



BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
WASHINGTON, D. C. 20551

January 26, 1978

CONFIDENTIAL (FR)  
CLASS II - FOMC

TO: Federal Open Market Committee

FROM: Arthur L. Broida

*ALB*

Enclosed is a copy of the report of examination of the System Open Market Account, made by the Board's Office for Federal Reserve Bank Activities as of the close of business October 28, 1977, and submitted by Mr. Wallace, Staff Director, on January 11, 1978. An audit of the Account is made in connection with examination of the Federal Reserve Bank of New York, in accordance with long-standing procedures.

It is contemplated that the enclosed report will be discussed at the February meeting of the Committee.

Enclosure



BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM

WASHINGTON, D. C. 20551

OFFICE OF THE STAFF DIRECTOR  
FOR FEDERAL RESERVE BANK ACTIVITIES

January 11, 1978

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Mr. Arthur L. Broida  
Secretary  
Federal Open Market Committee  
Board of Governors of the Federal Reserve System  
Washington, D. C. 20551

Dear Mr. Broida:

The following report is submitted for the information of the Federal Open Market Committee in compliance with the Committee's standing request. An examination of the System Open Market Account, including domestic security and foreign currency operations, was made as of the close of business October 28, 1977, in conjunction with the annual financial examination of the Federal Reserve Bank of New York. Accounts relating to transactions in bankers' acceptances and to repurchase agreements were also examined. In addition, operational reviews of the Securities Department were conducted during January and September, 1977.

SCOPE OF EXAMINATION

The financial examination was conducted in accordance with generally accepted auditing standards. The procedures used included: the verification of System Open Market Account holdings and the related asset and liability accounts; tests of departmental accounting records to determine the appropriateness of the balances reported in earnings and profit and loss accounts; reviews of transactions to determine the level of compliance with established procedures and the adequacy of internal control systems; reviews of the scope and frequency of audits made by the resident auditing staff; and other examination procedures as we considered necessary or appropriate.

The operational reviews of the Securities Department were intended to evaluate the adequacy of internal control systems and the effectiveness of processing procedures. The evaluation of operations was based upon observations of processing procedures, interviews with personnel, reviews of procedure manuals, and discussions with management.

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SUMMARY OF FINDINGS

Domestic Open Market Operations

In our opinion, the records of the Securities Department fairly represented the domestic security holdings as of October 28, 1977, (see attached tables) and the results of operations for the interval since the last examination on August 20, 1976.

During the interval between examinations, it was determined that security holdings, earnings, and profits and losses resulting from transactions were allocated among the twelve Federal Reserve Banks according to the procedures approved by the Federal Open Market Committee and that transactions had been executed within the limits prescribed by the Committee.

The operational review of the Securities Operations Division indicated that the internal control systems, operating procedures, and supervision of employees were satisfactory. Management's response to the recommendations included in the staff's report was positive. The review of the Acceptance Division revealed weaknesses in the procedures used for controlling bankers' acceptances and for balancing the face amount of acceptances received, delivered, and held in custody. The recommendations presented to management for improving the internal control systems have been accepted in principle.

Audit attention to operations was reviewed during the examination and, in our opinion, is adequate.

Foreign Currency Operations

In our opinion, the records of the Foreign Department presented fairly the asset and liability accounts related to the foreign currency operation as of October 28, 1977. (See attached tables.)

During the interval between examinations, distribution of interest earnings on foreign currency balances and net losses on foreign exchange operations among the Federal Reserve Banks was made according to procedures approved by the Federal Open Market Committee.

The review of transactions in effect on the date of our examination indicated that the pertinent authorizations issued by the

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Federal Open Market Committee were being followed. In our opinion, the accounting records, the internal controls in effect, and the audit attention are adequate.

Sincerely yours,

A handwritten signature in black ink, appearing to read "William H. Wallace". The signature is written in a cursive style with a large initial "W".

William H. Wallace  
Staff Director

Table I

SYSTEM OPEN MARKET DOMESTIC SECURITY AND FOREIGN CURRENCY HOLDINGS

As of October 28, 1977

A. Domestic Operations

Bankers' Acceptances: 1/

Bought Outright	\$	800,000.00	
Less Unearned Discount		<u>355.30</u>	
Book Value			\$ 799,644.70
Held Under Repurchase Agreements		104,332,827.31	
Less Unearned Discount		<u>56,304.33</u>	
Book Value			104,276,522.98

U. S. Treasury and Government  
Agency Securities:

Bought Outright		103,881,493,131.97	
Less Discount		994,437,765.05	
Plus Premium		184,635,143.55	
Plus Interest Accrued		<u>1,412,057,615.03</u>	
Book Value			104,483,748,125.50
Held Under Repurchase Agreements <u>1/</u>		671,500,000.00	
Less Discount		8,550,627.22	
Plus Premium		520,000.00	
Plus Interest Accrued		<u>118,995.07</u>	
Book Value			<u>663,588,367.85</u>
Total Book Value			\$ 105,252,412,661.03

B. Foreign Currency Operations

	<u>Units of</u>	
	<u>Foreign Currency</u>	
Belgian Francs	7,857,080.00	\$ 205,181.15
Canadian Dollars	121,867.01	115,488.22
British Pounds	62,387.82	159,318.39
French Francs	10,759,127.81	2,148,148.81
German Marks	10,290,770.74	4,435,110.85
Japanese Yen	329,846,028.00	1,047,362.99
Netherland Guilders	22,566,613.52	9,130,884.43
Swiss Francs	955,326.57	410,594.66
		<u>\$ 17,652,089.50</u>
Total Holdings		\$ <u>105,270,064,750.53</u>

1/ Bankers' acceptances and securities held under repurchase agreements are held for the account of the Federal Reserve Bank of New York at the direction of the Federal Open Market Committee and are included here to provide an accounting of all holdings purchased under the authority granted to the New York Bank by the Committee.

Table II

INCOME RESULTING FROM SYSTEM OPEN MARKET  
DOMESTIC SECURITY AND FOREIGN CURRENCY OPERATIONS

January 1 through October 28, 1977

A. Domestic Operations

Bankers' Acceptances	
Discount Earned - Outright Purchase	\$ 3,670,823.82
Discount Earned - Repurchase Agreements	7,019,603.62
U. S. Treasury and Government Agency Securities	
Earnings on Outright Purchases	\$ 5,511,052,381.61 <sup>1/</sup>
Earnings on Repurchase Agreements	51,617,910.04
Earnings on SOMA Securities Loaned	1,986,889.41
Penalty Charges to Dealers - SOMA Security Loans	13,184.18
Net Profit on Securities Sold	34,265,006.17
Total	\$ 5,609,625,798.85

B. Foreign Currency Operations

Interest Earned on Foreign Currency Investments	\$ 4,131,632.33
Loss on Foreign Exchange Transactions	(99,651,246.94)
Total	(\$95,519,614.61)
Total Income	\$ <u>5,514,106,183.24</u>

<sup>1/</sup> Includes \$ 1,506,849.32 interest earned on Certificates of Indebtedness - Special Series