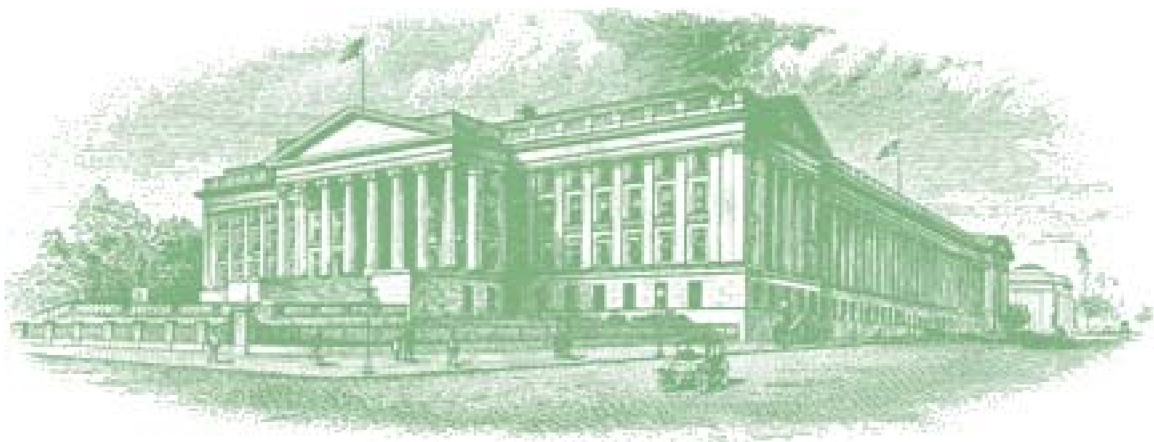
Audit Report



OIG-12-023

Audit of the Exchange Stabilization Fund's Fiscal Years 2011 and 2010 Financial Statements

December 7, 2011

Office of Inspector General

Department of the Treasury

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

OFFICE OF
INSPECTOR GENERAL

December 7, 2011

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

FROM: Michael Fitzgerald
Director, Financial Audits

SUBJECT: Audit of the Exchange Stabilization Fund's Fiscal Years 2011 and 2010 Financial Statements

I am pleased to transmit the attached audited Exchange Stabilization Fund (ESF) financial statement for fiscal years 2011 and 2010. Under a contract monitored by the Office of Inspector General, KPMG LLP, an independent certified public accounting firm, performed an audit of the financial statements of ESF as of September 30, 2011 and 2010 and for the years then ended. The contract required that the audit be performed in accordance with generally accepted government auditing standards; applicable provisions of Office of Management and Budget Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements,* as amended; and the *GAO/PCIE Financial Audit Manual*.

The following reports, prepared by KPMG LLP, 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 LLP found:

- the financial statements were fairly presented, in all material respects, in conformity 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 and regulations tested.

In connection with the contract, we reviewed KPMG LLP'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 LLP is responsible for the attached auditors' reports dated December 1, 2011 and the conclusions expressed in the reports. However, our review disclosed no instances where KPMG LLP did not comply, in all material respects, with generally accepted government auditing standards.

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

Attachment

KPMG

DEPARTMENT OF THE TREASURY
EXCHANGE STABILIZATION FUND

Financial Report

Fiscal Year 2011

DEPARTMENT OF THE TREASURY
EXCHANGE STABILIZATION FUND

Table of Contents

EXCHANGE STABILIZATION FUND
POLICY AND OPERATIONS STATEMENTS
FISCAL YEAR 2011

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. Intervention

During fiscal year 2011, the ESF engaged in an intervention with Japan. ESF sold 40.8075 billion yen, $500 million equivalent of yen.

b. Euros and Japanese Yen

The ESF had a net valuation gain of $1.144 billion on its holdings of euros and yen. The ESF had investment income of $250.5 million equivalent on its euro and yen assets.

c. Mexico

In December 2010, 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 2011.

II. SDR Operations

As of September 30, 2011, U.S. holdings (assets) of SDRs totaled SDR 35.8 billion ($55.9 billion equivalent), a net decrease of SDR 1.1 billion during Fiscal Year 2011. However, as the SDR appreciated against the dollar in this period, there was a net valuation gain of $229.4 million on U.S. holdings of SDRs. The ESF reimbursed the Treasury's General Fund $63.1 million for SDRs received from the IMF as remuneration on the U.S. reserve position in the IMF. The ESF received $1.9 billion from the Treasury's General Fund for the IMF Quota increase. The ESF earned interest of $250.1 million equivalent on its SDR holdings.

