investment until a market price recovery and considers whether evidence indicating the cost of the investment is recoverable outweighs evidence to the contrary. Based on the circumstances present at the date of evaluation if we do not expect a full recovery of value or do not intend to hold such securities until they have fully recovered their carrying value, we recognize an impairment charge.

During the year ended September 30, 2014, the yen has continued to depreciate in value. ESF expects the yen to continue to further depreciate in the near future, and ESF does not expect to recover the dollar equivalent invested for certain yen-denominated securities before their maturity. Accordingly, ESF has recognized other-than-temporary impairment on Japanese Government Bonds with a maturity date before the end of FY 2015. No other-than-temporary impairment has been identified.

NOTE 5 – INVESTMENT SECURITIES AND OTHER FOREIGN CURRENCY DENOMINATED ASSETS (Continued)

Fair Value

The fair value of securities available-for-sale are measured using the hierarchy or lowest level input that is significant to the fair value measurement of the investment in its entirety. The following table presents assets that are measured at fair value on a recurring basis at September 30, 2014 and 2013.

		Fair Value Measurements at Reporting Date Using		
September 30, 2014 (In Thousands)	**Fair Value At 9/30/2014**	**Quoted Prices In Active Markets For Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Available-for-sale:				
FIXBIS	$ 1,035,823	$ 1,035,823	-	-
French Time Deposits	5,589,380	5,589,380		
German Bonds	2,360,298	2,360,298		-
French Bonds	1,774,667	1,774,667		-
French Notes	1,376,847	1,376,847		-
Japanese Bonds	5,698,186	5,698,186	-	-
Total	$ 17,835,201	$ 17,835,201	-	-

		Fair Value Measurements at Reporting Date Using		
September 30, 2013 (In Thousands)	**Fair Value At 9/30/2013**	**Quoted Prices In Active Markets For Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Available-for-sale:				
FIXBIS	$ 2,883,988	$ 2,883,988	-	-
German Bonds	2,392,040	2,392,040		-
French Bonds	1,199,681	1,199,681		-
French Notes	1,191,881	1,191,881		-
Japanese Bonds	6,349,322	6,349,322	-	-
Total	$ 14,016,912	$ 14,016,912	-	-

NOTE 6 – ACCUMULATED OTHER COMPREHENSIVE INCOME/(LOSS)

The accumulated balances for other comprehensive income/(loss) are as follows:

September 30, 2014 (In Thousands)	**Accumulated Other Comprehensive Income/(Loss)**	
Balance at September 30, 2013		$ (187,509)
Unrealized holding gains/(losses) arising during the period	$ (1,416,506)	
Less: reclassification of gains recognized in net income	(68,249)	
Less: reclassification of gains/(losses) related to impaired instruments recognized in net income	491,256	
Other comprehensive loss		(993,499)
Balance at September 30, 2014		$ (1,181,008)

September 30, 2013 (In Thousands)	**Accumulated Other Comprehensive Income/(Loss)**	
Balance at September 30, 2012		$ 354,897
Unrealized holding gains/(losses) arising during the period	$ (894,594)	
Less: reclassification of gains recognized in net income	(175,539)	
Less: reclassification of gains/(losses) related to impaired instruments recognized in net income	527,727	
Other comprehensive loss		(542,406)
Balance at September 30, 2013		$ (187,509)

NOTE 7 – SDR CERTIFICATES ISSUED TO FEDERAL RESERVE BANKS

The Special Drawing Right Act of 1968 authorized the Secretary of the Treasury to issue Special Drawing Right Certificates (SDRCs), not to exceed the value of SDR holdings, to the Federal Reserve System 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 operations of the ESF. Certificates issued have no set maturity and 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, 2014 and 2013, the amount of certificates issued to Federal Reserve Banks was $5.2 billion.

NOTE 8 - FAIR VALUES OF FINANCIAL INSTRUMENTS

Financial Instruments (FASB ASC 825-10) requires all entities to disclose the fair value of financial instruments, where feasible, in an effort to provide financial statement users with information in making rational investment and credit decisions.

To estimate the fair value of each class of financial instrument, the ESF applied the following methods using the indicated assumptions:

Cash and Cash Equivalents

Cash and Cash Equivalents consist of U.S. government securities and FCDAs, and are reported in the Statements of Financial Position at amounts that approximate their fair values.

Securities Purchased Under Agreement to Resell

The fair value is based upon quoted market interest rates for similar securities.

SDR Certificates Issued to Federal Reserve Banks

The fair value of these certificates is based on the face value of the certificate as they are not subject to market or interest rate risk nor are they subject to fluctuations in exchange rates.

Special Drawing Right (SDR) Holdings and SDR Allocations

The fair values are based on quoted prices published weekly by the IMF.

Investment Securities and Other FCDAs

The fair value of Investment Securities and Other FCDAs are based upon quoted market and current exchange rates.

NOTE 8 - FAIR VALUES OF FINANCIAL INSTRUMENTS (Continued)

The estimated fair values of the ESF's financial instruments at September 30 are as follows:

	2014		**2013**	
September 30 (In Thousands)	**Carrying Amount**	**Fair Value**	**Carrying Amount**	**Fair Value**
Assets:				
Cash and Cash Equivalents	$27,087,365	$27,087,365	$30,561,249	$30,561,249
Securities Purchased-Under Agreement to Resell	-	-	2,233,275	2,233,275
Investment Securities and Other Foreign Currency Denominated Assets	17,835,201	17,835,201	14,016,912	14,016,912
SDR Holdings	53,148,237	53,148,237	54,966,034	54,966,034
Liabilities:				
Certificates Issued to Federal Reserve Banks	5,200,000	5,200,000	5,200,000	5,200,000
SDR Allocations	52,358,322	52,358,322	54,177,080	54,177,080

NOTE 9 – COMMITMENTS AND CONTINGENCIES

Foreign Currency Denominated Agreements

Foreign currency denominated agreements that exist between the Treasury and foreign entities or governments provide for drawings of dollars by those entities or governments and drawings of foreign currencies by the Treasury. The Treasury enters into these agreements through the ESF. Under these agreements, the ESF receives repayment of an agreed-upon amount in dollars regardless of currency fluctuations. With the exception of the Mexico agreement noted below, there were no foreign currency denominated exchange stabilization agreements as of September 30, 2014 and 2013.

Exchange Stabilization Agreements

The ESF has an Exchange Stabilization Agreement (ESA) with Mexico. In April 1994, the Treasury signed the North American Framework Agreement, which includes the ESA with Mexico. The ESA provides for a $3 billion standing swap line between the Bank of Mexico and the ESF.

The amounts and terms (including the assured source of repayment) of any new borrowings under the North American Framework Agreement are subject to certain requirements of the agreement that specify the transactions are exchange rate neutral for the ESF and would bear interest referenced to U.S. Treasury bills. Drawings are contingent on certain other conditions being met.

There were no drawings outstanding on the ESF swap line as of September 30, 2014 and 2013. On December 10, 2013, the Treasury renewed its participation in the agreement until December 14, 2014.

NOTE 10 – SUBSEQUENT EVENTS

We evaluated and have had no subsequent events through December 5, 2014, the date that these financial statements were available to be issued.