Audit Report

OIG-08-016

Audit of the Exchange Stabilization Fund's Fiscal Years 2007 and 2006 Financial Statements

December 10, 2007

Office of Inspector General

Department of the Treasury

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

OFFICE OF
INSPECTOR GENERAL

December 10, 2007

MEMORANDUM FOR CLAY LOWERY
ASSISTANT SECRETARY FOR INTERNATIONAL AFFAIRS

FROM: Michael Fitzgerald /s/
Director, Financial Audits

SUBJECT: Audit of the Exchange Stabilization Fund's Fiscal Years 2007 and 2006 Financial Statements

I am pleased to transmit the attached audited Exchange Stabilization Fund (ESF) financial statements for fiscal years (FY) 2007 and 2006. Under a contract monitored by the Office of Inspector General, Clifton Gunderson LLP, an independent certified public accounting firm, performed an audit of the financial statements of ESF as of September 30, 2007 and 2006 and for the years then ended. The contract required that the audit be performed in accordance with generally accepted government auditing standards and the *GAO/PCIE Financial Audit Manual*.

The following reports, prepared by Clifton Gunderson LLP, are incorporated in the attachment:

- Independent Auditor's Report;
- Independent Auditor's Report on Internal Control; and
- Independent Auditor's Report on Compliance with Laws and Regulations.

In its audit, Clifton Gunderson LLP found:

- the financial statements present fairly, in all material respects, the financial position as of September 30, 2007 and 2006, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America;
- no matters involving internal control and its operation that are considered material weaknesses; and
- no instances of reportable noncompliance with laws and regulations tested.

In connection with the contract, we reviewed Clifton Gunderson LLP's reports and related documentation and inquired of its representatives. Our review, as differentiated from an audit 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. Clifton Gunderson LLP is responsible for the attached auditor's reports dated November 9, 2007 and the conclusions expressed in the reports. However, our review disclosed no instances where Clifton Gunderson 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 Susan L. Barron, Audit Manager, Financial Audits at (202) 927-5776.

Attachment

DEPARTMENT OF THE TREASURY,
Exchange Stabilization Fund

FINANCIAL STATEMENTS

September 30, 2007 and 2006

TABLE OF CONTENTS

Clifton Gunderson LLP
Certified Public Accountants & Consultants

Independent Auditor's Report

Inspector General
of the Department of the Treasury and the
Assistant Secretary for International Affairs

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, 2007 and 2006, and the related Statements of Income and Retained Earnings, and Statements of Cash Flows for the years then ended. These statements are the responsibility of ESF's management. Our responsibility is to express an opinion on these statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America; and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. 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 ESF as of September 30, 2007 and 2006, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards,* we have also issued our reports dated November 9, 2007, on our consideration of ESF's internal control over financial reporting and on our tests of ESF's compliance with certain provisions of laws and regulations 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 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 considered in assessing the results of our audit.

Our audits were conducted for the purpose of forming an opinion on the accompanying financial statements taken as a whole. The policy and operations statements are presented for purposes of additional analysis and are not a required part of the financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion or any other form of assurance on it. However, we compared the information for consistency with the financial statements and, based on these limited procedures, we found no material inconsistencies.

Clifton Gunderson LLP

Calverton, Maryland
November 9, 2007

Clifton Gunderson LLP
Certified Public Accountants & Consultants

Independent Auditor's Report on Internal Control

Inspector General
of the Department of the Treasury and the
Assistant Secretary for International Affairs

We have audited the financial statements of the U. S. Department of the Treasury's Exchange Stabilization Fund (ESF) as of and for the year ended September 30, 2007, and have issued our report thereon dated November 9, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

In planning and performing our audit, we considered ESF's internal control over financial reporting 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 ESF's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of ESF's internal control over financial reporting.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects ESF's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of ESF's financial statements that is more than inconsequential will not be prevented or detected by ESF's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by ESF's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. 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 management of ESF, the Department of the Treasury Office of Inspector General, the Office of Management and Budget, the Government Accountability Office and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

Clifton Gunderson LLP

Calverton, Maryland
November 9, 2007

Independent Auditor's Report on Compliance with Laws and Regulations

Inspector General
of the Department of the Treasury and the
Assistant Secretary for International Affairs

We have audited the financial statements of the U. S. Department of the Treasury's Exchange Stabilization Fund (ESF) as of and for the year ended September 30, 2007, and have issued our report thereon dated November 9, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

As part of obtaining reasonable assurance about whether ESF's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. 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 that are required to be reported under *Government Auditing Standards*.

