Audit Report

OIG-16-018

FINANCIAL MANAGEMENT

Audit of the Exchange Stabilization Fund's Fiscal Years 2015 and 2014 Financial Statements

December 8, 2015

Office of Inspector General

Department of the Treasury

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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

OFFICE OF
INSPECTOR GENERAL

December 8, 2015

MEMORANDUM FOR ANDREW BAUKOL
DEPUTY ASSISTANT SECRETARY FOR INTERNATIONAL MONETARY POLICY

FROM: Adé Bankole
Acting Director, Financial and Procurement Audit

SUBJECT: Audit of the Exchange Stabilization Fund's Fiscal Years 2015 and 2014 Financial Statements

We contracted with the independent certified public accounting firm of KPMG LLP (KPMG) to audit the financial statements of the Exchange Stabilization Fund (ESF) as of September 30, 2015 and 2014, and for the years then ended, to provide a report on internal control over financial reporting, and to report any reportable noncompliance with laws, regulations, and contracts tested. The contract required that the audit be performed in accordance with U.S. generally accepted government auditing standards, Office of Management and Budget (OMB) Bulletin No. 15-02, *Audit Requirements for Federal Financial Statements*, and the Government Accountability Office/President's Council on Integrity and Efficiency *Financial Audit Manual*.

In its audit of ESF, KPMG found

- the financial statements were fairly presented, in all material respects, in accordance with U.S. generally accepted accounting principles,
- no deficiencies in internal control over financial reporting that are considered material weaknesses, and
- no instances of reportable noncompliance with laws, regulations, and contracts 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 U.S. generally accepted government auditing standards, was not intended to enable us to express, and we do not express, opinions on ESF's 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 4, 2015, and the conclusions expressed in the report. However, our review disclosed no instances where KPMG did not comply, in all material respects, with U.S. generally accepted government auditing standards.

Should you have any questions, please contact me at (202) 927-5329, or a member of your staff may contact Renee Whittington, Manager, Financial and Procurement Audit, at (202) 927-0362.

Attachment

DEPARTMENT OF THE TREASURY
EXCHANGE STABILIZATION FUND

Financial Statement

September 30, 2015 and 2014

DEPARTMENT OF THE TREASURY
EXCHANGE STABILIZATION FUND

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EXCHANGE STABILIZATION FUND
POLICY AND OPERATIONS STATEMENTS
FISCAL YEAR 2015

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 $2.9 billion on its holdings of euros and yen. The ESF had investment income of $41.5 million equivalent on its euro and yen assets.

b. Mexico

In November 2014, 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 2015. The agreement was subsequently renewed October 2015 for another year to December 2016.

II. SDR Operations

As of September 30, 2015, U.S. holdings (assets) of SDRs totaled SDR 35.9 billion ($50.3 billion equivalent), a net increase of 7.0 million SDR during Fiscal Year 2015. However, as the SDR depreciated against the dollar in this period, there was a net valuation loss of $2.8 billion on U.S. holdings of SDRs. The ESF reimbursed the Treasury's General Fund $10.4 million for SDRs received from the IMF as remuneration on the U.S. reserve position in the IMF. The ESF earned interest of $24.8 million equivalent on its SDR holdings.

As of September 30, 2015, cumulative allocations to (liabilities of) the United States totaled SDR 35.3 billion ($49.6 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 2015.

III. Income and Expense

Interest revenue totaled $71.3 million, consisting of $5.0 million in interest on dollar holdings invested in U.S. Government securities, $24.8 million equivalent in interest on SDR holdings, and $41.5 million equivalent in interest on foreign currency investments.

Interest expense totaled $24.5 million, primarily representing interest charges on SDR Allocations.

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

Independent Auditors' Report

Inspector General
Department of the Treasury

Report on the Financial Statements

We have audited the accompanying financial statements of the Department of the Treasury's Exchange Stabilization Fund (ESF), which comprise the statements of financial position as of September 30, 2015 and 2014, 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. 15-02, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin No. 15-02 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.

