# Annual Report: Budget Review

*Board of Governors of the Federal Reserve System*

*1998–99*

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*Introduction*

# *Federal Reserve Budget Processes and Operational Areas*

To improve its effectiveness in addressing priorities and allocating resources, the Board of Governors in 1997 converted its annual budgeting and planning process to a two-year budget cycle and a four-year planning cycle. Given their current business needs, the Federal Reserve Banks will continue to maintain an annual budget cycle.

The multiyear process involves the Board members more actively and earlier in the discussion of alternative expenditures and thus allows the Board and the staff to concentrate less on detailed budgeting and more on planning and the allocation of resources among activities. In particular, the Board can now better define and implement its longer-term strategies across functional areas. The longer budget cycle also promises to be less burdensome to the participants and more comprehensible to observers. The first budget produced under the new system covers calendar years 1998 and 1999.

## Background on the Federal Reserve

The Federal Reserve System consists of the seven-member Board of Governors in Washington, D.C., the twelve Federal Reserve Banks with their twenty-five Branches distributed throughout the nation, the Federal Open Market Committee (FOMC), and three advisory groups—the Federal Advisory Council, the Consumer Advisory Council, and the Thrift Institutions Advisory Council. The System was created in 1913 by the Congress to establish a safe and flexible monetary and banking system. Over the years, the Congress has given the Federal Reserve more authority and responsibility for achieving broad national economic and financial objectives.

As the nation's central bank, the Federal Reserve has many, varied responsibilities: It acts to ensure growth of the nation's economy consistent with price stability; it serves as the nation's lender of last resort, with responsibility for forestalling national liquidity crises; and it is involved in bank supervision and regulation, with responsibilities for bank holding companies, state-chartered banks that are members of the Federal Reserve System, the foreign activities of U.S. banks, and the U.S. activities of foreign banks. The Federal Reserve also administers the nation's consumer credit protection laws.

The Federal Reserve System plays a major role in the nation's payments mechanism. The Reserve Banks distribute currency and coin, provide wire and automated clearinghouse transfers of funds and securities, and process domestic checks. In addition, the Federal Reserve Banks serve as the fiscal agents of the United States and provide a variety of financial services for the Treasury and other government agencies.

## Summary of 1997 Income and Expenditures

In carrying out its responsibilities in 1997, the Federal Reserve System incurred an estimated $1.1 billion in net operating expenses. Total spending of an estimated $2.2 billion was offset by an estimated $1.1 billion in revenue from priced services, reimbursements, and other income.

The major source of Federal Reserve income is earnings on the portfolio of U.S. government securities in the System Open Market Account, estimated at $25.7 billion in 1997. Earnings in excess of expenses, dividends, and surplus are transferred to the U.S. Treasury—in 1997 an estimated $20.7 billion. (These earnings are treated as receipts in the U.S. budget accounting system and as anticipated earnings projected by the Office of Management and Budget in the U.S. budget.)

## Budget Processes

The following sections give an overview of the separate budgets and budgeting processes followed by the Board of Governors and the Reserve Banks.

### Board of Governors

The Board's budget covers a two-year period. The first year of the budget cycle—the even-numbered year—is used to develop a strategic plan for the next four years, and the second year is used to develop the budget for the next two years. As the first under the new system, the 1998–99 budget and 1998–2002 plan were prepared and approved entirely in 1997.

The two-year cycle begins in the summer (thus, for the 2000–01 budget, the summer of 1998). At that time, the Board's divisions examine their operating environments and look for any adjustments to their priorities, activities, and resources that might improve the efficiency and effectiveness of the Board's operations. The management of each division discusses with its Board oversight committee the issues that result from its review. After any adjustment, the results are given to the Staff Planning Group, a small group of senior managers with a Boardwide perspective, for use in their analysis of the Board's budget options.

After consulting with the Board-level Budget Committee for final guidance, the Staff Planning Group drafts a strategic plan and, ultimately, a preliminary budget objective that identifies the level and allocation of resources needed to support the plan. The Budget Committee reviews the plan and preliminary budget objective, clarifies outstanding issues with the Staff Planning Group and division directors, and by late summer of odd numbered years develops a final budget objective for consideration by the Board.

The divisions use the budget objective approved by the Board to complete their budgeting under the approved plan. The Board's Budget Committee, under authority delegated by the Chairman, oversees the process until the budget is submitted to the Board for action at an open meeting in November of the odd-numbered year.

The Board of Governors budgets its activities across four operational areas (described below). Costs for data processing are charged as a direct expense to each of the four areas, according to actual usage at rates agreed upon before the budget year starts; expenses for other elements of support and overhead are distributed among the operational areas in proportion to the share of direct costs attributable to each area.

The Board, in accordance with generally accepted accounting principles, capitalizes certain assets and depreciates their value over appropriate periods instead of expensing them in their year of purchase. Hence, the Board has both an operating budget and a capital budget.

The Board's Office of Inspector General (OIG), in keeping with its statutory independence, prepares its proposed budget apart from the Board's budget. The OIG presents its two-year budget directly to the Chairman for action by the Board of Governors, also at an open meeting in November.

After it is approved by the Board, the budget is converted to an operating plan that allocates expenditures by month; the operating plan is also the vehicle for subsequent adjustments within the budget. Also at this point, the cash requirement for the first half of the calendar year is estimated and the amount is raised by an assessment on each of the Reserve Banks in proportion to its capital stock and surplus. The cash requirement for the second half of each year is estimated in June and another assessment is made in July.

### Reserve Banks

Each year the Federal Reserve Banks establish major operating goals for the coming year, devise strategies for their attainment, estimate required resources, and monitor results. The process begins with development of a budget guideline. The Board of Governors reviews the proposed level of spending and communicates the budget objective to the Reserve Banks for their guidance. Each Bank then develops its own budget. The budgets are reviewed at the Board by a committee of three governors—the Committee on Federal Reserve Bank Affairs—both as separate documents and in light of Systemwide issues and the plans of the other Banks, before they are presented to the full Board of Governors for final action at an open meeting in December.

The Banks' budgets are also structured in four operational areas (described below), with support and overhead charged to these areas. Special projects are approved separately from the operations budgets; these projects are long-range research and development efforts that have the potential to make major improvements in the nation's payments mechanism or in the Federal Reserve's ability to provide services (the special project for 1998 is described in appendix A).

The Banks, in accordance with generally accepted accounting principles, also capitalize certain assets and depreciate their value over appropriate periods instead of expensing them in their year of purchase. Hence, the Banks have an operating budget, a special projects budget, and a capital budget.

The operations and financial performance of the Reserve Banks are monitored throughout the year via a cost-accounting system, the Planning and Control System (PACS), which was implemented by the Banks in 1977. Under PACS, the costs of all Reserve Bank services, both priced and nonpriced, are grouped by operational area, and the costs of support and overhead are charged to the four areas. PACS makes it possible to compare budgets with actual expenses and enables the Board of Governors to compare the financial and operating performances of the Reserve Banks.

## Operational Areas

For budgeting purposes, the Board of Governors and the Reserve Banks account for their activities in four major operational areas. Three of the areas—monetary and economic policy, supervision and regulation of financial institutions, and services to financial institutions and the public—are common to the Board and the Banks. The Banks' fourth operational area is services to the U.S. Treasury and other government agencies, and the Board's fourth area is System policy direction and oversight.

## Monetary and Economic Policy

The monetary and economic policy operational area encompasses Federal Reserve actions to influence the availability and cost of money and credit in the nation's economy. These actions include setting reserve requirements, setting the discount rate (which affects the cost of borrowing), and conducting open market operations.

A vast amount of banking and financial data flows through the Reserve Banks to the Board, where it is compiled and made available to the public. The research staffs at the Board and the Reserve Banks use these data, along with information collected by other public and private institutions, to assess the state of the economy and the relationships between the financial markets and economic activity. Staff members provide background information for the Board of Governors and for each meeting of the FOMC by preparing detailed economic and financial analyses and projections for the domestic economy and international markets. They also conduct longer-run economic studies on regional, national, and international issues.

## Supervision and Regulation

The Federal Reserve System plays a major role in the supervision and regulation of banks and bank holding companies. The Board of Governors adopts regulations to carry out statutory directives and establishes System supervisory and regulatory policies; the Reserve Banks conduct on-site examinations and inspections of state member banks and bank holding companies, review applications for mergers, acquisitions, and changes in control from banks and bank holding companies, and take formal supervisory actions. In 1997 the Federal Reserve conducted approximately 550 examinations of state member banks and approximately 1,780 inspections of bank holding companies and acted on a total of 3,641 international and domestic applications.

The Board also enforces compliance by state member banks with the federal laws protecting consumers in their use of credit. In 1997 the System conducted more than 560 compliance examinations.

The Board's supervisory responsibilities also extend to the foreign operations of U.S. banks and, under the International Banking Act, to the U.S. operations of foreign banks. Beyond these activities, the Federal Reserve maintains continuous oversight of the banking industry to ensure the overall safety and soundness of the financial system. This broader responsibility is reflected in the System's presence in financial markets, through open market operations, and in the Federal Reserve's role as lender of last resort.

## Services to Financial Institutions and the Public

The Federal Reserve System plays a central role in the nation's payments mechanism, which is composed of many independent systems that move funds among financial institutions across the country. The Reserve Banks obtain currency and coin from the Bureau of Engraving and Printing and from the Mint and distribute it to the public through depository institutions; they also identify counterfeits and destroy currency that is unfit for circulation. In 1997 the Reserve Banks received $406.7 billion in currency and $4.1 billion in coin from depository institutions, distributed $438.2 billion in currency and $4.8 billion in coin, and destroyed $123.4 billion in unfit currency.

The Reserve Banks (along with their Branches and regional centers) also process checks for collection—approximately 16 billion in checks in 1997 with a total value of more than $12 trillion.

The Federal Reserve also plays a central role in the nation's payments mechanism through its wire transfer system, Fedwire. Through Fedwire, depository institutions can draw on their reserves or clearing accounts at the Reserve Banks and transfer funds anywhere in the country. Approximately 8,400 depository institutions use Fedwire through direct computer connections with Reserve Banks, and another 1,750 institutions use Fedwire through off-line means such as telephone. In 1997, approximately 89.5 million transfers valued at about $288 trillion were sent over Fedwire, an average of $3 million per transfer and $1.1 trillion per day.

The Federal Reserve allows participants in private clearing arrangements to exchange and settle transactions on a net basis through reserve or clearing account balances. Users of net settlement services include local check clearinghouse associations, automated clearinghouse (ACH) networks, credit card processors, automated teller machine networks, and national and regional funds transfer and securities transfer networks.

Approximately 28,100 entities participate in the Federal Reserve's ACH service, which allows them to send or receive payments electronically instead of by check. The institutions use the ACH service for credit and debit transactions. In 1997, the Reserve Banks processed approximately 3.28 billion ACH transactions valued at about $10.7 trillion; approximately 21 percent of the transactions were for the federal government, and the rest were for commercial establishments.

The securities services provided by the Reserve Banks cover the handling of book-entry and definitive securities and the collection of coupons and miscellaneous items. The book-entry service, begun in 1968, enables the holders of Treasury and government agency securities to transfer the securities electronically to other institutions throughout the country. In 1997 the Reserve Banks processed approximately 13.9 million securities transfers valued at $183 trillion. The noncash collection service, through which maturing coupons and bonds are presented for collection, processed about 1.7 million transactions in 1996 and about 1.2 million transactions in 1997.

## Services to the U.S. Treasury and Other Government Agencies

The U.S. government uses the Federal Reserve as its bank. Through deposit accounts at the Reserve Banks, the government issues checks and payments and collects receipts. The Reserve Banks also process wire transfers of funds and automated clearing house payments and give the Treasury daily statements of account activity.

Beyond these typical depository activities, the Reserve Banks, in their role as fiscal agents of the United States, provide several unique services to the government. They process the business tax receipts deposited in more than 10,000 tax and loan accounts that are maintained by depository institutions designated to perform this function; they hold and monitor the collateral that those institutions pledge to support these and other government deposits and investments; and they transfer funds to the Treasury's account at its request. The Reserve Banks assist the Treasury in its financing of the public debt by issuing, servicing, and redeeming all marketable securities as well as U.S. savings and retirement plan bonds. The Reserve Banks also process and destroy redeemed food coupons for the U.S. Department of Agriculture.

## System Policy Direction and Oversight

This operational area encompasses activities by the Board of Governors in supervising Board and Reserve Bank programs. Expenses for these activities are considered overhead expenses of the System and are therefore allocated across the other operational areas. ■

# *Part I*

# *The Budgets*

*Chapter 1*

# *Federal Reserve System*

For 1998, the Federal Reserve System has budgeted net operating expenses of $1,111.6 million, a decrease of 1.9 percent from 1997. Revenue from priced services provided to depository institutions is expected to total $815.9 million, or 36.4 percent of total budgeted operating expenses. Total operating expenses are budgeted at $2,240.2 million, an increase of 2.7 percent over estimated 1997 expenses. Of this total, $2,054.7 million is for the Reserve Banks, and $185.5 million is for the Board of Governors (tables 1.1 and 1.2).[1]

Not included in the budget for operations are expenses for a Reserve Bank special project, which is budgeted at $4.7 million for 1998, down from the $34.7 million estimated for 1997.[2] Also excluded is the cost of currency, budgeted at $370.3 million for 1998, an increase of 0.8 percent over the estimated 1997 cost of $367.5 million.[3] The distribution of expenses is similar to that in previous years, with the Reserve Banks accounting for approximately three-fourths of the total (chart 1.1).

System employment is budgeted at 24,404 for 1998, a decline of 455 from the estimated 1997 level. (Details are given in chapters 2 and 3.)

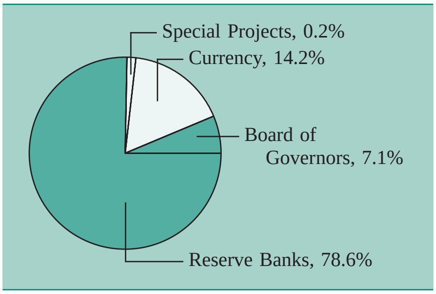
## Net Expenses

The System expects to recover 50.4 percent of its budgeted 1998 operating expenses through revenue from priced services, other income, and claims for reimbursement. Reimbursable claims are projected to increase 34.5 percent from 1997 to 1998 as a result of submitting claims for services provided to the government based on the full cost of the services provided. After these items are deducted from budgeted 1998 operating expenses, the net expenses of the System show a decrease of 1.9 percent from estimated 1997 net operating expenses (table 1.1).

As required by the Monetary Control Act of 1980, revenue from priced services represents fees set to recover, over

*Chart 1.1*

Distribution of Expenses of the Federal Reserve System, 1998




NOTE. See text notes 1, 2, and 3.

1. The Board of Governors now budgets on a two-year cycle (see chapter 2); in this chapter, 1998 values shown for the System and the Board reflect the approximate first-year effect of the Board's 1998–99 budget.

2. As research and development efforts, special projects are separate from the continuing operations of the System and are therefore not included in the System's operations budget. These relatively costly, short-term projects are expected to benefit both the System and the banking industry as a whole. The special project approved for 1998 is described in appendix A.

3. The Federal Reserve bears the cost associated with the printing of new currency at the Bureau of Engraving and Printing. Because this cost is determined largely by public demand for new currency, it is not included in Federal Reserve operating expenses. See appendix A.

the long run, all direct and indirect costs of providing the services plus imputed costs, such as taxes that would have been paid and the return on capital that would have been earned had the services been provided by a private business firm. Projected revenue from priced services is detailed in table 1.3; the constraint imposed on Federal Reserve budgets by the need to keep such services competitive and the calculation of fees are discussed in appendix A.