As of September 30, 2011, cumulative allocations to (liabilities of) the United States totaled SDR 35.3 billion ($55.1 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 2011.

III. Income and Expense

Interest revenue totaled $514.9 million, consisting of $14.3 million in interest on dollar holdings invested in U.S. Government securities, $250.1 million equivalent in interest on SDR holdings, and $250.5 million equivalent in interest on foreign currency investments.

Interest expense totaled $244.0 million, primarily representing interest charges on SDR Allocations.

KPMG LLP
2001 M Street, NW
Washington, DC 20036-3389

Independent Auditors' Report

Inspector General
U.S. Department of the Treasury:

We have audited the accompanying statements of financial position of the U.S. Department of the Treasury's Exchange Stabilization Fund ("ESF") as of September 30, 2011 and 2010, and the related statements of income and comprehensive income and retained earnings, and cash flows, (hereinafter referred to as "financial statements") for the years then ended. These financial statements are the responsibility of the ESF's management. 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. 07-04, *Audit Requirements for Federal Financial Statements*, as amended. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the ESF's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the ESF as of September 30, 2011 and 2010, and the results of its operations and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Our audits were conducted for the purpose of forming an opinion on the financial statements taken as a whole. The information in the Policy and Operations Statements section on pages 1 to 3 is presented for purposes of additional analysis and are not required as part of the financial statements. This information has not been subjected to auditing procedures and, accordingly, we express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our reports dated December 1, 2011, on our consideration of the ESF's internal control over financial reporting and 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* and should be read in conjunction with this report in assessing the results of our audits.

KPMG LLP

December 1, 2011

KPMG LLP
2001 M Street, NW
Washington, DC 20036-3389

Independent Auditors' Report on Internal Control Over Financial Reporting

Inspector General
U.S. Department of the Treasury:

We have audited the statements of financial position of the U.S. Department of the Treasury's Exchange Stabilization Fund ("ESF") as of September 30, 2011 and 2010 and the related statements of income and comprehensive income and retained earnings, and cash flows (hereinafter referred to as "financial statements") for the years then ended, and have issued our report thereon dated December 1, 2011.

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. 07-04, *Audit Requirements for Federal Financial Statements*, as amended. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement.

The management of the ESF is responsible for establishing and maintaining effective internal control. In planning and performing our fiscal year 2011 audit, we considered the ESF's internal control over financial reporting by obtaining an understanding of the design effectiveness of the ESF's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls as a basis for designing our auditing procedures 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 over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the ESF's internal control over financial reporting. 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.

Our consideration of internal control over financial reporting was for the limited purpose described in the third paragraph of this report and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. In our fiscal year 2011 audit, we did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

This report is intended solely for the information and use of the ESF's management, the U.S. Department of the Treasury's Office of Inspector General, OMB, the U.S. Government Accountability Office, and the U.S. Congress and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

December 1, 2011

KPMG LLP
2001 M Street, NW
Washington, DC 20036-3389

Independent Auditors' Report on Compliance and Other Matters

Inspector General
U.S. Department of the Treasury:

We have audited the statements of the financial position of the U.S. Department of the Treasury's Exchange Stabilization Fund ("ESF") as of September 30, 2011 and 2010, and the related statements of income and comprehensive income and retained earnings, and cash flows (hereinafter referred to as "financial statements") for the years then ended, and have issued our report thereon dated December 1, 2011.

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. 07-04, *Audit Requirements for Federal Financial Statements*, as amended. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

The management of the ESF is responsible for complying with laws, regulations, and contracts applicable to the ESF. As part of obtaining reasonable assurance about whether the ESF's financial statements are free of material misstatement, we performed tests of the ESF's compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of the financial statement amounts. We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws, regulations, and contracts applicable to the ESF. 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 described in the preceding paragraph of this report, disclosed no instances of noncompliance or other matters that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 07-04.