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 Department of the Treasury's Exchange Stabilization Fund as of September 30, 2015 and 2014, and the results of its operations and its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

KPMG

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 4, 2015 on our consideration of the ESF's internal control over financial reporting and our report dated December 4, 2015 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 4, 2015

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

Independent Auditors' Report on Internal Control Over Financial Reporting

Inspector General
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. 15-02, *Audit Requirements for Federal Financial Statements*, the financial statements of the Department of the Treasury's Exchange Stabilization Fund (ESF), which comprise the statements of financial position as of September 30, 2015 and 2014, 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 4, 2015.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements as of and for the year ended September 30, 2015, 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. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

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 4, 2015

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

Independent Auditors' Report on Compliance and Other Matters

Inspector General
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. 15-02, *Audit Requirements for Federal Financial Statements*, the financial statements of the Department of the Treasury's Exchange Stabilization Fund (ESF), which comprise the statements of financial position as of September 30, 2015 and 2014, 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 4, 2015.

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, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. 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. 15-02.

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 4, 2015

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

As of September 30		**30-Sep 2015**		**30-Sep 2014**
Assets				
Fund Balance with Treasury	$	1,870,534	$	–
Cash and Cash Equivalents (Note 2)		29,084,706		27,087,365
Investment Securities and Other Foreign Currency Denominated Assets, at fair value (Note 4)		11,649,905		17,835,201
Special Drawing Right Holdings (Note 3)		50,331,727		53,148,237
Interest Receivable		67,393		69,204
Interest Receivable on Special Drawing Right Holdings		4,206		5,359
Total Assets	$	93,008,471	$	98,145,366
Liabilities and Equity				
Liabilities:				
Special Drawing Rights Certificates Issued to Federal Reserve Banks (Note 6)	$	5,200,000	$	5,200,000
Special Drawing Right Allocations (Note 3)		49,574,034		52,358,322
Interest Payable on Special Drawing Right Allocations		4,143		5,279
Other		345		153
Total Liabilities		54,778,522		57,563,754
Commitments and Contingencies (Note 8)				
Equity:				
Appropriated Capital		200,000		200,000
Retained Earnings		38,677,580		41,562,620
Accumulated Other Comprehensive Loss (Notes 1 and 5)		(647,631)		(1,181,008)
Total Equity		38,229,949		40,581,612
Total Liabilities and Equity	$	93,008,471	$	98,145,366

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 period-ended September 30	30-Sep 2015	30-Sep 2014
Interest Income		
Interest on Cash and Cash Equivalents, net	$ (2,702)	$ 10,705
Interest on Securities Purchased Under Agreement to Resell	–	2,116
Interest on Investment Securities and Other Foreign Currency Denominated Assets	49,188	80,305
Interest on Special Drawing Right Holdings	24,823	54,055
Total Interest Income	71,309	147,181
Interest Expense		
Interest on Special Drawing Right Allocations	(24,451)	(53,265)
Interest on Special Drawing Right - Remuneration due to the U.S. Treasury	–	(1)
Total Interest Expense	(24,451)	(53,266)
Net Interest Income	46,858	93,915
Net Gains/(Losses)		
Gain/(Loss) on Foreign Currency Valuation of:		
Special Drawing Rights Holdings	(2,826,670)	(1,846,456)
Special Drawing Rights Allocations	2,784,472	1,818,927
Investment Securities and Other Foreign Currency Denominated Assets, net (Notes 1 and 4) (Includes net gain/(loss) of $(561,788) and $68,249 in fiscal years 2015 and 2014, respectively, in accumulated other comprehensive income reclassifications for previously unrealized net gains/losses on available-for-sale securities)	(1,880,868)	(477,914)
Other-Than-Temporary Losses on Investment Securities	(1,007,807)	(491,256)
Securities Purchased Under Agreement to Resell	–	(1,200)
Total Net Losses	(2,930,873)	(997,899)
Other Expenses		
International Monetary Fund Annual Assessment	(1,025)	(396)
Total Other Expenses	(1,025)	(396)
Net Loss	(2,885,040)	(904,380)
Other Comprehensive Loss		
Unrealized Holding Gain/(Loss), net (Notes 1 and 5)	533,377	(993,499)
Comprehensive Loss	$ (2,351,663)	$ (1,897,879)
Retained Earnings, Beginning of Year	$ 41,562,620	$ 42,467,000
Net Loss	(2,885,040)	(904,380)
Retained Earnings, End of Year	$ 38,677,580	$ 41,562,620