"Other income" (table 1.1) comes from services provided on behalf of the U.S. Treasury that are paid for by the depository institutions using the ser-

*Table 1.1*

Operating Expenses of the Federal Reserve System Net of Receipts and Claims for Reimbursement, 1996–98

Millions of dollars except as noted

| Item | 1996 actual | 1997 estimate | 1998 budget | Percentage change | |
|---|---|---|---|---|---|
| | | | | 1996 to 1997 | 1997 to 1998 |
| Total System operating expenses | 2,121.6 | 2,181.7 | 2,240.2 | 2.8 | 2.7 |
| LESS | | | | | |
| Revenue from priced services | 815.9 | 815.1 | 815.9 | –.1 | .1 |
| Other income | 5.7 | 5.6 | 5.5 | –1.9 | –1.9 |
| Claims for reimbursement[1] | 215.8 | 228.4 | 307.2 | 5.8 | 34.5 |
| EQUALS | | | | | |
| **Net System operating expenses** | **1,084.2** | **1,132.6** | **1,111.6** | **4.5** | **–1.9** |

Note. In this and subsequent tables in this volume, components may not sum to totals and may not yield percentages shown because of rounding.

Operating expenses reflect all redistributions for support and allocations for overhead, and they exclude capital outlays and special projects.

1. Cost of fiscal agency and depository services provided to the U.S. Treasury and other government agencies that are billed to these agencies.

*Table 1.2*

Expenses of the Federal Reserve System for Operations, Special Projects, and Currency, 1996–98

Millions of dollars except as noted

| Entity and type of expense | 1996 actual | 1997 estimate | 1998 budget | Percentage change | |
|---|---|---|---|---|---|
| | | | | 1996 to 1997 | 1997 to 1998 |
| Reserve Banks[1] | 1,956.1 | 2,011.6 | 2,054.7 | 2.8 | 2.1 |
| Personnel | 1,236.6 | 1,265.3 | 1,286.0 | 2.3 | 1.6 |
| Nonpersonnel | 719.5 | 746.3 | 768.7 | 3.7 | 3.0 |
| Board of Governors[2] | 165.5 | 170.1 | 185.5 | 2.8 | 9.1 |
| Personnel | 124.7 | 127.7 | 129.9 | 2.4 | 1.7 |
| Nonpersonnel | 40.8 | 42.4 | 55.6 | 3.9 | 31.1 |
| **Total System operating expenses** | **2,121.6** | **2,181.7** | **2,240.2** | **2.8** | **2.7** |
| **Personnel** | **1,361.3** | **1,393.0** | **1,415.9** | **2.3** | **1.6** |
| **Nonpersonnel** | **760.3** | **788.7** | **824.3** | **3.7** | **4.5** |
| Special projects[3] | 38.3 | 34.7 | 4.7 | –9.4 | –86.5 |
| Currency[4] | 403.0 | 367.5 | 370.3 | –8.8 | .8 |

NOTE. See general note to table 1.1.

1. For detailed information, see chapter 3.

2. Includes extraordinary items and expenses of the Office of Inspector General. See text note 1 and chapter 2.

3. See text note 2 and appendix A.

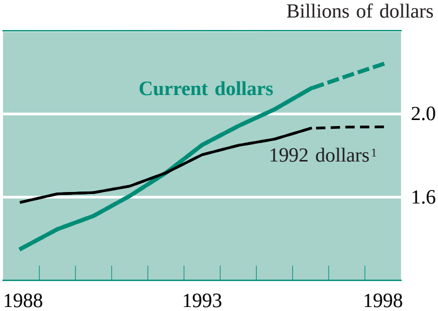
4. See text note 3 and appendix A.

*Table 1.3*
Revenue from Priced Services, 1996–98

Millions of dollars

| Service | 1996 actual | 1997 estimate | 1998 budget |
|---|---|---|---|
| Funds transfers and net settlement | 97.6 | 95.3 | 88.6 |
| Automated clearinghouse | 79.8 | 72.4 | 68.6 |
| Commercial checks | 610.6 | 621.1 | 636.3 |
| Book-entry securities transfers | 17.1 | 16.7 | 16.3 |
| Noncash collection | 5.4 | 4.5 | 3.4 |
| Special cash services | 5.4 | 5.1 | 2.7 |
| **Total** | **815.9** | **815.1** | **815.9** |

*Chart 1.2*
Operating Expenses of the Federal Reserve System, 1988–98




NOTE. For 1997, estimate; for 1998, budget. See also text note 1 and general note to table 1.1.
1. Calculated with the GDP price deflator.

vices; included are fees for such services as the settlement of transfers among depository institutions and the wire transfer of funds between depository institutions and the Treasury.

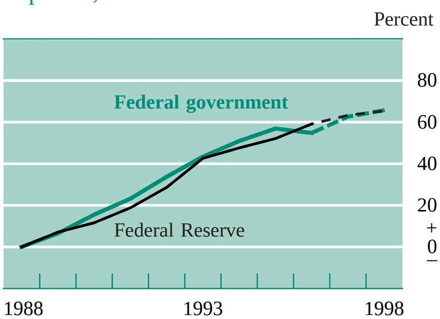
Claims for reimbursement represent the expenses incurred by Reserve Banks in providing fiscal agency services to the Treasury and other government agencies for which claims for reimbursement are made. The marked rise in claims for reimbursement in 1998 is associated with the 1998 implementation of the System initiative "Accounting and Reporting for Government Services." The initiative requires that claims for services provided to the government be based on the full cost of the service.

Sources and uses of funds are presented in appendix B, and the audits of the System are listed in appendix C.

## Trends in Expenses and Employment

From actual 1988 to budgeted 1998 amounts, the operating expenses of the Federal Reserve System (excluding special projects) have increased an average of 5.2 percent per year (2.1 percent per year when adjusted for inflation) (chart 1.2) and total System expenditures (including special projects) have also increased an average of 5.2 percent per year. Over the same period, nondefense discretionary spending by the federal government has increased an average of 5.2 percent (chart 1.3). Federal Reserve System employment, including staff working on special projects and Federal Reserve Automation Services (FRAS), has decreased 417 over the period (chart 1.4).

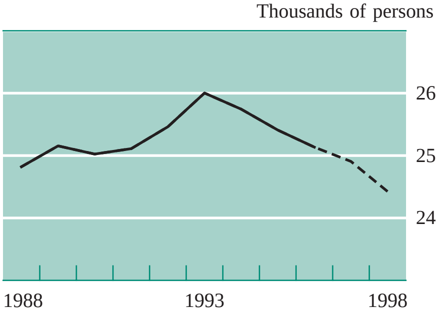
*Chart 1.3*
Cumulative Change in Federal Reserve System Expenses and Federal Government Expenses, 1988–98




NOTE. Federal Reserve System expenses shown here are operating expenses plus the cost of special projects; federal government expenses are discretionary spending less expenditures on defense. See also general note to chart 1.2.

*Chart 1.4*

Employment in the Federal Reserve System, 1988–98




NOTE. Includes Federal Reserve Automation Services staff. See also general note to chart 1.2.

From 1982, when the transition to the requirements of the Monetary Control Act of 1980 was completed, through 1984, System expenses remained essentially flat when adjusted for inflation, and employment declined. In 1985, the staffing level was increased in a pronounced effort to strengthen supervision and regulation of member banks and bank holding companies. The System was able to partially offset the increase in staff through reductions in employment in other areas, mainly services to financial institutions and the public; support; and overhead.

The Expedited Funds Availability Act, which became effective in 1988, requires the Federal Reserve to issue regulations to ensure the prompt availability of funds and the expeditious return of checks. Increases in staff levels throughout the System in 1988 and 1989 resulted from the implementation of this legislation.

Beginning in 1991 and continuing through 1997, spending on bank supervision expanded. This expansion reflected

*Table 1.4*

Operating Expenses of the Federal Reserve System, by Operational Area, 1996–98

Millions of dollars except as noted

| Operational area and entity | 1996 actual | 1997 estimate | 1998 budget | Percentage change | |
|---|---|---|---|---|---|
| | | | | 1996 to 1997 | 1997 to 1998 |
| Monetary and economic policy | 223.8 | 233.5 | 250.3 | 4.3 | 7.2 |
| Reserve Banks | 138.6 | 144.7 | 152.7 | 4.4 | 5.5 |
| Board of Governors | 85.2 | 88.8 | 97.6 | 4.2 | 9.9 |
| Services to the U.S. Treasury and other government agencies[1] | 215.6 | 212.0 | 220.9 | –1.7 | 4.2 |
| Services to financial institutions and the public | 1,181.6 | 1,219.2 | 1,230.7 | 3.2 | .9 |
| Reserve Banks | 1,177.4 | 1,214.9 | 1,226.3 | 3.2 | .9 |
| Board of Governors | 4.2 | 4.3 | 4.4 | 2.4 | 2.3 |
| Supervision and regulation | 500.6 | 517.0 | 538.3 | 3.3 | 4.1 |
| Reserve Banks | 424.5 | 440.0 | 454.8 | 3.7 | 3.4 |
| Board of Governors | 76.1 | 77.0 | 83.5 | 1.2 | 8.4 |
| **Total** | **2,121.6** | **2,181.7** | **2,240.2** | **2.8** | **2.7** |
| **Reserve Banks** | **1,956.1** | **2,011.6** | **2,054.7** | **2.8** | **2.1** |
| **Board of Governors[2]** | **165.5** | **170.1** | **185.5** | **2.8** | **9.1** |

NOTE. Operating expenses reflect all redistributions for support and allocations for overhead, and they exclude capital outlays and special projects. The operational area unique to the Board of Governors, System policy direction and oversight, which is shown separately in chapter 2, has been allocated across the operational areas listed here. As a result, the numbers for the operational areas in chapter 2 are not the same as the numbers shown in this table.

1. Reserve Banks only; the Board of Governors does not provide these services.

2. Includes expenses of the Office of Inspector General and extraordinary items. See also text note 1.

an increase in the number and complexity of examinations; greater attention to problem institutions; and the requirements of FIRREA (the Financial Institutions Reform, Recovery, and Enforcement Act of 1989) and FDICIA (the Federal Deposit Insurance Corporation Improvement Act of 1991). The System was able to partially offset these increases by reducing staff levels in other operational areas, mainly services to the U.S. Treasury and services to financial institutions and the public.

During 1998, the Federal Reserve System will continue to realize staff reductions in the operational areas, and the staffing needs in Supervision and Regulation should begin to moderate.

## Operational Areas

For budgeting purposes, the expenses of the Federal Reserve are classified according to the four major operational areas of the System (table 1.4). The costs of support and overhead (including Board expenditures for System policy direction and oversight, considered an overhead expense of the System) are redistributed or allocated to these four areas.

## 1998 Budget Initiatives

Several major initiatives that have an impact on System budgets will continue or begin in 1998:

- Century date change compliance (see chapter 4)
- Installation of equipment and software to support the image processing of commercial and Treasury checks and the archiving of Treasury checks
- Enhancements to high-speed currency processors
- Facilities repair and maintenance.

Partly offsetting the greater expenditures associated with these initiatives are lower costs associated with staff reductions made possible by several reengineering initiatives and programs to increase efficiency in Federal Reserve operations. In addition, efforts to consolidate System automation, an initiative that began in 1992, will be completed during 1998. ■

*Chapter 2*

# *Board of Governors*

The 1998–99 budget for the Board of Governors provides $352.3 million for operations, $15.4 million for extraordinary items (projects of a unique nature), and $6.4 million for the Office of Inspector General. The Board has authorized 1,711 staff positions for operational areas and 29 positions for the Office of Inspector General; no positions are required for the extraordinary items. The total of 1,740 positions is a decrease of 40 from the number authorized at the end of 1997.

## Overview of the Board's Budget

The Board accounts for extraordinary items separately from the operations budget so that unique, one-time requirements do not compete with regular operations and so that expenses in those operations can be readily compared across years without distortion. The budget of the Office of Inspector General is prepared separately in keeping with the independence of the office.

As noted in the introduction to this volume, the 1998–99 budget is the Board's first to cover two years (calendar years 1998 and 1999). In the course of the following discussion, the 1998–99 budget is compared with the immediately preceding "two-year base," which is the sum of final expenses for 1996 and budgeted expenses for 1997.

Average annual changes in operating expenses are also presented to allow comparisons with earlier (annual) budgets and expenses. The figures in the charts for 1998 and 1999 expenditures are, however, only the estimated annual effects of the two-year, 1998–99 budget.

### Board Operations

The $352.3 million operations budget covers the Board's four operational areas (described in the introduction to this volume) for calendar years 1998 and 1999; it is 6.2 percent ($20.5 million) greater than the 1996–97 base. The average annual change in expenses for the two-year period is 3.0 percent.

The 1998–99 budget reflects major changes to support the plans developed in 1997 as part of a revised planning process. The $20.5 million net increase in the budget relative to the two-year base is a result of $36.3 million in higher costs for salaries, benefits, and some goods and services as well as initiatives, less $15.8 million in program reductions and improved efficiencies. The increases arise from $14.5 million in merit pay increases over the two years; investments in programs and automation worth $11.3 million; $4.9 million in costs resulting from policy decisions in 1996 and 1997; and increases in insurance premiums and other costs paid on behalf of employees, and higher prices for goods and services, which together total $5.6 million. Reductions in programs save $11.4 million, and administrative actions to reduce the cost of benefits save an additional $4.4 million.[1]

The $14.5 million for merit salary raises is the largest component of the budget increase for 1998–99; the raises, which reflect the market for skills

1. The reduction in the cost of benefits is based on legislation that is pending in the Congress. The level of savings will depend on the timing of the passage of a final bill.

required by the Board, average 3.8 percent in 1998 and 3.5 percent in 1999.

Policy changes adopted in 1996 and 1997 account for $4.9 million of increased spending in 1998–99. The new policies consist of a change in the method of funding the Office of Employee Benefits; an expanded cash award program to recognize excellent performance by individual employees; revised System accounting for communication costs under Federal Reserve Automation Services; funding for recruitment and training of a small number of welfare recipients to prepare them for employment at the Federal Reserve; and an increase in the scope and frequency of the external audits of the Reserve Banks.

The $5.6 million associated with benefits and with inflation in prices for goods and services include, for benefits, rate increases for federal health and life insurance and other standard benefits and a higher wage base for the social security tax; and, for goods and services, a 2.7 percent price increase as projected in the federal budget.

### Extraordinary Items

In the past, certain periodic or one-time expenses have produced undue volatility in the Board's budget, creating competition for funds to carry out the Board's basic mission. To address this problem, funding for such "extraordinary items" has, for the past several years, been set apart from the Board's operating budget. For 1998–99, $8.1 million in operating funds and $3.1 million in capital have been budgeted for work on software to ensure its operation after the century date change, and $7.3 million has been budgeted for two major economic surveys. Details on these projects appear at the end of the chapter.

### Office of Inspector General

The 1998–99 budget of $6.4 million for the Office of Inspector General (OIG) represents an average annual increase of 3.3 percent over the OIG's combined 1996 actual and 1997 budgeted expenses of $6.0 million. The budget for the OIG is prepared in a manner that is administratively consistent with the preparation of the Board's operating budget; but in conformance with the statutory independence of the office, the OIG presents its budget directly to the Chairman of the Board of Governors for consideration by the Board.