This report is intended solely for the information and use of the ESF's management, the U.S Department of the Treasury's Office of Inspector General, OMB, the U.S. Government Accountability Office, and the U.S. Congress and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

December 1, 2011

DEPARTMENT OF THE TREASURY

EXCHANGE STABILIZATION FUND

STATEMENTS OF FINANCIAL POSITION

(In Thousands)

As of September 30	**2011**	**2010**
Assets		
Cash and Cash Equivalents (Note 2)	$ 30,974,114	$ 28,520,996
Securities Purchased Under Agreement to Resell (Note 3)	2,505,269	2,503,143
Investment Securities and Other Foreign Currency Denominated Assets (Note 5)	15,671,256	15,353,238
Special Drawing Right Holdings (Note 4)	55,875,301	57,410,474
Interest Receivable	114,112	113,597
Interest Receivable on Special Drawing Right Holdings	35,607	28,815
Total Assets	$ 105,175,659	$ 103,930,263
Liabilities and Equity		
Liabilities:		
Certificates Issued to Federal Reserve Banks (Note 7)	$ 5,200,000	$ 5,200,000
Special Drawing Right Allocations (Note 4)	55,149,673	54,957,909
Interest Payable on Special Drawing Right Allocations	35,145	27,585
Other	313	182
Total Liabilities	60,385,131	60,185,676
Commitments and Contingencies (Note 9)		
Equity:		
Appropriated Capital	200,000	200,000
Retained Earnings	43,823,544	42,371,994
Accumulated Other Comprehensive Income (Note 6)	766,984	1,172,593
Total Equity	44,790,528	43,744,587
Total Liabilities and Equity	$ 105,175,659	$ 103,930,263

See accompanying notes to financial statements.

DEPARTMENT OF THE TREASURY

EXCHANGE STABILIZATION FUND

STATEMENTS OF INCOME AND COMPREHENSIVE INCOME AND RETAINED EARNINGS

(In Thousands)

For the years-ended September 30	2011	2010
Interest Income		
Interest on Cash and Cash Equivalents	$ 47,459	$ 32,390
Interest on Securities Purchased Under Agreement to Resell	19,175	7,320
Interest on Government Sponsored Enterprise Securities	-	150
Interest on Investment Securities and Other Foreign Currency Denominated Assets	198,123	210,450
Interest on Special Drawing Right Holdings	250,143	147,140
Total Interest Income	514,900	397,450
Interest Expense		
Interest on Special Drawing Right Allocations	(243,958)	(141,003)
Interest on Special Drawing Right - Remuneration due to the U.S. Treasury	(3)	(3)
Total Interest Expense	(243,961)	(141,006)
Net Interest Income	270,939	256,444
Net Gains/(Losses)		
Gain/(Loss) on Foreign Currency Valuation of:		
Special Drawing Rights Holdings	230,832	(1,039,862)
Special Drawing Rights Allocations	(193,105)	994,821
Investment Securities and Other Foreign Currency Denominated Assets, net (Notes 1 and 5)	1,171,738	121,262
Securities Purchased Under Agreement to Resell	(27,973)	(172,821)
Total Net Gains/(Losses)	1,181,492	(96,600)
Other Expenses		
International Monetary Fund Annual Assessment	(881)	(392)
Net Income	1,451,550	159,452
Other Comprehensive Income		
Unrealized Holding (Loss) (Notes 1 and 6)	(405,609)	(261,377)
Comprehensive Income/(Loss)	$ 1,045,941	$ (101,925)
Retained Earnings, Beginning of Year	$ 42,371,994	$ 42,212,542
Net Income	1,451,550	159,452
Retained Earnings, End of Year	$ 43,823,544	$ 42,371,994