See accompanying notes to financial statements.

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

For the period-ended September 30		30-Sep 2015		30-Sep 2014
Cash Flows from Operating Activities:				
Interest Received/(Paid) on:				
Cash and Cash Equivalents	$	(611)	$	10,312
Securities Purchased Under Agreement to Resell		–		2,151
Investment Securities and Other Foreign Currency Denominated Assets		143,094		158,273
Other		(10,570)		(7,326)
Net Cash Provided by Operating Activities		131,913		163,410
Cash Flows from Investing Activities:				
Net Maturities of Securities Purchased Under Agreement to Resell		–		2,232,075
Purchases of Investment Securities and Foreign Currency Denominated Assets		(5,225,939)		(14,733,840)
Maturities of Investment Securities and Foreign Currency Denominated Assets		9,589,028		9,317,318
Reimbursement for Remuneration Received		(10,419)		(28,056)
Other		831		367
Net Cash Used in Investing Activities		4,353,501		(3,212,136)
Effect of Exchange Rate on Cash		(617,539)		(425,158)
Net Increase/ (Decrease) in Cash and Cash Equivalents		3,867,875		(3,473,884)
Cash and Cash Equivalents, Beginning of Year		27,087,365		30,561,249
Fund Balance with Treasury and Cash and Cash Equivalents, End of Year	$	30,955,240		27,087,365
Reconciliation of Net Loss to Net Cash Provided by Operating Activities				
Net Loss	$	(2,885,040)	$	(904,380)
Adjustments to Reconcile Net Loss to Net Cash Provided by Operating Activities:				
Net Exchange Rate Loss on Repos, FCDAs, and Investment Securities		1,880,868		479,114
Decrease in Special Drawing Right Holdings Due to Valuation		2,826,484		1,846,285
Net Increase in Special Drawing Rights Holdings		(385)		(799)
Decrease in Accrued Interest Receivable		2,963		11,001
Net Amortization of Bond Premium		84,447		60,721
Decrease in Special Drawing Right Allocations Due to Valuation		(2,784,288)		(1,818,758)
Decrease in Accrued Interest Payable and Other		(943)		(1,030)
Other-Than-Temporary Losses on Investment Securities		1,007,807		491,256
Total Adjustments		3,016,953		1,067,790
Net Cash Provided by Operating Activities	$	131,913	$	163,410

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 of the Treasury, with the approval of the President, to deal in gold, foreign exchange, and instruments of credit and securities consistent with U.S. 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 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. Fund Balance with Treasury

The ESF does not maintain cash in commercial bank accounts. The Treasury processes investments and redemptions. Fund Balance with Treasury at September 30, 2015 is composed of the suspended daily reinvestment of the dollar-balance of the Exchange Stabilization Fund in order to avoid exceeding the statutory debt limit.

E. 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.

F. 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.

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 Loss

Accumulated Other Comprehensive Loss represents 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, 2015 and 2014 are as follows:

September 30 (In Thousands)	2015	2014
Cash and cash equivalents:		
U.S. government securities	$ 20,773,223	$ 22,649,209
Short-term FCDAs:		
European euro	5,733,812	1,626,653
Japanese yen	2,577,671	2,811,503
Total short-term FCDAs	8,311,483	4,438,156
Total cash and cash equivalents	$ 29,084,706	$ 27,087,365

NOTE 3 – SPECIAL DRAWING RIGHTS

The Special Drawing Right (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.