## Reductions in the Cost of Programs

During the planning process, the Budget Committee asked each division director to look for ways to improve efficiency (generate savings that would not reduce the effectiveness of operations, and eliminate lower-priority work). Ultimately, in conjunction with the Voluntary Retirement Incentive Program, directors identified program reductions worth $11.4 million over the 1998–99 budget period.[2] The reductions were in each of the operational areas and in the administrative areas.

### Monetary Policy

Reductions in the monetary policy function amounted to $0.6 million and twelve positions, six of which were for summer interns. The savings resulted from rearranging tasks to reduce clerical requirements, efforts to improve the

2. The Voluntary Retirement Incentive Program offered employees already eligible to retire a financial incentive to move up their retirement date. Approximately 100 employees accepted the offer.

capture and distribution of data on financial futures and options, and filling positions vacated by the retirement incentive program at lower salary levels.

### Supervision and Regulation

Reductions in the supervision and regulation function were more substantial and reflect improvements in the health of the financial industry.

Reorganization of the Division of Banking Supervision and Regulation reduced expenses by $1.0 million and eliminated twelve positions (ten of them in late 1997). The restructuring realigns and simplifies the division's major line functions and improves coordination and consistency, particularly with respect to large interstate and foreign organizations. The reorganization also improves the use of automation and information technology and changes the management structure to improve the development of supervisory policies and procedures.

The Legal Division was able to eliminate three positions and reduce expenses by $0.4 million because of reductions in workload associated with the health of the industry. Finally, the Regulatory Planning and Review Section in the Office of the Secretary was abolished; absorbing its work in the line divisions eliminated five positions and saved $0.5 million.

### System Policy Direction and Oversight

The budget for the System policy direction and oversight function reflects the elimination of five positions and a savings of $1.1 million. In the Division of Reserve Bank Operations and Payment Systems, the financial examination and automation management areas shifted to the use of outside auditors and consolidated the information systems staff with the information technology staff. These actions reduced authorized staffing by three positions and costs by $0.4 million. The remaining $0.7 million in savings arose from the consolidation of EEO activities, which eliminated two positions, and from the replacement, at lower salary levels, of staff members accepting the retirement incentive.

### Other Savings

Program changes that eliminated activity or revised procedures resulted in division-specific reallocations (discussed below under ''Program Requests'') amounting to $5 million. Additional management actions to adjust program activities reduced administrative costs and yielded gains in efficiency that account for the remainder of the $11.4 million in program savings. Among the management actions were the elimination of fourteen positions and $2.4 million of expense by merging the Office of the Controller with the Division of Human Resources Management and steps taken in the Division of Support Services to streamline procedures, implement new automation, and reduce some services. Miscellaneous efforts in other divisions to gain efficiencies yielded another $0.4 million in savings.

### Current Issues

A number of efficiency issues raised by the Budget Committee are still under review. The more significant of these concern the philosophy of the Board's oversight of the Reserve Banks, the flow of information from the Board to the public, the advisory group structure, data collection initiatives, and the Board's use of automated data sources.

As the reviews are completed, any changes in funding that arise will be incorporated in the budget.

## Program Requests

During the planning process, division directors identified approximately $16.0 million in opportunities for new or expanded programs. The Budget Committee found most of these to be worthwhile but did not fund approximately $4.7 million of the requests. Of the remaining $11.3 million in requested activities, the Board followed the Budget Committee's recommendation in providing new funding in the amount of $6.3 million and encouraging division directors to indirectly fund the remaining $5 million in requested activities through reallocations from lower-priority areas and savings.

### Reallocations

For research on the domestic economy (primarily in the Division of Research and Statistics and the Division of Monetary Affairs), resources were reallocated to enhance the efficacy of policy rules, manage the transition to a new data system for monetary aggregates, study competitive forces in banking markets, improve coordination of changes in the implementation of interest rates, analyze the mutual funds industry, better utilize financial market data, and study explicit inflation targets and loan and deposit rates.

For research on the international economy (primarily the Division of International Finance), resources were transferred to better understand the opportunities and risks of the continuing globalization of the U.S. economy, increase analysis of financial linkages, and upgrade country analyses (including additional attention to Asia).

The Division of Reserve Bank Operations and Payment Systems reallocated funds to expand efforts to ensure the safety and efficiency of the payments system; these efforts include the study of potentially useful regulatory or policy changes and the examination of electronic money issues, multicurrency clearinghouses and settlement services, and new net settlement services for retail payment systems.

Management in the Division of Consumer and Community Affairs redirected some resources to data systems to better handle the high volume of requests for interpretive information arising from revisions to the Community Reinvestment Act. Other responsibilities, such as unifying the regulations implementing the Truth in Lending Act and the Real Estate Settlement Procedures Act will be met by expanding the involvement of Reserve Bank personnel. Should such resources not be available, the division may have difficulty in accomplishing the regulatory unification.

### New Funding

The Board approved the Budget Committee's recommendations for $6.3 million in additional funding for programs.[3] The majority of the funds, $4.1 million, are for Boardwide automation activities that contribute to the standardization of automation tools throughout the System and that advance the ability of the staff to quickly manipulate large quantities of data.

3. Recent amendments to the Freedom of Information Act became effective at various times during 1997, most recently in November. The amendments require agencies to provide electronic access to information without limiting other forms of access. Additional resources may be required to comply with the amendments, but the resource implications were not fully known at the time the budget was completed.

In addition, $1.0 million was provided in the monetary policy function; most of it, $0.7 million, is for data to improve the measurement of prices, output, productivity, and aggregate resource utilization. The remainder was for four positions to further study the process of inflation and assess whether developments in the labor and product markets have altered it.

To assist the Division of Banking Supervision and Regulation in operating effectively with a smaller staff in a rapidly changing environment, $0.3 million was allocated for improved training of division staff, additional domestic and international travel for division business generally, and additional travel to assist in the training of foreign supervisors. Investments in facilities and equipment of $0.8 million are intended to maintain the quality of work life and improve productivity in various Board operations; productivity improvements include advances in electronic printing and the preparation of electronic manuals available to System staff and financial institutions. Minor investments account for the $0.1 million remainder of the $6.3 million total.

### Requests Not Recommended

The remainder of the $16.0 million in requested increases, approximately $4.7 million, were recommended neither for funding nor for reallocations. Among these were program requests that the Budget Committee found to be of interest; most of them were offered for longer-term consideration rather than immediate implementation.

Automation and facilities projects were also among the requests that were not recommended. The Boardwide plan to increase bandwidth to employees' desktop computers by installing fiber optic cable has been delayed in part because of potential infrastructure improvements in the Board building. Requests for upgrades and replacements for furniture and equipment, including a plan to replace in all offices the furniture that accommodates computers and their peripheral devices, were deferred.

## The Operations Budget

Presented here are the Board's operating expenses and authorized positions for 1998–99 in comparison to those for the 1996–97 base. Expenses and authorized positions by organizational unit appear in tables 2.1 and 2.2. Discussed below are expenses by object (table 2.3) and operational area (table 2.4) and the number of authorized positions by operational area (table 2.5).

### By Object of Expense

The largest dollar increase in the 1998–99 budget by object of expense is in personnel costs (table 2.3). The total cost of personnel (which consists of salaries, retirement, and insurance) increased $11.5 million, or 4.6 percent, over the 1996–97 base; projected salary increases more than offset declines from lower staffing and from administrative actions to reduce health insurance costs.

For goods and services, the increase of $9.0 million, or 5.2 percent, came from higher telecommunications costs associated with an accounting change, software investments to improve standardization and ensure year 2000 compliance, and investments in training. Higher costs for contractual professional services were offset by added income from reimbursement for those services.

### By Operational Area

The Board's budget supports four major functions: monetary and economic policy, supervision and regulation, services to financial institutions and the public, and System policy direction and oversight. Expense data for the four operational areas include overhead and support costs. Factors affecting all operational areas—including the largest one, merit pay and benefits—have already been discussed. Detailed below are the major factors affecting cost changes that are unique to each function (tables 2.4 and 2.5).

### *Monetary and Economic Policy*

The 1998–99 budget for the monetary and economic policy function is $152.0 million, an increase of $11.7 million, or 8.3 percent (4.1 percent annually), from the 1996–97 base. Activities in this area relate to the Board's role in the management of the nation's monetary policy; they include monitoring and analysis of developments in the money and credit markets, setting of reserve requirements, and approval of changes in the discount rate.

The increase in this function is primarily the result of investments in automation, taking on some responsibilities for the Regulatory Planning and Review activities formerly housed in the supervision and regulation function, and a small addition to staff to study causes

*Table 2.1*

Operating Expenses of the Board of Governors, by Division, Office, or Special Account, 1996–97 to 1998–99

Thousands of dollars except as noted

| Division, office, or special account | 1996–97 base[1] | 1998–99 budget | Change | |
|---|---|---|---|---|
| | | | Amount | Percent |
| Board Members | 8,977 | 8,873 | –104 | –1.2 |
| Secretary | 8,661 | 8,443 | –218 | –2.5 |
| Research and Statistics | 53,446 | 57,052 | 3,606 | 6.7 |
| International Finance | 20,091 | 20,788 | 697 | 3.5 |
| Monetary Affairs | 17,837 | 18,530 | 694 | 3.9 |
| Banking Supervision and Regulation | 52,171 | 55,143 | 2,972 | 5.7 |
| Consumer and Community Affairs | 13,843 | 14,995 | 1,152 | 8.3 |
| Legal | 16,812 | 17,101 | 290 | 1.7 |
| Reserve Bank Operations and Payment Systems | 27,659 | 29,973 | 2,313 | 8.4 |
| Staff Director for Management | 4,439 | 2,252 | –2,187 | –49.3 |
| Controller | 6,588 | 6,925 | 337 | 5.1 |
| Human Resources Management | 10,767 | 9,240 | –1,526 | –14.2 |
| Support Services | 55,733 | 57,945 | 2,212 | 4.0 |
| Information Resources Management (IRM) | 56,862 | 68,842 | 11,981 | 21.1 |
| IRM income account[2] | –31,040 | –39,551 | –8,511 | –27.4 |
| Publications Committee | 1,394 | 2,951 | 1,557 | 111.7 |
| Special projects | 7,540 | 12,751 | 5,211 | 69.1 |
| **Total, Board operations** | **331,779** | **352,255** | **20,476** | **6.2**[3] |
| Extraordinary items | 3,786 | 15,392 | . . . | . . . |
| Office of Inspector General | 6,016 | 6,419 | 403 | 6.7[3] |

NOTE. Operating expenses reflect all redistributions for support and allocations for overhead, and they exclude capital outlays.

The budget was approved as shown above. Effective January 1, 1998, the Office of the Controller, the Division of Human Resources Management, the Equal Employment Opportunity Program in the Office of the Staff Director for Management, and the Procurement Section of the Division of Support Services are to be combined in a new Management Division.

1. The sum of actual expenses in 1996 and budgeted expenses for 1997.

2. Income from various Board divisions for use of central IRM resources.

3. Average annual percentage change from 1997 to 1999 is 3.0 for Board operations and 3.3 for the Office of Inspector General.

. . . Not applicable.

of inflation and better analyze the resulting data. These costs offset savings from more efficient deployment of staff members who are analyzing monetary aggregates and from reductions of temporary resources that had been budgeted for international economic analyses.

### *Supervision and Regulation*

The 1998–99 budget for the supervision and regulation function is $129.9 million, an increase of $5.9 million, or 4.8 percent (2.4 percent annually), from the 1996–97 base. Supervision includes review of the Reserve Banks' examination reports on state member banks and of their inspection reports on bank holding companies, special studies related to international applications, the direction of enforcement actions, and oversight of trust activities. Regulation includes the formulation of regulations, oversight of mergers and foreign banking activities, enforcement of consumer protection regulations, and the regulation of securities credit.

The rate of increase in this operational area is less than that for the Board as a whole. The lower rate reflects the elimination of twelve positions in the Division of Banking Supervision and Regulation (ten in late 1997 and two in 1998) and three in the Legal Division, all of which were permitted by the generally healthy state of the financial industry. The modifications of the

*Table 2.2*
Positions Authorized at the Board of Governors, by Division, Office, or Special Account, 1997 to 1998–99

| Division, office, or special account | Year-end 1997 base[1] | 1998–99 budget | Change |
|---|---|---|---|
| Board Members | 42 | 39 | –3 |
| Secretary | 62 | 54 | –8 |
| Research and Statistics | 275 | 273 | –2 |
| International Finance | 113 | 109 | –4 |
| Monetary Affairs | 66 | 64 | –2 |
| Banking Supervision and Regulation | 225 | 223 | –2 |
| Consumer and Community Affairs | 71 | 71 | 0 |
| Legal | 87 | 84 | –3 |
| Reserve Bank Operations and Payment Systems | 125 | 129 | 4 |
| Staff Director for Management | 7 | 19 | 12 |
| Controller | 35 | 31 | –4 |
| Human Resources Management | 44 | 32 | –12 |
| Concern[2] | 31 | 31 | 0 |
| Support Services | 263 | 247 | –16 |
| Information Resources Management (IRM) | 279 | 279 | 0 |
| Special projects | 1 | 1 | 0 |
| **Subtotal** | **1,726** | **1,686**[3] | **–40** |
| Reimbursable IRM support[4] | 25 | 25 | 0 |
| **Total, Board operations** | **1,751** | **1,711** | **–40** |
| Office of Inspector General | 32 | 29 | –3 |

NOTE. See general note to table 2.1 regarding creation of a Management Division effective January 1, 1998.

1. Projected. Positions for total Board operations at year-end 1996 totaled 1,733.

2. EEO summer intern and youth positions managed by the Division of Human Resources Management.

3. Includes 20 temporary (two-year) positions that will be abolished by year-end 1999.

4. Positions that provide IRM support to the Federal Financial Institutions Examination Council for processing data collected under the Home Mortgage Disclosure Act and the Community Reinvestment Act.

*Table 2.3*

Operating Expenses of the Board of Governors, by Account Classification, 1988–89 to 1998–99

Thousands of dollars except as noted

| Account classification | 1988–89 | 1990–91 | 1992–93 | 1994–95 |
|---|---|---|---|---|
| *Personnel services* | | | | |
| Salaries | 117,432 | 143,130 | 169,265 | 190,210 |
| Retirement | 7,328 | 9,662 | 13,366 | 15,564 |
| Insurance | 8,116 | 11,429 | 14,407 | 16,862 |
| Subtotal | 132,876 | 164,222 | 197,039 | 222,637 |
| *Goods and services* | | | | |
| Travel | 6,489 | 6,864 | 8,453 | 9,399 |
| Postal and other package delivery | 2,226 | 2,347 | 2,327 | 2,483 |
| Telecommunications | 3,114 | 3,364 | 3,665 | 4,168 |
| Printing and binding | 2,200 | 2,238 | 2,237 | 2,866 |
| Publications | –764 | 406 | 2,212 | 2,976 |
| Stationery and supplies | 1,467 | 1,668 | 1,635 | 1,755 |
| Software | 5,017 | 4,529 | 5,615 | 6,453 |
| Furniture and equipment | 1,211 | 1,521 | 2,442 | 2,497 |
| Rentals | 474 | –282 | 3,156 | 7,202 |
| Books and subscriptions | 1,087 | 1,187 | 1,451 | 1,913 |
| Utilities | 3,170 | 3,388 | 3,683 | 4,145 |
| Building repairs and alterations | 1,893 | 1,945 | 3,402 | 3,273 |
| Furniture and equipment repairs and maintenance | 3,906 | 3,734 | 4,072 | 4,198 |
| Contingency Processing Center | 142 | 327 | 465 | 206 |
| Contractual professional services | 6,482 | 5,355 | 9,666 | 13,797 |
| Tuition/registration and membership fees | 1,077 | 1,273 | 1,823 | 2,394 |
| Subsidies and contributions | 1,110 | 1,168 | 1,504 | 1,433 |
| Depreciation | 14,269 | 11,489 | 12,574 | 14,347 |
| Other | –2,228 | –4,635 | –8,309 | –16,175 |
| Subtotal | 52,343 | 47,986 | 62,074 | 69,330 |
| **Total, Board operations** | **185,219** | **212,208** | **259,113** | **291,967** |
| Extraordinary items | 0 | 0 | 0 | 0 |
| Office of Inspector General | 139 | 227 | 780 | 239 |

Regulatory Planning and Review function mentioned above also affected the rate of increase. The budget provides for additional computer hardware and software to help offset the effect of the position reductions; greater spending on information technology is also directed at the workstation project to improve efficiency in supervising foreign banking organizations.