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

Clifton Gunderson LLP

Calverton, Maryland
November 9, 2007

EXCHANGE STABILIZATION FUND
POLICY AND OPERATIONS STATEMENTS
FISCAL YEAR 2007

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

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

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

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

I. Foreign Currency Operations

During fiscal year 2007, the ESF engaged in no market transactions.

a. Euros and Japanese Yen

The ESF had a net valuation gain of $1.679 million on its holdings of euros and yen. The ESF had investment income of $501.2 million equivalent on its euro and yen assets.

b. Mexico

In December 2006, the Treasury and Federal Reserve Bank of New York renewed the Exchange Stabilization Agreement with Mexico for another year to December 2007. Renewal for another year to December 2008 was in process at the time this report was being issued.

II. SDR Operations

As of September 30, 2007, U. S. holdings (assets) of SDRs totaled SDR 6.0 billion ($9.3 billion equivalent), a net increase of SDR 0.1 billion during Fiscal Year 2007. However, as the SDR appreciated against the dollar in this period, there was a net valuation gain of $476.6 million on U. S. holdings of SDRs. The ESF reimbursed the Treasury's General Fund $107.2 million for SDRs received from the IMF as remuneration on the U. S. reserve position in the IMF. The ESF earned interest of $370.9 million equivalent on its SDR holdings.

As of September 30, 2007, cumulative allocations to (liabilities of) the United States totaled SDR 4.9 billion ($7.6 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 $2.2 billion of SDR certificates that had been issued to the Federal Reserve System prior to Fiscal Year 2007 and remained outstanding at the end of the fiscal year.

III. Income and Expense

Interest revenue totaled $1,706 million, consisting of $834.2 million in interest on dollar holdings invested in U. S. Government securities, $370.9 million equivalent in interest on SDR holdings, and $501.2 million equivalent in interest on foreign currency investments.

Interest expense totaled $307.1 million, which included $306.6 million in interest charges on SDR Allocations and $0.5 million paid by the ESF to the Treasury General Fund on the dollar counterpart of SDRs received as remuneration on the U. S. reserve positioning the IMF.

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

As of September 30	2007	2006
ASSETS		
CASH AND CASH EQUIVALENTS (note 2)		
U. S. Government securities	$ 16,436,114	$ 15,711,045
Foreign currency denominated assets	7,599,522	6,809,712
Total cash and cash equivalents	24,035,636	22,520,757
OTHER FOREIGN CURRENCY DENOMINATED ASSETS (note 3)	4,445,254	3,830,956
Special drawing right holdings (note 4)	9,300,550	8,654,510
Investment securities, held to maturity (note 5)	9,918,457	9,171,379
Accrued interest receivable	224,353	187,636
TOTAL ASSETS	$ 47,924,250	$ 44,365,238
LIABILITIES AND EQUITY		
LIABILITIES		
Certificates issued to Federal reserve banks (note 6)	$ 2,200,000	$ 2,200,000
Special drawing right allocations (note 4)	7,626,853	7,233,519
Accrued expenses and other	51,454	46,929
Total liabilities	9,878,307	9,480,448
EQUITY		
Appropriated capital	200,000	200,000
Retained earnings	37,845,943	34,684,790
Total equity	38,045,943	34,884,790
TOTAL LIABILITIES AND EQUITY	$ 47,924,250	$ 44,365,238

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

DEPARTMENT OF THE TREASURY
EXCHANGE STABILIZATION FUND
STATEMENTS OF INCOME AND RETAINED EARNINGS
(In Thousands)