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	2011	2010
Cash Flows from Operating Activities:		
Interest Received on:		
Cash and Cash Equivalents	$ 46,599	$ 32,513
Securities Purchased Under Agreement to Resell	19,124	7,318
Investment Securities and Other Foreign Currency Denominated Assets	241,541	236,031
Government Sponsored Enterprises	-	150
Other	(7,759)	(1,706)
Net Cash Provided by Operating Activities	299,505	274,306
Cash Flows from Investing Activities:		
Maturities of Government Sponsored Enterprises Securities	-	1,100,000
Net Purchases/Maturities of Securities Purchased Under Agreement to Resell	(30,099)	(33,398)
Purchases of Investment Securities and Foreign Currency Denominated Assets	(10,155,496)	(9,286,464)
Maturities of Investment Securities and Foreign Currency Denominated Assets	10,298,549	8,664,544
Reimbursement for Remuneration Received	(63,077)	(23,470)
Purchase of Special Drawing Rights	(140,775)	(476,707)
IMF Quota Increase	1,974,719	-
Other	751	391
Net Cash Provided by/(Used) in Investing Activities	1,884,572	(55,104)
Effect of Exchange Rate on Cash	269,041	(182,670)
Net Increase in Cash and Cash Equivalents	2,453,118	36,532
Cash and Cash Equivalents, Beginning of Year	28,520,996	28,484,464
Cash and Cash Equivalents, End of Year	$ 30,974,114	$ 28,520,996
Reconciliation of Net Income to Net Cash Provided by Operating Activities		
Net Income	$ 1,451,550	$ 159,452
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Net Exchange Rate (Gain)/Loss on Repos, FCDAs, and Investment Securities	(1,107,748)	51,559
(Increase) Decrease in Special Drawing Right Holdings Due to Valuation	(229,412)	1,040,255
Net Increase in Special Drawing Rights Holdings	(7,033)	(5,803)
(Increase)/Decrease in Accrued Interest Receivable	(7,307)	11,371
(Decrease)/Increase in Special Drawing Right Allocations Due to Valuation	191,764	(995,196)
Increase in Accrued Interest Payable and Other	7,691	12,668
Total Adjustments	(1,152,045)	114,854
Net Cash Provided by Operating Activities	$ 299,505	$ 274,306

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 Financial Management 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 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
- 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.

Trading securities are bought and held principally for the purpose of selling them in the near term. ESF has no securities classified as trading.

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 gains and losses related to foreign currency valuation are excluded from earnings and are reported as a separate component of accumulated other comprehensive income until realized. 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, and these 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 current 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 Income and Comprehensive Income 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. 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 are quoted prices (unadjusted) in active markets for identical assets or liabilities that the ESF has the ability to access at the measurement date.

- Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

- Level 3 inputs are unobservable inputs for the asset or liability.

All of the ESF's investments, except for the Securities Purchased under Agreement to Resell, are Level 1 measurements since these financial assets are traded in active markets where quotable values are readily available. Securities Purchased under Agreement to Resell are considered Level 2 as they are not traded on active exchanges; however, there are similar securities that can be used to estimate fair value.

I. Other-than-temporary-Impairment

A decline in the market value 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 an 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 and the general market condition in the geographic area or industry the investee operates in. ESF regularly evaluates whether unrealized losses on investment securities indicate other-than-temporary impairment that would require recognition in the financial statements.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

J. Certificates Issued to Federal Reserve Banks

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 Public Debt.

L. Other Comprehensive Income

Accumulated Other Comprehensive Income (Loss) is made up only of changes in the fair value of investments classified as available-for-sale. Unrealized gains and losses, if any, would subsequently be reclassified into income in the same period the underlying investment is either sold 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.

N. Reclassifications

Certain reclassifications have been made to prior year amounts to conform to the current year presentation. On the Statement of Cash Flows, purchases and maturities of investment securities and foreign currency denominated assets have been presented as gross amounts.

NOTE 2 – CASH AND CASH EQUIVALENTS

Cash and cash equivalent amounts held as of September 30, 2011 and 2010 are as follows:

September 30 (In Thousands)	2011	2010
Cash and cash equivalents:		
U. S. government securities	$ 22,721,204	$ 20,436,050
Short-term FCDAs:		
European euro	4,277,368	4,264,817
Japanese yen	3,975,542	3,820,129
Total short-term FCDAs	8,252,910	8,084,946
Total cash and cash equivalents	$ 30,974,114	$ 28,520,996

NOTE 2 – CASH AND CASH EQUIVALENTS (Continued)

On March 17, 2011 the Treasury Secretary authorized an intervention by the FRBNY in the form of a sale of $500 million equivalent of Japanese yen, held by the ESF, against U.S. dollars. On March 17, the G-7 finance ministers and central bank governors issued a statement that “excess volatility and disorderly movements in exchange rates” arising from events in Japan had “adverse implications for economic and financial stability.” On, March 18, 2011, the FRBNY sold the $500 million equivalent of yen. Actual settlement occurred on, March 23, and the ESF invested $500 million in overnight Treasury securities.