*Services to Financial Institutions and the Public*

The 1998–99 budget for services to financial institutions and the public is $6.8 million, a decrease of $0.1 million, or 1.5 percent, from the 1996–97 base. This function covers the Board's oversight and control with regard to services provided by the Reserve Banks and Branches for check payments; for electronic payments; and for the handling of currency, coin, and food coupons. The 1997 completion of automation projects is the primary cause of the decrease in this operational area.

*System Policy Direction and Oversight*

The 1998–99 budget for System policy direction and oversight is $63.6 million,

*Table 2.3*
Continued

Thousands of dollars except as noted

| Account classification | 1996–97 base[1] | 1998–99 budget | Average annual change (percent) | |
|---|---|---|---|---|
| | | | 1997–99 | 1989–99 |
| *Personnel services* | | | | |
| Salaries | 212,523 | 226,012 | 3.1 | 6.8[2] |
| Retirement | 17,231 | 19,089 | 5.3 | 10.0 |
| Insurance | 18,117 | 14,244 | –11.3 | 5.8 |
| Subtotal | 247,871 | 259,345 | 2.3 | 6.9 |
| *Goods and services* | | | | |
| Travel | 9,813 | 10,236 | 2.1 | 4.7 |
| Postal and other package delivery | 2,257 | 2,455 | 4.3 | 1.0 |
| Telecommunications | 4,369 | 5,334 | 10.5 | 5.5 |
| Printing and binding | 2,772 | 2,573 | –3.6 | 1.6[2] |
| Publications | 2,845 | 2,947 | 1.8 | . . .[2] |
| Stationery and supplies | 1,847 | 2,061 | 5.6 | 3.5[2] |
| Software | 8,132 | 10,471 | 13.5 | 7.6 |
| Furniture and equipment | 7,436 | 8,015 | 3.8 | 20.8[3] |
| Rentals | 8,706 | 8,616 | –.5 | 33.7[3] |
| Books and subscriptions | 2,045 | 2,061 | .4 | 6.6 |
| Utilities | 4,039 | 4,255 | 2.7 | 3.0 |
| Building repairs and alterations | 2,936 | 3,315 | 6.3 | 5.8 |
| Furniture and equipment repairs and maintenance | 3,463 | 3,570 | 1.9 | –.8 |
| Contingency Processing Center | 0 | 0 | . . . | . . . |
| Contractual professional services | 19,098 | 23,430 | 10.8 | 13.7 |
| Tuition/registration and membership fees | 2,629 | 3,225 | 10.8 | 11.6 |
| Subsidies and contributions | 1,376 | 1,418 | 1.5 | 2.5 |
| Depreciation | 17,220 | 20,625 | 9.4 | 3.8 |
| Other | –17,067 | –21,726 | 12.8 | 25.6 |
| Subtotal | 83,908 | 92,910 | 5.2 | 5.9 |
| **Total, Board operations** | **331,779** | **352,255** | **3.0** | **6.6** |
| Extraordinary items | 3,786 | 15,392 | . . . | . . . |
| Office of Inspector General | 6,016 | 6,419 | 3.3 | 46.7 |

1. The sum of actual expenses in 1996 and budgeted expenses for 1997.

2. Accounting for income in performance reports changed during the period. Until 1991, income was netted against expenses in the appropriate cost center and program; since then, income has been captured in the ‘‘all other’’ account. The change has had only a minor effect on the 1988–99 percentage change in the accounts for salaries, printing and binding, and stationary and supplies, but in the accounts for publications and rentals, it has made a measurement of the 1989–99 change meaningless.

3. Beginning in 1998 the threshold expenditure for capitalizing and depreciating a purchase rather than expensing it rose from $1,000 to $5,000. The data for 1996–97 have been adjusted, but accurate adjustments for earlier years are not possible.

. . . Not applicable.

an increase of $3.0 million, or 4.9 percent (2.4 percent annually), from the 1996–97 base. This operational area covers oversight, direction, and supervision of System and Board programs, including the work of Board members in overseeing Reserve Bank operations; budgeting and accounting; financial examinations; audit and operations reviews; and automation and communications.

The rate of increase in this operational area is less than that for the Board as a whole. The rate was held down by a reduction in the program for the internal examination of Reserve Banks in favor of outside audits of the Banks. To ensure their independence, the audits were budgeted as overhead items rather than in this operational area.

## The Capital Budget

The Board's 1998–99 capital budget is $13.0 million, a decrease of $4.1 million, or 24.0 percent, from the 1996–97 base. The budgeted amount provides for improvements in office automation and the automation infrastructure; security; and other facility elements. The capital budget also funds design work for major repairs to the facility infrastructure, but it does not fund the repair work.

*Table 2.4*

Operating Expenses of the Board of Governors, by Operational Area, 1996–97 to 1998–99

Thousands of dollars except as noted

| Operational area | 1996–97 base[1] | 1998–99 budget | Change | |
|---|---|---|---|---|
| | | | Amount | Percent |
| Monetary and economic policy | 140,299 | 151,955 | 11,656 | 8.3 |
| Supervision and regulation | 123,956 | 129,894 | 5,938 | 4.8 |
| Services to financial institutions and the public | 6,892 | 6,787 | –105 | –1.5 |
| System policy direction and oversight | 60,632 | 63,619 | 2,987 | 4.9 |
| **Total, Board operations** | **331,779** | **352,255** | **20,476** | **6.2**[2] |
| Extraordinary items | 3,786 | 15,392 | . . . | . . . |
| Office of Inspector General | 6,016 | 6,419 | 403 | 6.7[2] |

NOTE. Operating expenses reflect all redistributions for support and allocations for overhead, and they exclude capital outlays.

1. The sum of actual expenses in 1996 and budgeted expenses for 1997.

2. Average annual percentage change from 1997 to 1999 is 3.0 for Board operations and 3.3 for the Office of Inspector General.

. . . Not applicable.

*Table 2.5*

Positions Authorized at the Board of Governors for Operational Areas, Support and Overhead, and Office of Inspector General, 1997 to 1998–99

| Activity | Year-end 1997 base[1] | 1998–99 budget | Change |
|---|---|---|---|
| Monetary and economic policy | 434 | 426 | –8 |
| Supervision and regulation | 379 | 374 | –5 |
| Services to financial institutions and the public | 22 | 22 | 0 |
| System policy direction and oversight | 160 | 173 | 13 |
| Support and overhead[2] | 731 | 691 | –40 |
| **Subtotal** | **1,726** | **1,686** | **–40** |
| Reimbursable IRM support[3] | 25 | 25 | 0 |
| **Total, Board operations** | **1,751** | **1,711** | **–40** |
| Office of Inspector General | 32 | 29 | –3 |

1. Projected. Positions for total Board operations at year-end 1996 totaled 1,733.

2. Includes 10 youth positions, 11 summer intern positions, 10 worker-trainee positions, and 20 temporary (two-year) positions that will be abolished by year-end 1999.

3. Positions that provide IRM support to the Federal Financial Institutions Examination Council for processing data collected under the Home Mortgage Disclosure Act and the Community Reinvestment Act.

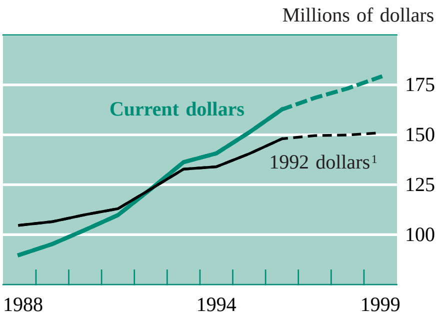
## Trends in Expenses and Employment

The 1998–99 budget increased 3.0 percent on an annual basis. In comparison, 1997 budgeted expenses were 2.5 percent higher than 1996 actual expenses. The increase from 2.5 percent to 3.0 percent is largely the result of salary increases, which rose from 3.0 percent for 1997 to 3.8 percent for 1998. The 3.0 percent average annual increase in operations expenses between 1996–97 and 1998–99 is, however, less than half the 6.6 percent average annual rise over the ten years from 1988–89 to 1998–99 (table 2.3). The decline is largely attributable to moderating growth in the supervision and regulation function and to aggressive steps to streamline operations and reduce costs. Charts 2.1 through 2.5 show trends over 1988–99.

Approximately 73.6 percent of Board operating expenses is for personnel (salaries, retirement, and insurance benefits); consequently, any discussion of trends involves trends in staffing. Over the ten years between 1989 and 1999, the number of authorized positions at the Board has increased by 152 (a total of 9.7 percent), from 1,559 to 1,711. Most of the increase—107 positions—was in the supervision and regulation

*Chart 2.1*

Operating Expenses of the Board of Governors, 1988–99



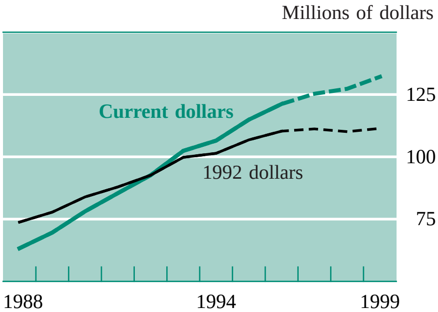

| Year | Millions of dollars | |
|---|---|---|
| | Current dollars | 1992 dollars[1] |
| 1988 ........... | 89.9 | 104.7 |
| 1989 ........... | 95.3 | 106.5 |
| 1990 ........... | 102.4 | 110.0 |
| 1991 ........... | 109.8 | 113.0 |
| 1992 ........... | 122.8 | 122.8 |
| 1993 ........... | 136.3 | 132.8 |
| 1994 ........... | 140.7 | 134.0 |
| 1995 ........... | 151.2 | 140.5 |
| 1996 ........... | 162.7 | 148.0 |
| 1997 ........... | 168.5 | 149.6 |
| 1998 ........... | 173.2 | 149.9 |
| 1999 ........... | 179.0 | 151.0 |

NOTE. Excludes the Office of Inspector General and extraordinary items. For 1997, estimate; for 1998 and 1999, the values are the approximate calendar-year effects of the two-year budget.

1. Calculated with the GDP price deflator.

*Chart 2.2*

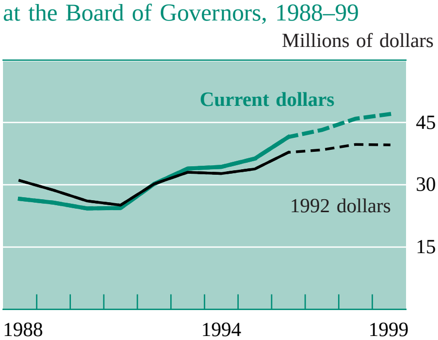
Expenses for Personnel Services at the Board of Governors, 1988–99




NOTE. See notes to chart 2.1.

*Chart 2.3*

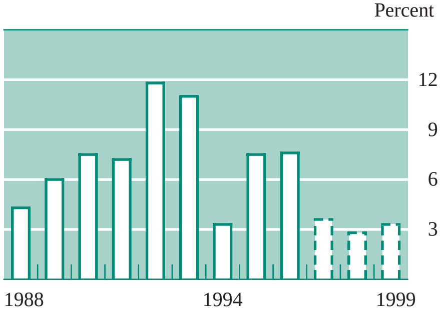
Expenses for Goods and Services at the Board of Governors, 1988–99




NOTE. See notes to chart 2.1.

*Chart 2.4*

Annual Change in Operating Expenses of the Board of Governors, 1988–99



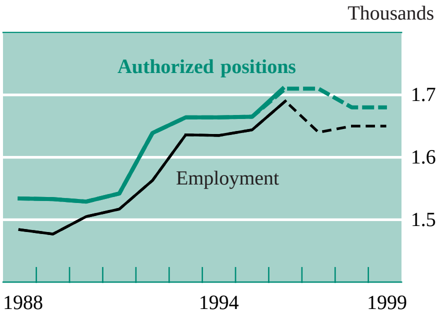

NOTE. Year-end data. See also general note to chart 2.1.

While the number of positions at the Board have fluctuated during the ten-year period, the salary budget (not including retirement and insurance benefits) has remained relatively stable at roughly 65 percent of operating expenses. The portion of operating expenses devoted to retirement and insurance has increased as a result of increases in health insurance costs, a change in the law to apply Medicare costs to federal employees, and increases in the Board contribution rate for the employee thrift plan. The increases were function. The decrease of 40 positions between 1997 and the 1998–99 budget is the result of automation investments, adjustments to programs and services, streamlining and mergers affecting administrative functions, and careful reviews by division directors of the resources needed to support each function.

Early in the 1989–99 period, the number of positions at the Board hit a low—1,529 in 1990. From 1990 to 1995 the number of authorized positions rose to meet an increasing workload driven in large part by expanded statutory responsibilities and requirements. Passage of legislation emphasizing safety and soundness, regulation, and consumer issues significantly increased staffing requirements in these areas. The increase in positions over the past several years has been moderate. The advent of the century date change problem caused a temporary increase of 20 positions, which began in 1997 and will be reversed once Board systems are compliant. The increase associated with the century date change was followed by a program that will eliminate 40 positions during the 1998–99 budget period and more positions in the future.

*Chart 2.5*

Employment and Authorized Positions at the Board of Governors, 1988–99




| Year | Employment | Authorized positions |
|---|---|---|
| 1988 ........... | 1,484 | 1,534 |
| 1989 ........... | 1,477 | 1,533 |
| 1990 ........... | 1,505 | 1,529 |
| 1991 ........... | 1,517 | 1,542 |
| 1992 ........... | 1,563 | 1,639 |
| 1993 ........... | 1,636 | 1,664 |
| 1994 ........... | 1,635 | 1,664 |
| 1995 ........... | 1,644 | 1,665 |
| 1996 ........... | 1,686 | 1,712 |
| 1997 ........... | 1,638 | 1,713 |
| 1998 ........... | 1,650 | 1,680 |
| 1999 ........... | 1,650 | 1,680 |

NOTE. Year-end data. For 1997, estimate; for 1998–99, budget. Data exclude summer intern, worker-trainee, and youth positions as well as positions for the Office of Inspector General. For 1998–99 these positions number 31 and 29 respectively; figures for 1993–99 include positions that provide support to the Federal Financial Institutions Examination Council for processing data collected under the Home Mortgage Disclosure Act and the Community Reinvestment Act.

partially offset by factors eliminating the Board contribution to the retirement plan and the transfer of most employees in the Civil Service Retirement Plan to the Board Retirement Plan.