Years Ended September 30	2007	2006
INTEREST REVENUE		
Interest on U. S. Government securities	$ 834,219	$ 685,477
Interest on foreign currency denominated assets	329,551	193,328
Interest on special drawing right holdings	370,916	288,607
Interest on investment securities	171,600	135,111
Total interest revenue	1,706,286	1,302,523
INTEREST EXPENSE		
Interest on special drawing right allocations	306,583	243,944
Interest on special drawing right received as remuneration by the U. S. Treasury	518	490
Total interest expense	307,101	244,434
NET INTEREST REVENUE	1,399,185	1,058,089
NET GAINS		
Net gain on valuation of:		
Special drawing rights	83,620	24,477
Foreign currency denominated assets	1,678,690	250,330
Total net gains	1,762,310	274,807
OTHER EXPENSES		
International monetary fund annual assessment	342	344
NET INCOME	3,161,153	1,332,552
RETAINED EARNINGS, BEGINNING OF YEAR	34,684,790	33,352,238
RETAINED EARNINGS, END OF YEAR	$ 37,845,943	$ 34,684,790

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

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

Years Ended September 30	**2007**	**2006**
CASH FLOWS FROM OPERATING ACTIVITIES		
Interest received on:		
U. S. Government securities	$ 832,771	$ 683,282
Foreign currency denominated assets	317,243	180,656
Investment securities	146,156	165,815
Net gain on valuation of foreign currency denominated assets	1,678,690	250,330
Other	9,096	(26,847)
Net cash provided by operating activities	2,983,956	1,253,236
CASH FLOWS FROM INVESTING ACTIVITIES		
Net increase in foreign currency denominated assets	(614,298)	(273,847)
Net increase in investment securities	(747,078)	(61,965)
Purchases of special drawing rights received as remuneration by the U. S. Treasury and related interest	(107,701)	(210,011)
Net cash used in investing activities	(1,469,077)	(545,823)
NET INCREASE IN CASH AND CASH EQUIVALENTS	1,514,879	707,413
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	22,520,757	21,813,344
CASH AND CASH EQUIVALENTS, END OF YEAR	$24,035,636	$22,520,757
RECONCILIATION OF NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Net income	$ 3,161,153	$ 1,332,552
Adjustments to reconcile net income to net cash provided by operating activities:		
Increase in special drawing right holdings due to valuation	(476,567)	(156,122)
Net interest received in special drawing rights	(61,772)	(43,715)
Increase in accrued interest receivable	(36,717)	(26,082)
Increase in special drawing right allocations due to valuation	393,334	131,846
Increase in accrued expenses and other	4,525	14,757
Total adjustments	(177,197)	(79,316)
NET CASH PROVIDED BY OPERATING ACTIVITIES	$ 2,983,956	$ 1,253,236

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

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

A. 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. The Federal Accounting Standards Advisory Board (FASAB) was designated by the American Institute of Certified Public Accountants (AICPA) as the standards-setting body for financial statements of Federal government entities, with respect to the establishment of generally accepted accounting principles. FASAB has indicated, however, that financial statements prepared based upon accounting standards published by the FASB may also be regarded as in accordance with generally accepted accounting principles for those Federal entities, such as the ESF, that have issued financial statements based upon FASB accounting standards in the past. Accordingly, consistent with historical reporting, the ESF financial statements are presented in accordance with accounting standards published by the FASB. In accordance with generally accepted accounting principles, the preparation of financial statements requires the use of management to make estimates and assumptions that affect the reported amounts of assets and 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. Actual results could differ from those estimates.

B. Fair Values of Financial Instruments

Cash and Cash Equivalents, which consist of U. S. Government securities and Foreign Currency Denominated Assets (FCDA), are reported in the Statement of Financial Position at amounts that approximate their fair values. The fair value of Investment Securities is based upon quoted market prices (See Note 5). FCDA, Other FCDAs, Special Drawing Right (SDR) Holdings, and SDR Allocations have been revalued in the Statement of Financial Position, using current exchange rates, to amounts which approximate fair value. The SDR Certificates issued to Federal Reserve Banks (FRB) are reflected on the Statement of Financial Position at their face value.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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