NOTE 3 – SECURITIES PURCHASED UNDER AGREEMENT TO RESELL

The FRBNY, on behalf of 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 Euros, 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 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 short-term interest rates of the SDR basket of 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

NOTE 4 – SPECIAL DRAWING RIGHTS (Continued)

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, 2011 and 2010, the value of SDR allocations to the United States was the equivalent of $55.1 billion and $54.9 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.

On May 11, 2011 25 million SDRs were purchased from the Bank of International Settlements. On June 29, 2011 two separate transactions with the Bank of International Settlements took place; 35 and 28.435 million SDRs were purchased respectively.

Pursuant to the Supplemental Appropriations Act, 2009 (P.L. 111-32), the United States consented to an increase in its quota in the International Monetary Fund. Twenty-five percent of the quota was paid by the United States using SDRs (equivalent to SDR 1,243.275 million).

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. ESF is the only agency within Treasury permitted to transact in SDRs. SDRs received become the resources of ESF, as required by law, and 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.

NOTE 4 – SPECIAL DRAWING RIGHTS (Continued)

ESF paid to the TGA $2,700 and $2,900 in fiscal years 2011 and 2010, respectively, in interest due on the transferred dollars. The ESF did not sell SDRs to any participating members during fiscal year 2011 or 2010.

The following schedule reflects the activity related to SDR Holdings during fiscal years 2011 and 2010 in SDR and dollar equivalent.

September 30 (SDR In Thousands)	**2011**	**2010**
Beginning balance	36,891,687	36,573,014
Interest credits on holdings	153,817	87,324
Interest charges on allocations	(149,380)	(83,558)
Remuneration	39,533	15,195
IMF annual assessment	(473)	(288)
IMF Quota Increase	(1,243,275)	-
Purchases	88,435	300,000
Total SDR - Holdings	35,780,344	36,891,687

September 30 (Dollar Equivalent In Thousands)	**2011**	**2010**
Beginning balance	$ 57,410,474	$ 57,945,186
Interest credits on holdings	244,771	134,513
Interest charges on allocations	(237,739)	(128,710)
Remuneration	63,077	23,470
IMF annual assessment	(750)	(437)
IMF Quota Increase	(1,974,719)	-
Purchases	140,775	476,707
Net gain/(loss) on valuation of holdings	229,412	(1,040,255)
Total Dollar Equivalent – Holdings	$ 55,875,301	$ 57,410,474

The table above reflects the actual dollar equivalent amount of SDRs received or transferred by ESF. Amounts within the financial statements computed on accrual basis will thus differ 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, 2011 and 2010 were as follows:

September 30, 2011 (In Thousands)	**Amortized Cost**	**Gross Unrealized Holdings Gains**	**Gross Unrealized Holding (Losses)**	**Fair Value**
Available for sale:				
Other FCDAs	$ 3,028,305	$ -	$(173,342)	$ 2,854,963
German Bonds	2,010,188	37,692	(29,249)	2,018,631
French Bonds	1,310,036	30,006	(17,459)	1,322,583
French Notes	1,372,644	36,998	(18,604)	1,391,038
Japanese Bonds	7,183,099	905,856	(4,914)	8,084,041
Total	$ 14,904,272	$ 1,010,552	$ (243,568)	$ 15,671,256

September 30, 2010 (In Thousands)	**Amortized Cost**	**Gross Unrealized Holdings Gains**	**Gross Unrealized Holding (Losses)**	**Fair Value**
Available for sale:				
Other FCDAs	$ 2,679,777	$ 167,965	$ -	$ 2,847,742
German Bonds	1,870,922	34,242	(23,791)	1,881,373
French Bonds	1,180,688	46,889	(5,607)	1,221,970
French Notes	1,590,177	45,874	(7,527)	1,628,524
Japanese Bonds	6,859,081	914,548	-	7,773,629
Total	$ 14,180,645	$ 1,209,518	$ (36,925)	$ 15,353,238

Other FCDAs represent Euro denominated instruments issued by the Bank of International Settlements, and typically mature within one year.