## Extraordinary Items

The 1998–99 budget for extraordinary items, summarized at the outset of the chapter, includes $8.1 million in operating funds and $3.1 million in capital to bring the Board's software into compliance with the century date change. The Federal Reserve accelerated work on it's century date change project in 1997, and the new goal is to complete all critical systems by year-end 1998. The largest cost is for labor, and some of these costs will be absorbed through reallocations from lower-priority work. Associated hardware costs are for test environments that will parallel the production environments. The Board is sharing mainframe resources with Federal Reserve Automation Services where possible.

The budget for extraordinary items also provides $4.3 million to conduct a Survey of Consumer Finances (SCF) in 1998. The SCF is designed to gather data from households on their income, assets, debts, pensions, employment, use of financial services, and other characteristics. The survey, which is part of a series begun in 1983, provides the only representative microlevel data for the United States on the structure of household finances and household uses of financial services, and the results are often used by the Federal Reserve in responding to requests from the Congress and federal agencies. The surveys are used in long-term research to support the Board's objectives as well as in policy analyses relating to consumer debt, the ''unbanked'' public, the effects of large price movements in the stock market, and projections of household data by income groups.

Last, the extraordinary-items budget provides $3.0 million for the National Survey of Small Business Finances (NSSBF). The survey gathers data from small businesses on their financial relationships, credit experiences, lending terms and conditions, income, balance sheets, location and types of financial institutions used, and other characteristics. Similar surveys were conducted in 1987 and 1993. The new survey will be conducted in 1999 for data as of year-end 1998. The NSSBF provides the only substantial financial services information regarding the scope of geographic and product markets for small businesses. The survey is used in analyzing the competitive effect of bank mergers, benchmarking of other data series (such as the noncorporate sector of the flow of funds accounts), as input to the quinquennial small business report mandated by section 227 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996, and for research and policy analyses of a wide variety of issues in small business finances. ■

*Chapter 3*

# Federal Reserve Banks

The 1998 Reserve Bank operating budgets approved by the Board of Governors total $2,054.7 million, an increase of $43.1 million, or 2.1 percent, over estimated 1997 expenditures (table 3.1). Including the cost of the Automation Consolidation special project ($4.7 million), the Reserve Banks' 1998 budgets total $2,059.4 million, an increase of $13.1 million, or 0.6 percent.[1]

Employment, including the staff associated with FRAS (Federal Reserve Automation Services), is budgeted at 22,754 ANP (average number of personnel), a decrease of 467 ANP, or 2.0 percent, from estimated 1997 employment.[2] Reserve Bank employment is expected to decline by 516 ANP, and FRAS employment will increase by 49 ANP.

Expenses for personnel (salaries and benefits) account for $1,286.0 million or 63 percent of the 1998 operations budget, an increase of $20.7 million, or 1.6 percent, over estimated 1997 personnel expenses (table 3.2). Nonpersonnel expenses (mainly for building and automation projects) are budgeted at $768.7 million, an increase of $22.4 million, or 3.0 percent, over estimated 1997 nonpersonnel expenses.

The following two sections discuss major initiatives and the budget objective for the Reserve Banks in 1998. Subsequent sections provide details for the four operational areas as well as for objects of expense, capital outlays, and long-term trends. Appendix A gives more information on capital outlays, the special project, and other special categories of expense, and appendix D gives additional data by District and operational area.

## Major Initiatives

The 1998 Reserve Banks budgets provide for the following initiatives (table 3.3):

*System-defined*

- Century date change compliance
- Installation of equipment and software to support image processing of commercial and government checks and archiving of the images
- Enhancements to high-speed currency processors

*District-defined*

- Office automation and upgrading of local area networks
- Reengineering programs

Contributing significantly to the 1998 operations budget are expenses associated with efforts to ensure century date change (CDC) compliance for all automated systems. The total cost of the CDC project in 1998 is expected to be $31.9 million and will involve 226 ANP.

1. The budget for the Automation Consolidation special project includes transition expenses associated with the move to a centralized environment and expenses for FRAS (Federal Reserve Automation Services, the unit responsible for consolidated data processing and data communications for the Reserve Banks). FRAS charges to the Automation Consolidation special project in 1998 are budgeted at $2.0 million.

2. The term *average number of personnel* describes levels and changes in employment at the Reserve Banks. ANP is the number of employees in terms of full-time positions for the time period. For instance, a full-time employee who starts work on July 1 counts as 0.5 ANP for that calendar year; two half-time employees who start on January 1 count as 1 ANP.

The majority of these costs ($22.8 million or 71 percent) represents a reallocation of current resources. The remaining incremental expense of $9.1 million is primarily for consulting services and contract programmers. The total CDC initiative includes $6.5 million and 52 ANP at FRAS; these expenses are reflected in the Reserve Bank budgets as FRAS charges for infrastructure.

Expenses for the ongoing check-imaging initiative are budgeted at $26.9 million, an increase of approximately $11.2 million over estimated 1997 expenditures. Approximately 45 percent of the funds are earmarked for a government check-imaging project, requested by the U.S. Treasury, whereby the Federal Reserve provides image-supported check truncation services to the Treasury. The plans also include funding for two additional government imaging services, EZ Clear Savings Bonds and Postal Money Orders.

In keeping with the System's effort to expand electronic delivery of check services, many Reserve Banks plan to expand the commercial check image services they offer to depository institutions and are upgrading sorters and check-processing control software to make them image-capable. The budget increase for 1998 is associated with

*Table 3.1*

Expenses and Employment at the Federal Reserve Banks, 1997–98

| Category | 1997 estimate | 1998 budget | Change | |
|---|---|---|---|---|
| | | | Amount | Percent |
| *Expenses (millions of dollars)* | | | | |
| Operations [1] | 2,011.6 | 2,054.7 | 43.1 | 2.1 |
| Special project | 34.7 | 4.7 | –30.0 | –86.5 |
| **Total** | **2,046.3** | **2,059.4** | **13.1** | **.6** |
| *Employment (average number of personnel)* [2] | | | | |
| Operations [1] | 22,672 | 22,156 | –516 | –2.3 |
| Federal Reserve Automation Services | 549 | 598 | 49 | 8.9 |
| **Total** | **23,221** | **22,754** | **–467** | **–2.0** |

NOTE. See general note to table 1.1, chapter 1. Excludes capital outlays.

1. Includes support and overhead (see appendix D, table D.3, note 1, for definitions).

2. See text note 2 for definition. The costs of the special project do not involve personnel.

*Table 3.2*

Operating Expenses of the Federal Reserve Banks, by Object, 1996–98

Millions of dollars except as noted

| Object | 1996 actual | 1997 estimate | 1998 budget | Percentage change | |
|---|---|---|---|---|---|
| | | | | 1996 to 1997 | 1997 to 1998 |
| Personnel | 1,236.6 | 1,265.3 | 1,286.0 | 2.3 | 1.6 |
| Nonpersonnel | 719.5 | 746.3 | 768.7 | 3.7 | 3.0 |
| **Total** | **1,956.1** | **2,011.6** | **2,054.7** | **2.8** | **2.1** |

NOTE. Includes support and overhead (see appendix D, table D.3, note 1, for definitions). Excludes special project.

additional equipment depreciation and maintenance, software amortization, and related programming and data processing for both commercial and government check processing. This initiative will also add 68 ANP in 1998, mainly in the New York, Philadelphia, Richmond, and Atlanta Districts to support imaging of commercial checks.

The initiative to enhance currency processors that have been installed over the last few year is budgeted at $2.9 million, an increase of $2.2 million over estimated 1997 expenditures. The enhancements to the currency processors will improve operating efficiency, automate processing functions, ensure CDC compliance, allow for currency design changes, and improve management information reporting.

Funding for office automation projects is projected to increase $3.0 million. Five Banks identified plans to improve their local area networks (LANs) by improving the existing infrastructure and addressing backup and contingency. Another Bank has budgeted funds to continue the conversion of the District's paper-based system to electronic images.

Several Reserve Banks are projecting savings, totaling $22.1 million and 280 ANP, associated with reengineering efforts—that is efforts to restructure business processes—and other operational improvements. Although the bulk of the savings are associated with Bankwide programs, three districts have identified specific cost reductions and realized efficiencies in their check operations. Reductions in the Supervision and Regulation examination staff are also contributing to cost savings and staff reductions.

## 1998 Budget Objective

In 1997 the Board approved a 1998 Reserve Bank budget objective that provided for an increase in total expenses, including special projects, of

*Table 3.3*

Contribution of Change in Major Initiatives to the Change in Operating Expenses of the Federal Reserve Banks, 1997 to 1998

Millions of dollars except as noted

| Initiative | 1997 estimate | 1998 budget | Contribution of change to change in total operating expenses, 1997 to 1998 | |
|---|---|---|---|---|
| | | | Amount | Percentage points |
| *System-defined* | | | | |
| Century date change | 14.4 | 31.9 | 17.5 | .9 |
| Check imaging | 15.7 | 26.9 | 11.2 | .6 |
| Currency processors | .7 | 2.9 | 2.2 | .1 |
| *District-defined* | | | | |
| Office automation and network upgrades | 7.1 | 10.1 | 3.0 | .1 |
| Reengineering | . . . | –22.1 | –22.1 | –1.1 |
| **Total** | **37.9** | **49.7** | **11.8** | **.6** |
| MEMO | | | | |
| Other operating expenses | 1,973.7 | 2,005.0 | 31.3 | 1.5 |
| **Total operating expenses** | **2,011.6** | **2,054.7** | **43.1** | **2.1** |

$24.9 million, or 1.2 percent above budgeted 1997 expenditures. Excluding expenses for a special project, which was expected to decrease in 1998, the increase was projected to be 2.8 percent. The Board anticipated that within this guideline expenses for ongoing Reserve Bank operations (including the impact of an overall savings target of $12.6 million) would increase 2.0 percent over budgeted 1997 expenditures. Expenses for three initiatives, century date change compliance, check imaging, and new currency processor enhancements, were expected to account for $16.6 million of the projected 1998 expenses. Table 3.4 shows the 1998 budget objective relative to the 1997 budget and the approved 1998 budget relative to estimated 1997 expenditures.

The 1998 increase for ongoing Reserve Bank operations (when the savings target is included) is $15.0 million less than anticipated in the budget objective. The increase is less than the 2.0 percent target, by 0.9 percentage point, for three main reasons: (1) lower-than-anticipated building expenses for the Cleveland and Minneapolis facilities projects; (2) 1997 expenses higher than budgeted because of unbudgeted costs for CDC compliance; unplanned one-time costs associated with closing the Lewiston office; unanticipated check write-offs; unbudgeted severance payments; and higher-than-planned use of outside agency help, primarily in the check and automation areas; and (3) savings greater than anticipated from various reengineering programs throughout the organization.

*Table 3.4*

Change in Budget Objective and Budget of the Federal Reserve Banks, 1997 to 1998

Percent

| Item | 1998 budget objective[1] | 1998 budget[2] |
|---|---|---|
| Operating expenses | 2.0 | 1.1 |
| System-defined initiatives[3] | .8 | 1.0 |
| Total, excluding special project | 2.8 | 2.1 |
| Special project | –1.6 | –1.5 |
| **Total, including special project** | **1.2** | **.6** |

1. As a change from 1997 budget.
2. As a change from 1997 estimated expenses.
3. Century date change, check imaging, and currency processors.

Spending on Reserve Bank initiatives is expected to be $3.1 million more than the target approved by the Board. The increase is due largely to a $5.5 million increase in costs for the check imaging initiative resulting from additional equipment requirements for this project because better information was available related to customer demands for commercial imaging products and the requirements for two additional services, EZ Clear Savings Bond and Postal Money Order image processing.

Offsetting the expected higher costs for the check imaging initiative are incremental costs for century date change efforts, which are $0.3 million less than projected, and costs associated with currency processor enhancements, which are $1.9 million less.

Both the 1998 budget objective and the 1998 Reserve Bank budget for the Automation Consolidation special project were $4.7 million. This project, which will be ending during 1998, is budgeted at $30.1 million less than in 1997.

## Budget by Operational Area

Tables 3.5 and 3.6 summarize employment and expenses for the Reserve Banks' four operational areas. Tables 3.7 through 3.11 give details for each area.

## Monetary and Economic Policy

The 1998 budget for the monetary and economic policy operational area is $152.7 million, an increase of $8.0 million, or 5.5 percent, over estimated 1997 expenditures. The increase is due to merit pay increases, slightly higher staff levels, century date change initiatives, and higher FRAS and local automation costs. Local automation initiatives include expansion of distributed processing platforms and applications and the expansion of electronic services to the public, including electronic reference services. The staffing level is increasing by 4 ANP, or 0.6 percent, over estimated 1997 employment, mainly because of the full-year impact of filling positions that were vacant during part of 1997.

## Services to the U.S. Treasury and Other Government Agencies

The 1997 budget for services to the Treasury and other government agencies of $220.9 million is $8.9 million,

*Table 3.5*

Employment at the Federal Reserve Banks, by Activity, 1996–98

Average number of personnel except as noted[1]

| Activity | 1996 actual | 1997 estimate | 1998 budget | Percentage change | |
|---|---|---|---|---|---|
| | | | | 1996 to 1997 | 1997 to 1998 |
| *Operational areas* | | | | | |
| Monetary and economic policy | 734 | 720 | 724 | –2.0 | .6 |
| Services to the U.S. Treasury and other government agencies | 1,542 | 1,469 | 1,397 | –4.8 | –4.8 |
| Services to financial institutions and the public | 8,083 | 7,958 | 7,773 | –1.5 | –2.3 |
| Supervision and regulation | 3,111 | 3,022 | 2,953 | –2.9 | –2.3 |
| *Support and overhead*[2] | | | | | |
| Support | 4,538 | 4,640 | 4,535 | 2.2 | –2.3 |
| Overhead | 4,901 | 4,863 | 4,773 | –.8 | –1.9 |
| **Total** | **22,909** | **22,672** | **22,156** | **–1.0** | **–2.3** |

NOTE. Excludes Federal Reserve Automation Services. The costs of the special project do not involve personnel.

1. See text note 2 for definition.
2. See appendix D, table D.3, note 1, for definitions.

*Table 3.6*

Operating Expenses of the Federal Reserve Banks, by Operational Area, 1996–98

Thousands of dollars except as noted

| Operational area | 1996 actual | 1997 estimate | 1998 budget | Percentage change | |
|---|---|---|---|---|---|
| | | | | 1996 to 1997 | 1997 to 1998 |
| Monetary and economic policy | 138,649 | 144,712 | 152,699 | 4.4 | 5.5 |
| Services to the U.S. Treasury and other government agencies | 215,609 | 212,010 | 220,939 | –1.7 | 4.2 |
| Services to financial institutions and the public | 1,177,444 | 1,214,810 | 1,226,243 | 3.2 | .9 |
| Supervision and regulation | 424,402 | 440,025 | 454,791 | 3.7 | 3.4 |
| **Total** | **1,956,104** | **2,011,557** | **2,054,672** | **2.8** | **2.1** |

NOTE. Includes support and overhead (see appendix D, table D.3, note 1, for definitions); excludes special project.

or 4.2 percent, above estimated 1997 expenditures. Increased costs are due mainly to higher FRAS charges for Treasury and agency services, due primarily to the CDC compliance project, and continued efforts to automate and enhance Treasury-related systems. Employment is projected to be 72 ANP, or 4.8 percent, lower than estimated 1997 employment. Staffing levels are being reduced in all services. Over one-third of the reduction is associated with a 26 ANP reduction in the Food Coupon processing area, resulting from expanded Electronic Benefits Transfer programs. Reductions in other areas are the result of reengineering efforts in several districts.