C. Translation of Foreign Currency Denominated Assets and Liabilities

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

D. U. S. Government Securities

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

NOTE 2 - CASH AND CASH EQUIVALENTS

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

The ESF invests a portion of its European Euro holdings through repurchase agreements in securities issued by, and backed by the full faith and credit of the Federal Republic of Germany. As of September 30, 2007 and September 30, 2006 the amounts of repurchase agreements were approximately $2.5 billion and $2.1 billion, respectively. These repurchase agreements are considered to be FCDAs with original maturities of three months or less, which are treated as cash equivalents, as discussed above. Such investments are made by the Federal Reserve Bank of New York (FRBNY), as fiscal agent of the Treasury, in connection with the ESF's

NOTE 2 - CASH AND CASH EQUIVALENTS (CONTINUED)

participation in such repurchase agreements. In this capacity, FRBNY enters into agreements under which German government securities are purchased from, and subsequently resold to, private counterparties. Such transactions are settled through a tri-party agent, Deutsche Bank. The securities are held by Deutsche Bank for FRBNY pending resale and are not transferred back to a private counterparty upon resale until cash has been received.

The FRBNY instructs the tri-party agent on matters related to these investments. The amounts held as of September 30, 2007 and September 30, 2006 are as follows:

September 30 (In Thousands)	2007	2006
Cash and cash equivalents:		
U. S. Government securities	$ 16,436,114	$ 15,711,045
FCDAs:		
European euro	4,871,893	4,187,722
Japanese yen	2,727,629	2,621,990
Total foreign currency denominated assets	7,599,522	6,809,712
Total cash and cash equivalents	$ 24,035,636	$ 22,520,757

NOTE 3 - OTHER FCDAS

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

September 30 (In Thousands)	2007	2006
Other FCDAs:		
European euro	$ 4,445,254	$ 3,830,956
Total other FCDAs	$ 4,445,254	$ 3,830,956

NOTE 4 - SPECIAL DRAWING RIGHTS

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

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

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

b. The SDR Department of the IMF is liquidated.

c. The IMF is liquidated.

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

Except for the payment of interest and charges on SDR allocations to the United States, the payment of the ESF's liability related to the SDR allocations is conditional on events listed above, in which the United States has a substantial or controlling voice. Allocations of SDRs were made on January 1, 1970, 1971, 1972, 1979, 1980 and 1981. Since 1981, the IMF has made no further allocations of SDRs. As of September 30, 2007 and September 30, 2006, the amounts of SDR allocations were the equivalent of $7.6 billion and $7.2 billion, respectively.

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

During Fiscal Years (FY) 2007 and 2006, the ESF purchased, at the prevailing rates, $108 million and $210 million, respectively, equivalent of SDRs received from the IMF by the General Fund of the U. S. Government as remuneration (interest) on the U. S. reserve position in the IMF, and paid the General Fund $0.5 million in fiscal year 2007 and in fiscal year 2006, in interest on dollars due the General Fund in return for SDRs received as remuneration. ESF did not sell or purchase SDRs from participating members during FY 2007 or FY 2006.

NOTE 4 - SPECIAL DRAWING RIGHTS (CONTINUED)

The following charts reflect the actual activity (i.e. amounts paid and received) related to SDRs during fiscal years 2007 and 2006.

As of September 30, 2007 (In Thousands)	SDR	Dollar Equivalent
Special drawing rights (in thousands):		
Beginning balance:	5,862,021	$ 8,654,510
Interest received on holdings	243,177	366,490
Interest paid on allocations	(201,624)	(303,843)
Remunerations and reimbursements	71,385	107,183
IMF annual assessment	(238)	(357)
Net gain on valuation of holdings	-	476,567
Ending balance	5,974,721	$ 9,300,550

As of September 30, 2006 (In Thousands)	SDR	Dollar Equivalent
Special drawing rights (in thousands):		
Beginning balance:	5,688,093	$ 8,244,662
Interest received on holdings	187,834	274,821
Interest paid on allocations	(157,339)	(230,221)
Remunerations and reimbursements	143,707	209,521
IMF annual assessment	(274)	(395)
Net gain on valuation of holdings	-	156,122
Ending balance	5,862,021	$ 8,654,510

NOTE 5 - INVESTMENTS AND RELATED INTEREST

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

NOTE 5 - INVESTMENTS AND RELATED INTEREST (CONTINUED)

The following schedule shows investment securities at their amortized cost and by year of maturity as of September 30, 2007 and September 30, 2006. There are no securities maturing after ten years.