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, 2015 and 2014, the value of SDR allocations to the United States was the equivalent of $49.6 billion and $52.4 billion, respectively.

NOTE 3 – SPECIAL DRAWING RIGHTS (Continued)

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 $157 and $565 in fiscal years 2015 and 2014, 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 2015 or 2014.

The following schedule reflects the activity related to SDR Holdings during fiscal years 2015 and 2014 in SDR and dollar equivalent.

September 30 (SDRs In Thousands)	**2015**	**2014**
Beginning balance	$ 35,848,478	$ 35,829,965
Interest credits on holdings	18,124	35,710
Interest charges on allocations	(17,853)	(35,190)
Remuneration	7,302	18,231
IMF annual assessment	(603)	(238)
Total SDR - Holdings	$ 35,855,448	$ 35,848,478

September 30 (Dollar Equivalent In Thousands)	**2015**	**2014**
Beginning balance	$ 53,148,237	$ 54,966,034
Interest credits on holdings	25,789	54,955
Interest charges on allocations	(25,403)	(54,155)
Remuneration	10,419	28,055
IMF annual assessment	(831)	(367)
Net loss on valuation of holdings	(2,826,484)	(1,846,285)
Total Dollar Equivalent – Holdings	$ 50,331,727	$ 53,148,237

NOTE 3 – SPECIAL DRAWING RIGHTS (Continued)

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 4 – 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, 2015 and 2014 were as follows:

September 30, 2015 (In Thousands)	Amortized Cost	Gross Unrealized Holdings Gains	Gross Unrealized Holding (Losses)	Fair Value
Available for sale:				
French Time Deposits	$ 641,852	$ –	$ –	$ 641,852
German Bonds	2,554,686	2,970	(206,308)	2,351,348
French Bonds	2,540,311	6,260	(225,679)	2,320,892
French Notes	1,202,210	–	(85,390)	1,116,820
Japanese Bonds	5,358,477	18,653	(158,137)	5,218,993
Total	$ 12,297,536	$ 27,883	$ (675,514)	$ 11,649,905

September 30, 2015 (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 4 – INVESTMENT SECURITIES AND OTHER FOREIGN CURRENCY DENOMINATED ASSETS (Continued)

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, 2015:

September 30, 2015 (In Thousands)	Unrealized Losses Greater Than 1 Year	Fair Value
Available-for-sale		
German Bonds	$ (135,510)	$ 817,270
French Bonds	(147,273)	791,380
French Notes	(37,374)	242,080
Japanese Bonds	(122,844)	670,021
Total	$ (443,001)	$ 2,520,751

September 30, 2015 (In Thousands)	Unrealized Losses Less Than 1 Year	Fair Value
Available-for-sale		
German Bonds	$ (70,798)	$ 790,494
French Bonds	(78,406)	761,926
French Notes	(48,016)	408,956
Japanese Bonds	(35,293)	1,353,952
Total	$ (232,513)	$ 3,315,328

Maturities of debt securities classified as available for sale were as follows at September 30, 2015:

September 30, 2015 (In Thousands)	Amortized Cost	Fair Value
Available-for-sale:		
Due within one year	$ 4,164,252	$ 4,164,252
Due after one year but before five years	7,783,480	7,132,051
Due after five years but before ten years	349,804	353,602
Total	$ 12,297,536	$ 11,649,905

NOTE 4 – INVESTMENT SECURITIES AND OTHER FOREIGN CURRENCY DENOMINATED ASSETS (Continued)

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, 2015, the euro and yen have continued to depreciate in value. Given the level of decline and current outlook, and ESF does not expect to recover the dollar equivalent invested for certain euro and yen-denominated securities in the near term and/or before their maturity. Accordingly, ESF has recognized other-than-temporary impairment on German Bonds, French Bonds, French Notes, Japanese Bonds and certain French Time Deposits with a maturity date before the end of fiscal year 2016. Additionally, ESF has recognized other-than-temporary impairment on certain Japanese Bonds with a maturity date before June 30, 2017.