## Services to Financial Institutions and the Public

Expenses for providing services to financial institutions and the public are budgeted at $1,226.2 million, an increase of $11.4 million, or 0.9 percent, over estimated 1997 expenditures. The budget for priced services is declining $6.1 million, or 0.9 percent, over estimated 1997 expenditures, and the budget for nonpriced services is increasing $17.5 million, or 3.5 percent.

The Reserve Banks budgeted $26.9 million in 1998 to provide commercial check, postal money order, and Treasury check imaging services; funding for this project is $11.2 million

*Table 3.7*

Expenses of the Federal Reserve Banks for Monetary and Economic Policy, 1996–98

Thousands of dollars except as noted

| Service | 1996 actual | 1997 estimate | 1998 budget | Percentage change | |
|---|---|---|---|---|---|
| | | | | 1996 to 1997 | 1997 to 1998 |
| Economic policy determination | 109,040 | 114,419 | 120,478 | 4.9 | 5.3 |
| Open market trading | 29,609 | 30,293 | 32,221 | 2.3 | 6.4 |
| **Total** | **138,649** | **144,712** | **152,699** | **4.4** | **5.5** |

NOTE. Excludes special project.

*Table 3.8*

Expenses of the Federal Reserve Banks for Services to the U.S. Treasury and Other Government Agencies, 1996–98

Thousands of dollars except as noted

| Service | 1996 actual | 1997 estimate | 1998 budget | Percentage change | |
|---|---|---|---|---|---|
| | | | | 1996 to 1997 | 1997 to 1998 |
| Centralized operations—savings bonds | 67,888 | 62,395 | 64,625 | –8.1 | 3.6 |
| Other Treasury issues | 22,065 | 14,862 | 16,278 | –32.6 | 9.5 |
| Centralized operations—other Treasury issues | 2,112 | 1,790 | 1,488 | –15.2 | –16.9 |
| Centrally provided Treasury and agency services | 26,474 | 35,048 | 36,268 | 32.4 | 3.5 |
| Government accounts | 37,491 | 34,085 | 36,563 | –9.1 | 7.3 |
| Food coupons | 25,002 | 25,922 | 26,588 | 3.7 | 2.6 |
| Other | 34,577 | 37,908 | 39,129 | 9.6 | 3.2 |
| **Total** | **215,609** | **212,010** | **220,939** | **–1.7** | **4.2** |

NOTE. Excludes special project.

higher than the 1997 estimate. Commercial check processed volume is projected to increase 3.4 percent, with individual district volume projections ranging from a decline of 1.8 percent to an increase of 9.1 percent. The volume for government checks processed is projected to decline 5.1 percent. Funding for BPS 3000 currency software enhancements is projected to be $2.9 million.

Staffing is budgeted to decline 185 ANP, or 2.3 percent, from estimated 1997 employment. Staff reductions are occurring in both priced and nonpriced services, including a decline of 89 ANP for the commercial check service due to extensive reengineering projects in several banks, and the closing of the Lewiston check processing facility. Staffing for ACH, Funds Transfer, and Book-Entry Securities services are

*Table 3.9*

Expenses of the Federal Reserve Banks for Services to Financial Institutions and the Public, 1996–98

Thousands of dollars except as noted

| Service | 1996 actual | 1997 estimate | 1998 budget | Percentage change | |
|---|---|---|---|---|---|
| | | | | 1996 to 1997 | 1997 to 1998 |
| Currency | 243,421 | 249,145 | 257,973 | 2.4 | 3.5 |
| Coin | 29,164 | 28,959 | 29,734 | –.7 | 2.7 |
| Special cash | 5,117 | 4,765 | 2,481 | –6.9 | –47.9 |
| Commercial check | 547,674 | 569,115 | 570,549 | 3.9 | .3 |
| Other check | 37,081 | 42,001 | 47,161 | 13.3 | 12.3 |
| Funds transfer | 62,507 | 68,643 | 64,930 | 9.8 | –5.4 |
| Automated clearinghouse | 79,254 | 68,215 | 69,763 | –13.9 | 2.3 |
| Book-entry securities transfer | 37,215 | 40,324 | 36,084 | 8.4 | –10.5 |
| Other securities and noncash collection | 7,616 | 6,884 | 5,259 | –9.6 | –23.6 |
| Loans to member banks and others | 22,583 | 23,901 | 23,654 | 5.8 | –1.0 |
| Public programs | 72,184 | 76,299 | 80,321 | 5.7 | 5.3 |
| Other | 33,628 | 36,559 | 38,334 | 8.7 | 4.9 |
| **Total** | **1,177,444** | **1,214,810** | **1,226,243** | **3.2** | **.9** |

NOTE. Excludes special project.

*Table 3.10*

Expenses of the Federal Reserve Banks for Services to the U.S. Treasury and Other Government Agencies and to Financial Institutions and the Public, 1996–98

Thousands of dollars except as noted

| Service | 1996 actual | 1997 estimate | 1998 budget | Percentage change | |
|---|---|---|---|---|---|
| | | | | 1996 to 1997 | 1997 to 1998 |
| U.S. government services[1] | 303,395 | 301,413 | 306,309 | –.7 | 1.6 |
| Cash services | 272,584 | 278,104 | 287,707 | 2.0 | 3.5 |
| Priced services | 690,744 | 713,115 | 707,001 | 3.2 | –.9 |
| Other | 126,331 | 134,188 | 146,165 | 6.2 | 8.9 |
| **Total** | **1,393,054** | **1,426,821** | **1,447,182** | **2.4** | **1.4** |

NOTE. Excludes special project.

1. The amounts shown here do not include expenses in this service that are recorded in the monetary and economic policy operational area. For 1996, these expenses were $647 thousand; for 1997, they are estimated at $606 thousand; and for 1998, they are budgeted at $880 thousand. These expenses increase the total costs of services provided by the Reserve Banks as fiscal agents and depositories of the United States.

projected to decline by 29 ANP due to efficiencies gained as a result of the transition to FRAS centralized applications. Consolidation continues in the Noncash service; one office will provide all processing for the Banks. Expenses for the CDC compliance project will be $1.2 million greater than estimated 1997 expenditures.

## Supervision and Regulation

The 1998 budget for the supervision and regulation operational area is $454.8 million, an increase of $14.8 million, or 3.4 percent, over estimated 1997 expenditures. Changes in individual Reserve Bank budgets vary considerably from District to District and range from a decline of 4.4 percent to an increase of 7.7 percent. Additional funding for market-based merit pay programs is partially offset by savings associated with staff reductions.

The supervision and regulation area continues to allocate resources toward enhancing distributed processing platforms and implementing new applications. Automation initiatives include expanding off-site access for examiners, automating resource tracking and scheduling functions, and implementing system software for examiner and consumer compliance applications.

The staffing level is budgeted to decrease by 69 ANP, or 2.3 percent, from the estimated 1997 level; reductions associated with the increased use of risk-based examinations, changes in examination frequency, and efficiencies gained through automation are partially offset by slight staff increases in three districts due to the full-year effect of filling positions that were vacant during part of 1997.

*Table 3.11*

Expenses of the Federal Reserve Banks for Supervision and Regulation, 1998

Thousands of dollars

| Service | 1998 budget |
|---|---|
| Supervision of large multistate, multi-District banking organizations | 64,615 |
| Supervision of domestic regional and community banking organizations | 177,752 |
| Supervision of foreign banking organizations | 48,638 |
| Administration of laws and regulations related to banking | 95,758 |
| Supervision activities benefiting the banking system | 46,003 |
| Studies of banking and financial markets | 22,025 |
| **Total** | **454,791** |

NOTE. Excludes special project. The services in this operational area have been redefined for 1998, and thus the budgets for them cannot be compared with service budgets of previous years.

## Budget by Object of Expense

Personnel expenses—officer and employee salaries, other compensation to personnel, and retirement and other benefits—account for 63 percent of Reserve Bank operating expenses budgeted for 1998. The amount budgeted is 1.6 percent more than estimated 1997 personnel expenses (table 3.12).

Salaries and other personnel expenses, which account for 49 percent of budgeted 1998 operating expenses, are expected to be $12.8 million, or 1.3 percent, greater than estimated 1997 expenses. Salaries for officers and employees are budgeted to increase $24.0 million, or 2.5 percent. Contributing to the increase are merit increases (4.0 percent of salary liability, or $36.6 million), promotions and reclassifications ($8.0 million), and market adjustments ($2.1 million). Partly offsetting these increases are a reduction in overtime ($6.2 million), lower expenses resulting from short-term position vacancies or lag ($5.6 million), and a decline in the staffing level of 516 ANP ($11.2 million). The decrease in other personnel expenses ($11.1 million) is due to a decline in the use of outside agency help and reduced severance and retention payments, partially offset by increased payments for cash awards and incentive-based programs.

Expenditures for retirement and other benefits, which account for 14 percent of budgeted 1998 operating expenses, are expected to increase $7.9 million, or 2.9 percent, over estimated 1997 expenses. Benefits tied to salaries, such as social security payments and thrift plan contributions, are budgeted to increase 2.2 percent, and costs for non-salary-related benefits, such as insurance and health care for active employees and retirees, are budgeted to increase 4.3 percent.

Nonpersonnel expenses, which account for 37 percent of Reserve Bank operating expenses budgeted for 1998, are projected to increase 3.0 percent over estimated 1997 expenditures.

Expenditures on equipment are expected to increase $10.3 million, or 5.9 percent, accounting for 9 percent of budgeted 1998 expenses. Depreciation and maintenance costs are increasing for equipment related to Reserve Bank initiatives, including check-imaging equipment and upgraded local area networks and end-user computing equipment. Expenses are also increasing as a result of depreciation on upgraded check-processing equipment, document-imaging equipment, dedicated systems for check adjustment and cash management, and upgraded telephone and voice response systems. These cost increases are partially offset by the planned release of the data processing mainframe computer in New York as the Bank completes the transition to FRAS.

Shipping expenses, which account for 4 percent of budgeted 1998 operating expenses, are expected to decrease $2.2 million, or 2.8 percent, mainly

*Table 3.12*
Operating Expenses of the Federal Reserve Banks, by Object, 1996–98

Thousands of dollars except as noted

| Object | 1996 actual | 1997 estimate | 1998 budget | Percentage change | |
|---|---|---|---|---|---|
| | | | | 1996 to 1997 | 1997 to 1998 |
| *Personnel* | | | | | |
| Officers' salaries | 100,161 | 104,955 | 109,957 | 4.8 | 4.8 |
| Employees' salaries | 834,913 | 853,070 | 872,021 | 2.2 | 2.2 |
| Other[1] | 34,151 | 38,548 | 27,433 | 12.9 | –28.8 |
| Retirement and other benefits | 267,376 | 268,699 | 276,578 | .5 | 2.9 |
| Total | 1,236,600 | 1,265,272 | 1,285,989 | 2.3 | 1.6 |
| *Nonpersonnel* | | | | | |
| Forms and supplies | 59,557 | 52,960 | 52,774 | –11.1 | –.4 |
| Equipment | 160,123 | 173,308 | 183,615 | 8.2 | 5.9 |
| Software | 32,726 | 37,128 | 36,940 | 13.5 | –.5 |
| Shipping | 77,849 | 80,058 | 77,825 | 2.8 | –2.8 |
| Travel | 44,931 | 45,059 | 42,848 | .3 | –4.9 |
| Buildings | 167,659 | 174,680 | 180,130 | 4.2 | 3.1 |
| Recoveries | –52,319 | –53,231 | –56,619 | 1.7 | 6.4 |
| Other[2] | 228,978 | 236,323 | 251,169 | 3.2 | 6.3 |
| Total | 719,504 | 746,285 | 768,683 | 3.7 | 3.0 |
| **Total** | **1,956,104** | **2,011,557** | **2,054,672** | **2.8** | **2.1** |

NOTE. Excludes special project.

1. Certain contractual arrangements and miscellaneous other personnel expenses.

2. Communications, fees, contra-expenses, shared costs distributed and received, excess capacity, and miscellaneous other expenses.

because of the implementation of the Interdistrict Transportation network design changes in late 1997.

Within the travel budget, expenditures on foreign travel are budgeted at $3.9 million, or 0.2 per cent of total budgeted 1998 operating expenses. Decreased examiner travel associated with the examination of foreign banks is offset by an increase in foreign travel by bank staff supporting research efforts related to newly industrializing countries and emerging markets.

Building expenses, which account for 9 percent of budgeted 1998 operating expenses, are expected to increase $5.5 million, or 3.1 percent. The increase is driven by increased real estate taxes and property depreciation resulting from various building improvements, building renovations, and completion of the Minneapolis' new building and Cleveland's operations center.

Recoveries will increase by $3.4 million. Nearly half of this increase ($1.4 million) is the result of the Reserve Bank's 1998 implementation of the Uniform Cash Access policy.

"Other" nonpersonnel expenses are budgeted to increase $14.8 million from estimated 1997 expenses, accounting for 12 percent of budgeted 1998 operating expenses. The increase is due mainly to the Banks receiving higher production charges from FRAS for infrastructure, data processing, and data communications services. These increases are partially offset by decreased fees to consultants and lower check write-offs.

## Capital Outlays

Capital outlays for 1998 are budgeted at $310.8 million, an increase of $26.1 million, or 9.2 percent, from estimated 1997 expenses (table 3.13). The budget includes FRAS capital outlays of $44.1 million, an increase of $11.1 million, or 33.8 percent, over estimated 1997 expenses. The budgets of six of the twelve Banks are below estimated 1997 outlays.

*Table 3.13*

Capital Outlays of the Federal Reserve Banks, by Class, 1996–98

Thousands of dollars except as noted

| Class | 1996 actual | 1997 estimate | 1998 budget | Percentage change | |
|---|---|---|---|---|---|
| | | | | 1996 to 1997 | 1997 to 1998 |
| Data processing and data communications equipment[1] | 81,580 | 107,573 | 126,583 | 31.9 | 17.7 |
| Buildings | 125,391 | 76,918 | 80,417 | –38.7 | 4.5 |
| Furniture, furnishings, and fixtures | 16,934 | 26,814 | 25,303 | 58.3 | –5.6 |
| Other equipment[2] | 73,449 | 27,433 | 16,196 | –62.7 | –41.0 |
| Land and other real estate | 7,107 | 8,518 | 2,323 | 19.9 | –72.7 |
| Building machinery and equipment | 20,422 | 20,707 | 29,634 | 1.4 | 43.1 |
| Leasehold improvements | 1,542 | 1,368 | 14,695 | –11.3 | 974.2 |
| Software[3] | 8,628 | 15,406 | 15,647 | 78.6 | 1.6 |
| **Total** | **335,053** | **284,737** | **310,798** | **–15.0** | **9.2** |
| MEMO | | | | | |
| FRAS | 19,714 | 33,004 | 44,146 | 67.4 | 33.8 |

1. For Federal Reserve Automation Services (FRAS), includes capital of $16,337 thousand in 1996, $28,725 thousand in 1997, and $39,465 thousand in 1998.

2. For FRAS, includes no outlay in 1996, $30 thousand in 1997, and $20 thousand in 1998.

3. For FRAS, includes $3,377 thousand in 1996, $4,249 thousand in 1997, and $4,661 thousand in 1998.

Outlays for data processing and data communications equipment, budgeted at $126.6 million, account for approximately 41 percent of capital outlays budgeted for 1998. Included in the budget is $38.4 million for the purchase of personal computers and to upgrade local area networks. Other significant outlays include $18.1 million for check imaging systems, check sorters, and related equipment, $10.4 million for central processing units (CPUs), storage devices, printers, and related equipment, and $12.8 million for various projects that include the replacement of systems in the Markets Group and Central Bank Services functions in New York and the purchase of a Counterfeit Catalogue and Retrieval system for the Currency Technology Office.