September 30	2007	2006
Securities, held to maturity (in thousands):		
All Securities (at Amortized Cost)		
German bonds	$ 2,129,248	$ 1,765,920
French bonds	1,134,770	1,212,807
French notes	1,125,937	802,045
Japanese Government bonds	5,528,502	5,390,607
Total amortized cost	$ 9,918,457	$ 9,171,379
Maturing Within 1 Year		
Fair Value:		
German bonds	$ 306,155	$ 261,191
French bonds	395,687	347,037
French notes	102,896	48,319
Japanese Government bonds	2,418,534	3,689,566
Total fair value	$ 3,223,272	$ 4,346,113
Amortized cost:		
German bonds	$ 300,135	$ 254,558
French bonds	380,442	332,441
French notes	102,761	47,663
Japanese Government bonds	2,414,804	3,690,093
Total amortized cost	$ 3,198,142	$ 4,324,755

NOTE 5 - INVESTMENTS AND RELATED INTEREST (CONTINUED)

September 30	2007	2006
Gross unrealized holdings gain (loss):		
German bonds	$ 6,020	$ 6,633
French bonds	15,245	14,596
French notes	135	656
Japanese Government bonds	3,730	(527)
Total gross unrealized holdings net gain	$ 25,130	$ 21,358

Maturing after 1 Year through 5 Years (German, French Bonds/Notes, & Japanese Bonds)

	2007	2006
Fair value:		
German bonds	$ 1,862,191	$ 1,550,346
French bonds	772,112	907,916
French notes	1,022,718	757,851
Japanese Government bonds	3,119,780	1,696,932
Total fair value	$ 6,776,801	$ 4,913,045
Amortized cost:		
German bonds	$ 1,829,113	$ 1,511,362
French bonds	754,328	880,366
French notes	1,023,176	754,382
Japanese Government bonds	3,113,698	1,700,514
Total amortized cost	$ 6,720,315	$ 4,846,624
Gross unrealized holdings gain (loss):		
German bonds	$ 33,078	$ 38,984
French bonds	17,784	27,550
French notes	(458)	3,469
Japanese Government bonds	6,082	(3,582)
Total gross unrealized holdings net gain	$ 56,486	$ 66,421

NOTE 6 - CERTIFICATES ISSUED TO FEDERAL RESERVE BANKS

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

As of September 30, 2007 and September 30, 2006 the amounts of SDR certificates outstanding were $2.2 billion, while the value of SDR holdings was $9.3 billion and $8.7 billion, for a difference of $7.1 billion and $6.5 billion, respectively. During fiscal years 2007 and 2006, ESF transacted no monetizations or demonetizations.

NOTE 7 - FOREIGN CURRENCY AGREEMENTS AND GUARANTEES

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

ESF enters into guarantee agreements which represent commitments by Treasury with lenders and/or investors that provide for repayment of all or part of the principal and/or interest on certain debt obligations of a borrower and/or issuer. ESF is exposed to credit risk on guarantees in the event it has to honor a guarantee and is unable to recover from the borrower amounts advanced under the guarantee. ESF did not enter into any guarantee agreements during FYs 2007 and 2006.

NOTE 7 - FOREIGN CURRENCY AGREEMENTS AND GUARANTEES (CONTINUED)

ESF's foreign currency agreements consisted of the following at September 30, 2007 and September 30, 2006:

In April 1994, Treasury signed the North American Framework Agreement, which includes an Exchange Stabilization Agreement (ESA), with Mexico. The ESA provides for a $3 billion standing swap line. The amounts and terms (including the assured source of repayment) of any new borrowings under the North American Framework Agreement would need to be negotiated. There were no drawings outstanding on these agreements as of September 30, 2007 and 2006. In December 2006, the Treasury and FRB extended this agreement to December 2007. Renewal for another year to December 2008 was in process at the time this report was being issued.