



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

May 11, 1987

CONFIDENTIAL (FR)
CLASS III - FOMC

TO: Federal Open Market Committee
FROM: Rosemary Loney

Attached is a report of examination of the System Open Market Account. The examination was conducted by the Board's Division of Federal Reserve Bank Operations as of the close of business on October 31, 1986, and the report was submitted by Mr. Farnsworth, Director of the Division, on May 11, 1987. An audit of the Account is made in connection with the annual financial examination of the Federal Reserve Bank of New York in accordance with long-standing procedures.

The attached report is on the agenda for consideration at the meeting of the Committee on May 19, 1987.

Attachment



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

CLYDE H. FARNSWORTH, JR.
DIRECTOR
DIVISION OF FEDERAL RESERVE
BANK OPERATIONS

May 11, 1987

RESTRICTED

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

Dear Mr. Kohn:

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 open market and foreign currency operations, was made as of the close of business, October 31, 1986, in conjunction with the annual Financial Examination of the Federal Reserve Bank of New York. Accounts relating to repurchase agreement transactions were also tested.

SCOPE OF EXAMINATION

The financial examination was conducted in accordance with generally accepted auditing standards. The procedures used included 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 selected 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.

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Mr. Donald L. Kohn

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SUMMARY OF FINDINGS

Domestic Open Market Operations

In our opinion, the records of the Securities Department presented fairly the domestic security holdings as of October 31, 1986 (see enclosed tables), and the results of operations for the interval since the last examination as of May 31, 1985.

During the interval between examinations, it was determined that security holdings, earnings, discounts, premiums and profits and losses resulting from open market operations were allocated among the Federal Reserve Banks in accordance with procedures approved by the Federal Open Market Committee and that transactions had been executed within the limits prescribed by the Committee.

The examiners noted, and reported to Bank management, a need to strengthen and better coordinate interdepartmental reconciliations of daily securities activities. In one instance, the Trading Room staff noted an error in January 1986 in the records of collateral held for loaned SOMA securities but a follow-up was not conducted to verify that the necessary corrections had been made in the safekeeping records of the Securities Clearance Division; the error was corrected when detected by the examiners.

Foreign Currency Operations

In our opinion, the records of the Foreign Department presented fairly the asset and liability accounts related to the foreign currency operations as of October 31, 1986 (see enclosed tables).

During the interval between examinations, distribution of interest earnings on foreign currency balances and profits and losses on foreign exchange operations among the Federal Reserve Banks was made according to procedures approved by the Federal Open Market Committee. Foreign currencies were periodically revalued in accordance with generally accepted accounting principles.

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Mr. Donald L. Kohn

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The review of transactions on the date of our examination indicated that the pertinent authorizations issued by the Committee were being followed. In our opinion, the accounting records, the internal controls in effect, and audit attention were adequate.

Sincerely yours,

A handwritten signature in cursive script, appearing to read "Clyde H. Hansen".

Enclosures
Table I
Table II

TABLE I

SYSTEM OPEN MARKET DOMESTIC SECURITY AND FOREIGN CURRENCY HOLDINGS

As of October 31, 1986

A. Domestic Operations

Bankers' Acceptances: <u>1/</u>		\$	-0-
U.S. Treasury and Government Agency Securities:			
Bought Outright	\$197,949,171,000.00		
Less Discount	(2,057,276,163.52)		
Plus Premium	390,232,487.41		
Plus Interest Accrued	3,032,408,315.12		
Book Value		\$199,314,535,639.01	
Held Under Repurchase Agreements <u>2/</u>	\$ -0-		
Less Discount	-0-		
Plus Premium	-0-		
Plus Interest Accrued	-0-		
Book Value			-0-
			<u>\$199,314,535,639.01</u>

B. Foreign Currency Operations

	<u>Units of Foreign Currency</u>	<u>U.S. Dollar Equivalent</u>
Belgian Francs	18,835,286.00	447,181.53
Canadian Dollars	225,182.00	162,153.09
British Pounds	8,929,940.36	12,633,633.12
French Francs	27,231,555.03	4,111,664.66
German Marks	13,255,045,667.90	6,534,407,526.70
Japanese Yen	331,579,682,152.00	2,069,010,870.79
Mexican Pesos	98,972,887,271.88	143,418,181.82
Netherlands Guilders	42,539,038.79	18,555,742.11
Swiss Francs	586,910,638.10	<u>350,603,726.46</u>
Total		\$ 9,133,350,680.28 <u>3/</u>
TOTAL HOLDINGS		\$208,447,886,319.29

1/ The use of Bankers' Acceptances to manage reserves was discontinued as of July 2, 1984; New York serves only as an agent in buying and selling acceptances for accounts of foreign central banks.

2/ 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 Reserve Bank by the Committee.

3/ Revalued U.S. Dollar Equivalent rates of October 29, 1986.

TABLE II

INCOME RESULTING FROM SYSTEM OPEN MARKET

DOMESTIC SECURITY AND FOREIGN CURRENCY OPERATIONS

January 1 through October 31, 1986

A. Domestic Operations

Bankers' Acceptances:

Discount Earned - Outright Purchases	\$	-0-
Discount Earned - Repurchase Agreements		-0-

U.S. Treasury and
Government Agency Securities:

Earnings - Outright Purchases	13,457,275,929.45
Earnings - Repurchase Agreements - New York	63,778,899.92
Earnings on SOMA New York Securities Loaned	5,439,733.03
Net Profit on Securities Sold	<u>57,705,676.47</u>
Total	\$ 13,584,200,238.87

B. Foreign Currency Operations

Interest Earned on Foreign Currency Investments <u>1/</u>	326,733,032.52
Profit or Loss on Foreign Exchange Transactions <u>2/</u>	<u>1,658,688,775.91</u>
Total	\$ 1,985,421,808.43
TOTAL INCOME	\$ 15,569,622,047.30

1/ All interest distributed as of October 31, 1986 (except \$24,514,111.24 collected between October 15 and 31, not included in the above amount, was distributed during November).

2/ Participations only distributed at month end (\$27,573,087.58 net loss was distributed October 31 based on revaluations of foreign currency holdings October 29, 1986).