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

Maturities of debt securities classified as available for sale were as follows at September 30, 2011:

September 30, 2011 (In Thousands)	Amortized Cost	Fair Value
Available-for-sale:		
Due within one year	$ 6,986,733	$ 7,299,093
Due after one year but before five years	7,917,539	8,372,163
Total	$ 14,904,272	$ 15,671,256

Impairment Assessment

The ESF evaluates whether unrealized losses on investment securities indicate other-than-temporary impairment. Based on this evaluation, ESF recognized no other-than-temporary impairment losses on any securities in fiscal years 2011 and 2010.

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, 2011 and 2010:

		Fair Value Measurements at Reporting Date Using		
September 30, 2011 (In Thousands)	Fair Value At 9/30/2011	Quoted Prices In Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available for sale:				
Other FCDAs	$ 2,854,963	$ 2,854,963	$ -	$ -
German Bonds	2,018,631	2,018,631	-	-
French Bonds	1,322,583	1,322,583	-	-
French Notes	1,391,038	1,391,038	-	-
Japanese Bonds	8,084,041	8,084,041	-	-
Total	$15,671,256	$ 15,671,256	-	-

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

		Fair Value Measurements at Reporting Date Using		
September 30, 2010 (In Thousands)	**Fair Value At 9/30/2010**	**Quoted Prices In Active Markets For Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Available for sale:				
Other FCDAs	$ 2,847,742	$ 2,847,742	$ -	$ -
German Bonds	1,881,373	1,881,373	-	-
French Bonds	1,221,970	1,221,970	-	-
French Notes	1,628,524	1,628,524	-	-
Japanese Bonds	7,773,629	7,773,629	-	-
Total	$15,353,238	$ 15,353,238	-	-

NOTE 6 – ACCUMULATED OTHER COMPREHENSIVE INCOME

The accumulated balances for other comprehensive income are as follows:

September 30, 2011 (In Thousands)	**Accumulated Other Comprehensive Income**	
Balance at September 30, 2010		$ 1,172,593
Unrealized holding gains/(losses) arising during the period	$ 239,221	
Less: reclassification of gains recognized as net income	(644,830)	
Other comprehensive loss		(405,609)
Balance at September 30, 2011		$ 766,984

NOTE 6 – ACCUMULATED OTHER COMPREHENSIVE INCOME (Continued)

September 30, 2010 (In Thousands)		**Accumulated Other Comprehensive Income**
Balance at September 30, 2009		$ 1,433,970
Unrealized holding gains/(losses)		
arising during the period	$ 42,555	
Less: reclassification of gains recognized		
as net income	(303,932)	
Other comprehensive loss		(261,377)
Balance at September 30, 2010		$ 1,172,593

NOTE 7 – 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, 2011 and 2010, 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.

NOTE 8 - FAIR VALUES OF FINANCIAL INSTRUMENTS (Continued)

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.

The estimated fair values of the ESF's financial instruments at September 30, 2011 and 2010 are as follows:

	2011		2010	
September 30, (In Thousands)	**Carrying amount**	**Fair value**	**Carrying amount**	**Fair value**
Assets:				
Cash & Cash Equivalents	$30,974,114	$30,974,114	$28,520,996	$28,520,996
Securities Purchased Under Agreement to Resell	2,505,269	2,505,269	2,503,143	2,503,143
Investment Securities and Other Foreign Currency Denominated Assets	15,671,256	15,671,256	15,353,238	15,353,238
SDR Holdings	55,875,301	55,875,301	57,410,474	57,410,474
Liabilities:				
Certificates Issued to Federal Reserve Banks	5,200,000	5,200,000	5,200,000	5,200,000
SDR Allocations	55,149,673	55,149,673	54,957,909	54,957,909

NOTE 9 – COMMITMENTS AND CONTINGENCIES

A. 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. Any balance the ESF may hold under such agreements is held until the foreign entity or government repays the dollar counterpart of that balance. The ESF is exposed to credit risk on foreign currency denominated agreements in the event of default by counterparties to the extent of any amounts that have been recorded in the Statement of Financial Position. Market risk would occur as a result of fluctuations in currency exchange rates. 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 below in Section B, there were no foreign currency denominated agreements as of September 30, 2011 and 2010.

B. 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, 2011 and 2010. On December 13, 2010, the Treasury renewed its participation in the agreement until December 2011.

NOTE 10 – SUBSEQUENT EVENTS

We evaluated and have had no subsequent events through December 1, 2011, the date that these financial statements were available to be issued.