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, 2015 and 2014.

		Fair Value Measurements at Reporting Date Using		
September 30, 2015 (In Thousands)	**Fair Value At 9/30/2015**	**Quoted Prices In Active Markets For Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Inputs (Level 3) Unobservable**
Available-for-sale:				
French Time Deposits	$ 641,852	$ 641,852	–	–
German Bonds	2,351,348	2,351,348	–	–
French Bonds	2,320,892	2,320,892	–	–
French Notes	1,116,820	1,116,820	–	–
Japanese Bonds	5,218,993	5,218,993	–	–
Total	$ 11,649,905	$ 11,649,905	–	–
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	–	–

NOTE 5 – ACCUMULATED OTHER COMPREHENSIVE LOSS

The accumulated balances for other comprehensive loss are as follows:

September 30, 2015 (In Thousands)	Accumulated Other Comprehensive Loss
Balance at September 30, 2014	$ (1,181,008)
Unrealized holding losses arising during the period	$ (1,036,218)
Less: reclassification of losses recognized in net income	561,788
Less: reclassification of losses related to impaired instruments recognized in net income	1,007,807
Other comprehensive gain, net	533,377
Balance at September 30, 2015	$ (647,631)
Balance at September 30, 2013	$ (187,509)
Unrealized holding losses arising during the period	$ (1,416,506)
Less: reclassification of gains recognized in net income	(68,249)
Less: reclassification of losses related to impaired instruments	491,256
Other comprehensive loss, net	(993,499)
Balance at September 30, 2014	$ (1,181,008)

NOTE 6 – 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, 2015 and 2014, the amount of certificates issued to Federal Reserve Banks was $5.2 billion.

NOTE 7 - 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:

Fund Balance with Treasury

The carrying amount, at face value, approximates fair value because of the short holding period of these funds.

NOTE 7 - FAIR VALUES OF FINANCIAL INSTRUMENTS (Continued)

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.

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 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.

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

September 30 (In Thousands)	2015 Carrying Amount	2015 Fair Value	2014 Carrying Amount	2014 Fair Value
Assets:				
Fund Balance with Treasury	$ 1,870,534	$ 1,870,534	$ –	$ –
Cash and Cash Equivalents	29,084,706	29,084,706	27,087,365	27,087,365
Investment Securities and Other Foreign Currency Denominated Assets	11,649,905	11,649,905	17,835,201	17,835,201
SDR Holdings	50,331,727	50,331,727	53,148,237	53,148,237
Liabilities:				
Certificates Issued to Federal Reserve Banks	5,200,000	5,200,000	5,200,000	5,200,000
SDR Allocations	49,574,034	49,574,034	52,358,322	52,358,322

NOTE 8 – 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, 2015 and 2014.

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, 2015 and 2014. On November 16, 2014, the Treasury renewed its participation in the agreement until December 11, 2015.

NOTE 9 – SUBSEQUENT EVENTS

On August 31, 2015, Treasury temporarily suspended, as necessary, the daily reinvestment of the dollar-balance of the Exchange Stabilization Fund in order to avoid exceeding the statutory debt limit. The amount suspended varied daily. The dollar-balance of the ESF is invested entirely in special-issue Treasury securities that are subject to the statutory debt limit. The entire dollar-balance matures daily and is ordinarily reinvested. On November 2, 2015, Congress enacted the *Bipartisan Budget Act of 2015* which temporarily suspended the debt limit through March 15, 2017. Following the suspension of the debt limit, Treasury resumed normal procedures for daily reinvestment of the dollar-balance of the ESF**.**

On October 30, 2015, the Treasury renewed its participation in the ESA until December 12, 2016.

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