FRAS has budgeted $39.4 million for data processing and data communications equipment in 1998. Outlays for CPUs account for $14.3 million. The FRAS budget also includes $15.0 million for computer peripheral and desk top equipment and $10.1 million for data communications equipment to improve and expand FEDNET (the Federal Reserve System's communication network) and enhance its security.

Building outlays are budgeted at $80.4 million, an increase of $3.5 million from the 1997 estimate. Cleveland is budgeting $21.8 million for renovation of its head office. Atlanta's building budget is $17.5 million; the funds are primarily for long-term facilities initiatives, which include architectural and engineering fees for the Atlanta and Birmingham projects and funds to begin construction in Birmingham. Building renovation and modernization projects in New York total $18.5 million. San Francisco is budgeting $11.2 million, largely for renovation projects at all offices in the district. A variety of smaller building projects accounts for the remaining building outlays included in the 1998 budget. Leasehold improvements, budgeted at $14.7 million, are primarily associated with New York's plans to improve and occupy newly leased space adjacent to its main building.

Purchases of furniture and other equipment are budgeted at $41.5 million and account for about 13 percent of total capital outlays. The majority of the furniture and equipment included in the 1998 budget is associated with the various remodeling, renovation, and leasehold improvement projects that are occurring in most districts. Year-over-year expenses in this category are declining due to the completion of major construction projects in Minneapolis and Cleveland and the final installation of BPS 3000 currency processors in those two locations.

Land and other real estate expenses are budgeted at $2.3 million, a reduction of $6.2 million from the 1997 estimate. The reduction is primarily due to the completion of the Minneapolis building during 1997 and a delay in the two land improvement projects associated with new buildings in the Atlanta District. The most significant outlay during 1998 is associated with the new building projects in Atlanta and Birmingham.

Building machinery and equipment outlays are budgeted at $29.6 million, or about 10 percent of total capital outlays. Included are items related to the building and renovation projects in New York ($6.4 million), Cleveland ($5.9 million) and Atlanta ($4.7 million) and San Francisco ($2.7 million). Other districts are also budgeting for a variety of smaller items, including replacement of elevators to comply with the Americans with Disabilities Act.

Software purchases in 1998 are budgeted at $15.6 million. FRAS has budgeted $4.7 million for software. The budget of the New York Reserve Bank includes $3.8 million for a new check adjustment system and replacement of the Bank's market data software. Check-image software in Boston accounts for about $2.1 million of the total, and smaller software purchases throughout the Reserve Banks account for the balance.

## Trends in Expenses and Employment

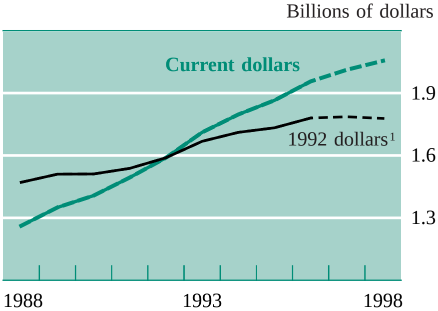
Over the ten years ending with the 1998 budget, Reserve Bank expenses have increased an average of 5.0 percent per year (chart 3.1), and the average number of employees at the Reserve Banks (including FRAS) has decreased by 591, from 23,345 to 22,754 (chart 3.2). Since 1988, staff levels have decreased in the commercial check service (783 ANP), the overhead services (180 ANP), securities safekeeping and noncash services (131 ANP), the ACH and funds transfer services (321 ANP), services to the Treasury and other government agencies (421), and the monetary policy service (42 ANP). These staff reductions have been due largely to consolidation of operations and increased operational efficiencies throughout the System.

Partly offsetting the decreases are staff additions in supervision and regulation (745 ANP) due mainly to implementation of the Federal Deposit Insurance Corporation Improvement Act and the Community Reinvestment Act, in data services due to the consolidation of data processing and data communications at FRAS (401 ANP), and in public programs due to efforts to enhance consumer education and communications with the public (93 ANP).

The average annual growth of operating expenses has slowed in recent years and is projected to be 3.7 percent over the five years ending with the 1998 budget. Affecting growth during this period were expanded bank supervision needs and the transition to a consolidated data processing and data communications environment at FRAS. Mainly because of production charges from FRAS, nonpersonnel costs have been increasing at a faster rate than personnel costs—5.5 percent compared with 2.3 percent—as the Reserve Banks downsize labor-intensive and computer

*Chart 3.1*

Operating Expenses of the Federal Reserve Banks, 1988–98

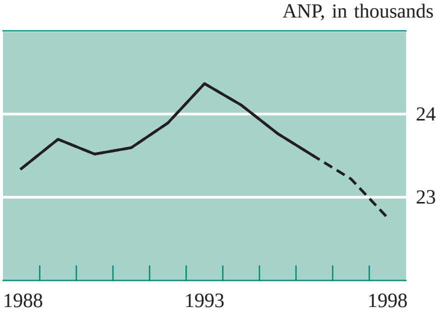



NOTE. Excludes special project. For 1997, estimate; for 1998, budget.

1. Calculated with the GDP price deflator.

*Chart 3.2*

Employment at the Federal Reserve Banks, 1988–98




NOTE. Includes Federal Reserve Automation Services. The costs of the special project do not involve personnel. For 1997, estimate; for 1998, budget. See text note 2 for definition of ANP.

operations and substitute technology for labor.

By operational area, expense increases over the five years have been highest for supervision and regulation (average annual increase of 6.9 percent), followed by monetary and economic policy (5.9 percent, reflecting increases in support and overhead services) and services to the Treasury and other government agencies and services to financial institutions and the public (both 3.7 percent).

Under services to financial institutions and the public, expenses for the currency service have increased an average of 6.5 percent per year, primarily because of the installation of new currency processors, and expenses for public programs have risen an average 7.3 percent per year. Nonetheless, overall growth in this service has slowed in recent years because of downsizing in the commercial check service resulting from declining volume and centralization efforts in the funds transfer and ACH services.

Just over half of the expenses in the Reserve Banks' 1998 budget (about 55 percent) are recoverable through revenues or are reimbursable by the Treasury and other government agencies. Recoverable expenses are increasing slightly from those of earlier years because of an increase in reimbursable claims for services provided to the U.S. Treasury and other agencies associated with the 1998 implementation of the System initiative "Accounting and Reporting for Government Services." The initiative requires that claims for services provided to the government be based on the full cost of the service.

## Volume and Unit Costs

The volume of measured services in 1998 is budgeted to increase 3.2 percent over estimated 1997 volume, and the unit cost is expected to decrease 2.7 percent (table 3.14). Since 1993, volume has grown at an average annual rate of 2.3 percent, and unit costs have decreased at an average annual rate of 0.5 percent.

*Table 3.14*

Change in Volumes and Unit Costs of Measured Federal Reserve Bank Services, 1997 to 1998

Percent

| Service | Volume | Unit cost |
|---|---|---|
| Payments | 3.9 | –4.8 |
| Commercial check | 2.7 | –3.6 |
| Automated clearinghouse | 12.0 | –8.7 |
| Funds transfer | 3.8 | –8.9 |
| Cash [1] | 1.1 | .5 |
| Fiscal | 1.9 | 3.1 |
| Securities and noncash | –3.3 | –7.5 |
| **All measured services** | **3.2** | **–2.7** |

1. Currency, coin, and special cash services.

The decrease in unit cost expected for 1998 reflects net decreases for the payments mechanism, book-entry securities, and fiscal services. The unit cost for commercial checks, the largest component in the overall index, is expected to decline 2.5 percent.

## 1997 Budget Performance

The Reserve Banks estimate that 1997 expenditures will be $2,011.6 million—$14.3 million, or 0.7 percent, more than the approved 1997 budget of $1,997.2 million. The 1997 budget approved by the Board in December 1996 represented an increase of $37.9 million, or 1.9 percent, over estimated 1996 expenses; at the estimated 1997 level of spending, the increase over actual 1996 expenditures will be 2.8 percent.

Four Reserve Banks expect their 1997 spending will come in below budget, by 1 percent or less. Six Banks expect to exceed their 1997 budgets by less than 1 percent, and two Banks expect larger overruns—Boston (4.7 percent) and St. Louis (2.3 percent). Boston's 1997 expenses were affected by a change in the allocation of costs among the twelve Banks, causing Boston to retain rather than share about $4.8 million. The overrun in St. Louis is due primarily to unbudgeted fees related to CDC compliance ($1.5 million). ▪

# Part II

# Special Analysis

*Chapter 4*

# *The Federal Reserve's Response to the Year 2000 Problem*

Until recently, the costs of computer processing, memory, and data storage were significant challenges to developers of software and designers of embedded chip systems. Consequently, these resources were treated as scarce and needed to be conserved; one obvious way of doing so was to designate years with two digits in date fields. So long as date calculations involved only one century, four-digit year fields were unnecessary. These calculations, however, produce inaccurate results when dates span centuries because both 1900 and 2000 are represented as "00" in the two-digit system.

This year 2000 problem is a challenge that affects all industries and systems that depend on computers, telecommunications, or embedded chip controls. If not corrected or replaced by the time the clock rolls over to the next century, these systems and chips—and the myriad activities that depend on them—will be crippled by errors and malfunctions.

Although most computer programs and systems developed over the last several years have been designed to be year 2000 ready, a large number of older systems remain to be renovated. In addition to correcting internally developed applications, organizations must coordinate with third-party providers of software, hardware, or services to ensure that these products are also year 2000 ready.

The Federal Reserve System considers the year 2000 problem to be the single greatest risk currently facing the U.S. financial system. The Federal Reserve has given its highest priority to ensuring that the depository institutions and other financial firms the Federal Reserve supervises and serves are devoting all necessary resources to meet their public responsibility to be fully compliant and prepared to continue normal operations on the arrival of the new millennium.

First, however, the Federal Reserve's own computer systems, including its payment system applications, must be ready. Readiness, however, applies to more than technical computer issues; the degree of readiness determines the degree of continuity with which the Federal Reserve System will be able to conduct its business. As such, the System's year 2000 efforts—correction as well as contingency planning—must go beyond the information technology (IT) areas to encompass all operational areas. Toward that end, the Federal Reserve in 1995 initiated the Systemwide Century Date Change (CDC) project to coordinate the year 2000 efforts of the Reserve Banks, Federal Reserve Automation Services (FRAS), and the Board of Governors, and in turn to coordinate all their work with related programs of the industry.

## Early Efforts at the Federal Reserve

The Federal Reserve recognized the scope of the year 2000 problem when, in 1992, it began consolidating mainframe data processing operations of the Reserve Banks under the new FRAS organization. The consolidation required the creation of new centralized applications, such as Fedwire funds transfer, Fedwire securities transfer, and automated clearinghouse systems. These applications were designed to recognize the century date change.

The consolidation also required a comprehensive inventory of other mainframe applications with a view to standardizing them, and this cataloging was also a necessary first step in the discovery and correction of two-digit year fields. The assessment of these applications required the review of approximately 90 million lines of computer code.

## Current Efforts

In 1998 the Federal Reserve will more than double the resources it commits to the year 2000 problem, from $13 million and 105 person-years during 1997 to $32 million (see chapter 3, table 3.3) and 226 person-years.

### Testing

The Federal Reserve is allocating significant resources to internal testing as well as to the testing needs of depository institutions and the rest of the financial services industry. Under the CDC project, all remaining year 2000 changes in essential (mission-critical) Federal Reserve software, along with testing by internal and external users, is scheduled for completion by the end of 1998. Furthermore, mission-critical computer programs that work in tandem with systems at depository institutions, will be ready by mid-1998, allowing eighteen months of testing before the arrival of the century date change.

The Federal Reserve is communicating its CDC plans to depository institutions through a series of newsletters. In October 1997 the Federal Reserve described its methodology for testing mission-critical applications using the date rollover between the last business day of 1999 and the first business day of 2000 as well as the three-day leap-year sequence between February 28 and March 1, 2000. Depository institutions will have the opportunity to test the same date change scenarios between single Federal Reserve applications or to test multiple applications on ‘‘shared test days’’ on six weekends in 1998.

Institutions will also be able to test funds transfers, securities transfers, and automated clearinghouse transactions with other institutions. In March 1998 the Federal Reserve is releasing a newsletter that describes specific testing opportunities, testing schedules, and the CDC readiness of software for Federal Reserve transactions and file transfers.

### Communication

The focus of the CDC effort at the Board goes beyond the immediate need to prepare systems and ensure reliable operation of its payment systems. The CDC project team is promoting awareness and commitment throughout the Federal Reserve and the wider financial services industry. The Federal Reserve continually advises depository institutions of its plans and schedules for making its software compliant and issues periodic bulletins addressing specific technical issues. Internet Web sites with extensive links to official and industry information on year 2000 issues have been deployed by the Federal Reserve Board (http://www.bog.frb.fed.us/y2k/) and the Federal Financial Institutions Examination Council (http://www.ffiec.gov/y2k/), which also has a toll-free Fax Back service (1-888-882-0982).

## Business Continuity

Because smooth and uninterrupted financial flows are obviously of utmost importance, the Federal Reserve has focused on continued system readiness and the avoidance of problems. As a result, computer and telecommunications systems are designed to maintain a high level of availability through use of redundant components and preparation for recovery after a disaster.

Federal Reserve IT and operational areas are working closely to anticipate internal and external year 2000 failures that could disrupt operations and to develop plans for alternative means of service delivery. Experience already gained in responding to liquidity problems in institutions as well as to such diverse events as earthquakes, fires, storms, and power outages is being applied in developing the Federal Reserve's CDC business continuity plans.

## Supervisory Issues

The Federal Reserve is also addressing the supervisory issues raised by the year 2000 problem. As a bank supervisor, the Federal Reserve has worked closely with the other agencies of the Federal Financial Institutions Examination Council (FFIEC) to communicate to the industry the complexities and urgency of the issue, to monitor year 2000 preparations, and to identify and address problems as they arise. In May 1997, federal banking agencies developed a questionnaire to collect information on the year 2000 readiness of federally insured institutions. The responses, together with other information, indicate that the banking industry's awareness improved substantially during 1997 and that institutions have intensified their CDC compliance work.

The Federal Reserve plans to examine the year 2000 readiness efforts of all state member banks, U.S. branches and agencies of foreign banks, large bank holding companies, and selected other organizations, such as service providers for banks, subject to its supervision—about 1,800 examinations—by June 30, 1998. The examination program reviews each organization's CDC plans, ensures that senior management and the board of directors are directly involved in overseeing CDC projects, and monitors progress against the plan. Institutions with problems receive intensified supervisory attention and high priority for subsequent examinations. ■

# *Appendixes*

*Appendix A*

# *Special Categories of System Expense*

Fees for priced services and the treatment of capital outlays are explained in this appendix. Also described are the Reserve Bank special project for 1998 and Federal Reserve expenses for currency printing.

## Priced Services

The Monetary Control Act of 1980 requires the Federal Reserve to make available to all depository institutions, for a fee, certain services that the Federal Reserve had previously provided without explicit charge and only to member banks. As the act requires, the fees charged for providing these priced services are based on the cost of providing the services, including all direct and indirect costs, the interest on items credited before actual collection (float), and the private sector adjustment factor (PSAF). The PSAF takes into account the return on capital that would have been provided, and the taxes that would have been paid, had the services been furnished by a private business firm.

### Annual Pricing Process

To meet the requirement for the full recovery of costs, the Federal Reserve has developed an annual pricing process involving a review of Reserve Bank expenses in addition to the review required by the System's budget processes. Use of the budgets is an integral part of the pricing exercise because most of the recoverable costs of priced services are direct and indirect costs as determined by the budgets. To assist depository institutions in their planning to provide or use correspondent banking services, the Federal Reserve usually sets each year's prices only once, in the fourth quarter of the preceding year.

Fees for Federal Reserve services must be approved by the product director for the respective service, by the Financial Services Policy Committee, and ultimately by the Board of Governors.[1] If fees for any service are set so that the full recovery of costs is not anticipated, the Board announces the rationale.

The cost of float is estimated by applying the current federal funds rate to the level of float expected to be generated in the coming year. Estimates of income taxes and the return on capital are based on tax and financing rates derived from a model of the fifty largest U.S. bank holding companies; these rates are applied to the assets the Federal Reserve expects to use in providing priced services in the coming year. The other components of the PSAF are derived from the budgets of the Reserve Banks and the Board: the imputed sales tax (based on budgeted outlays for materials, supplies, and capital assets); the imputed assessment for insurance by the Federal Deposit Insurance Corporation (FDIC) (based on expected

1. The product directors are the first vice presidents at selected Reserve Banks with responsibility for day-to-day policy guidance over specific Systemwide priced services. The Financial Services Policy Committee comprises the presidents of three Reserve Banks, the first vice presidents of three other Reserve Banks, and, as liaison, the director of the Board's Division of Reserve Bank Operations and Payment Systems.

clearing balances and amounts deferred to depository institutions for items deposited for collection with the Reserve Banks); and the portion of the expenses of the Board of Governors that is directly related to the development of priced services.

The intent of the PSAF calculation is to require the Federal Reserve to include in the costs of its priced services the costs that would have been incurred had the services been provided by a private-sector firm.

## Calculation of the PSAF for 1998

In 1997 the Board approved a 1998 private sector adjustment factor for Reserve Bank priced services of $108.5 million, an increase of $7.0 million, or 6.9 percent, from the PSAF of $101.5 million targeted for 1997.

*Table A.1*

### Pro Forma Balance Sheet for Federal Reserve Priced Services, 1997 and 1998

Millions of dollars

| Item | 1997 | | 1998 | |
|---|---|---|---|---|
| ASSETS | | | | |
| *Short-term assets* | | | | |
| Imputed reserve requirement on clearing balances | 545.7 | | 750.4 | |
| Investment in marketable securities | 4,911.3 | | 6,753.5 | |
| Receivables[1] | 64.3 | | 69.0 | |
| Materials and supplies[1] | 11.6 | | 4.3 | |
| Prepaid expenses[1] | 14.6 | | 14.1 | |
| Items in process of collection | 2,548.2 | | 2,922.8 | |
| Total short-term assets | | 8,095.7 | | 10,514.1 |
| *Long-term assets* | | | | |
| Premises[1,2] | 348.0 | | 360.4 | |
| Furniture and equipment[1] | 167.0 | | 145.2 | |
| Leasehold improvements and long-term prepayments[1] | 18.0 | | 23.3 | |
| Capital leases | .7 | | .0 | |
| Total long-term assets | | 533.7 | | 528.9 |
| **Total assets** | | **8,629.4** | | **11,043.0** |
| LIABILITIES | | | | |
| *Short-term liabilities* | | | | |
| Clearing balances and balances arising from early credit of uncollected items | 5,457.0 | | 7,503.9 | |
| Deferred-credit items | 2,548.2 | | 2,922.8 | |
| Short-term debt[3] | 90.5 | | 87.4 | |
| Total short-term liabilities | | 8,095.7 | | 10,514.1 |
| *Long-term liabilities* | | | | |
| Obligations under capital leases | .7 | | .0 | |
| Long-term debt[3] | 180.5 | | 185.1 | |
| Total long-term liabilities | | 181.2 | | 185.1 |
| Total liabilities | | 8,276.9 | | 10,699.2 |
| Equity[3] | | 352.5 | | 343.8 |
| **Total liabilities and equity** | | **8,629.4** | | **11,043.0** |

NOTE. Data are averages for the year.

1. Financed through the private sector adjustment factor; other assets are self-financing.

2. Includes allocations of Board of Governors' assets to priced services of $0.5 million for both 1997 and 1998.

3. Imputed figures representing the source of financing for certain priced-service assets.

### *Asset Base*

The value of Federal Reserve assets to be used in providing priced services in 1998 is estimated at $11,043.0 million (table A.1). The value of assets assumed to be financed through debt and equity in 1998 is $616.3 million, a decrease of $7.2 million, or 1.2 percent, from 1997 (table A.2); the decrease is due primarily to lower base levels of asset prices for Federal Reserve Automation Services.

### *Cost of Capital and Taxes and Other Imputed Costs*

For 1998, a pretax rate of return on equity of 22.4 percent, or $77.0 million,

*Table A.2*

Derivation of the Private Sector Adjustment Factor (PSAF), 1997 and 1998

Millions of dollars except as noted

| Item | 1997 | 1998 |
|---|---|---|
| PSAF COMPONENTS | | |
| *Assets to be financed* [1] | | |
| Short-term | 90.5 | 87.4 |
| Long-term [2] | 533.0 | 528.9 |
| Total | 623.5 | 616.3 |
| *Cost of capital (percent)* [3] | | |
| Short-term debt | 5.2 | 5.1 |
| Long-term debt | 7.1 | 6.8 |
| Pretax return on equity [4] | 19.1 | 22.4 |
| Weighted average long-term cost of capital | 15.1 | 16.9 |
| *Capital structure (percent)* | | |
| Short-term debt | 14.5 | 14.2 |
| Long-term debt | 29.0 | 30.0 |
| Equity | 56.5 | 55.8 |
| Tax rate (percent) | 32.1 | 32.1 |
| REQUIRED PSAF RECOVERIES | | |
| *Capital costs* [5] | | |
| Short-term debt | 4.7 | 4.5 |
| Long-term debt | 12.8 | 12.5 |
| Equity | 67.5 | 77.0 |
| Total | 85.0 | 94.0 |
| *Other costs* | | |
| Sales taxes | 11.6 | 9.1 |
| Assessment for federal deposit insurance | 2.0 | 2.6 |
| Expenses of Board of Governors | 2.9 | 2.8 |
| Total | 16.5 | 14.5 |
| ***Total PSAF recoveries*** | | |
| **Millions of dollars** | **101.5** | **108.5** |
| **As a percentage of capital** | **16.3** | **17.6** |
| **As a percentage of expenses** | **16.6** | **18.1** |

1. Calculated with the "direct determination of assets" method.
2. Consists of total long-term assets less capital leases that are self-financing.
3. All short-term assets are assumed to be financed with short-term debt. Of the total 1998 long-term assets, 35 percent are assumed to be financed with long-term debt and 65 percent with equity. The data are average rates paid by the fifty largest (by asset size) bank holding companies.
4. The pretax rate of return on equity is based on average after-tax rates of return on equity, adjusted by the effective tax rate to yield the pretax rate of return on equity for each bank holding company for each year. These data are then averaged over the five years 1992–96 to yield the pretax return on equity for use in the PSAF.
5. The calculations underlying these data use the dollar value of assets to be financed, divided as described in note 3, and the rates for the cost of capital.

is planned. Other required PSAF recoveries for 1998—imputed sales taxes, the imputed FDIC insurance assessment, and Board expenses—total $14.5 million (table A.2).

## Capital Outlays

Under generally accepted accounting principles (GAAP), the cost of an asset that is expected to benefit an entity over future periods should be allocated over those periods. Such treatment allows a realistic measurement of operating performance. In accordance with GAAP, the Federal Reserve System depreciates the cost of fixed assets over their estimated useful lives.

The Banks capitalize and depreciate all assets that cost $1,500 or more; they may either capitalize or expense assets costing less. The capitalization guideline for the Board is $5,000.

The Banks maintain a multiyear plan for capital spending. The Board, in turn, requires the Banks to budget annually for capital outlays by capital class to estimate the effect of total operating and capital spending. During the budget year, the Banks must submit proposals for major purchases of assets to the Board for further review and approval. The Board of Governors also reviews capital expenditures for the Board.

## Special Project: Automation Consolidation

Special projects are research and development activities that are expected to provide long-range benefits to the Federal Reserve System and the banking industry as a whole. Because spending on special projects is relatively high and short term, the Federal Reserve accounts for them separately from its operating expenses. For 1997–98, the Board of Governors has approved one special project.

In 1992 the Federal Reserve System began to incur expenses for a major effort to consolidate all its mainframe computer operations within a new System entity, Federal Reserve Automation Services (FRAS)

The Automation Consolidation special project was created to capture the extraordinary costs associated with this effort.

In 1992, work focused on establishing a project plan and on staffing and equipping the three data centers. In 1993 and 1994 the emphasis was on the conversion of District workloads and the transition of District EPS images to the production environment. In 1995 the processing of funds transfers was moved into FRAS, and the San Francisco and New York Reserve Banks completed the System's move into the District-unique environment. In 1996, consolidation efforts centered around implementation of the centralized ACH and, continuing through 1997, implementation of the new book-entry applications.

During 1998, the Banks will continue to implement the new book-entry application, and New York will complete its transition to FRAS. The Automation Consolidation special project will end during 1998 with the System's completion of its transition to FRAS.

The 1998 budget provides $4.7 million in support of these efforts. Including budgeted 1998 funding, expenditures on this special project to date total $276.0 million.

## Currency Printing and Circulation

The Department of the Treasury's Bureau of Engraving and Printing (BEP) prints U.S. currency; the Federal Reserve

Banks put it into circulation through depository institutions and destroy it as it wears out (table A.3). The Board of Governors establishes the annual budget for the costs associated with the printing of new notes and subsequently assesses the Federal Reserve Banks through an accounting procedure similar to that used in assessing the Reserve Banks for Board operating expenses.

The 1998 currency budget is $370.3 million, an increase of 0.8 percent over estimated 1997 expenditures (chart A.1).

In 1997, Federal Reserve expenditures related to supplying currency totaled an estimated $367.5 million, about 9.4 percent less than the budgeted amount, primarily for two reasons. First, the Reserve Banks finished the conversion to the BPS 3000 currency processors, which yielded an increase in the number of notes classified as fit (usable) and a corresponding decrease in the need for new notes. Second, the BEP has credited the Federal Reserve with $25 million for funds previously collected because of improved productivity and reduced overtime at the BEP.

*Table A.3*

Currency in Circulation, New Notes Issued, and Notes Destroyed, 1997

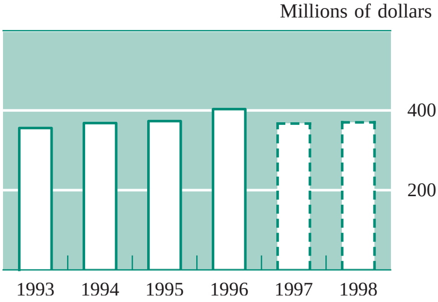
Millions of pieces

| Dollar denomination | Notes in circulation[1] | New notes issued[2] | Notes destroyed |
|---|---|---|---|
| 1 | 6,525 | 4,184 | 3,512 |
| 2 | 562 | 27 | 8 |
| 5 | 1,522 | 904 | 865 |
| 10 | 1,372 | 785 | 776 |
| 20 | 4,263 | 1,735 | 1,538 |
| 50 | 939 | 438 | 602 |
| 100 | 2,854 | 886 | 469 |
| **Total** | **18,036** | **8,959** | **7,770** |

1. As of November 1997.
2. Does not include additions to inventory at the Reserve Banks.

*Chart A.1*

Federal Reserve Budget for Supplying U.S. Currency, 1993–98




NOTE. For 1997, estimate; for 1998, budget.

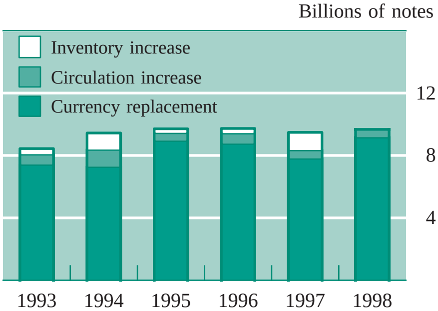
## Printing of Federal Reserve Notes

By far the largest expense in the currency budget is the cost of printing new Federal Reserve notes. The 1998 budget for the printing of new notes is $357.6 million, a 0.5 percent increase over estimated 1997 expenditures (table A.4). Several factors influence the size of this portion of the currency budget, the most important of which is the number of notes printed. The 1998 budget provides for the printing of 9.2 billion notes. This volume is based on the anticipated destruction of an estimated 9.0 billion notes, an expected increase of about 500 million notes in circulation, and a planned decrease of 300 million notes in Reserve Bank inventories (chart A.2).

The cost of printing the notes also influences the budget. The unit cost of producing Federal Reserve notes in 1998 will decrease 2.8 percent, from $40 per thousand notes to $39 (chart A.3).

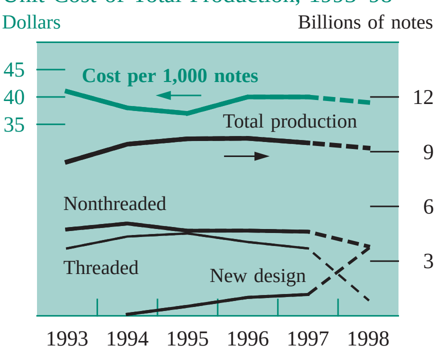
The unit cost, which is established by the Bureau of Engraving and Printing, was formerly a blend of the costs of the three types of notes produced—the new currency design, other threaded currency (bills with the special security

*Chart A.2*
Use of Currency Printed, 1993–98




NOTE. For 1998, projections.

*Chart A.3*
Production of Currency, by Type, and Unit Cost of Total Production, 1993–98




NOTE. Left scale is cost; right scale is production volume. Total production is the sum of nonthreaded, threaded, and new design.

thread), and $1 notes. Beginning in 1998, the BEP will charge the Board separately for each of the three types (chart A.3 and table A.5). The BEP's Western facility (located in Fort Worth, Texas) will produce all but the $50 and $100 denominations; the BEP's Washington facility produces all denominations.

In 1997 the BEP encountered problems in printing the Series 1996 $50 notes, producing 217.6 million of them before it could correct the problem. Steps were taken to ensure that the defective notes were not placed in circulation.

## Shipment of Currency

The Board contracts with armored-carrier companies to transport new currency from the BEP's Washington and Western facilities to the Federal Reserve Banks and their Branches. The 1998 budget for transporting new Federal Reserve notes is $9.0 million, a 5.9 percent increase from estimated 1997 expenditures; the increase is attributable to higher charges for airfreight.

The currency budget also includes funds for the shipment of fit currency

*Table A.4*
Federal Reserve Costs of Supplying Currency, 1997 and 1998

Thousands of dollars except as noted

| Item | 1997 estimate | 1998 budget | Percentage change |
|---|---|---|---|
| Printing of new Federal Reserve notes | 355,672 | 357,586 | .5 |
| Shipment of new notes | 8,500 | 9,000 | 5.9 |
| Shipment of fit notes within the System | 400 | 800 | 100.0 |
| Extended custodial inventory program | 200 | 175 | –12.5 |
| Return of currency pallets to Bureau of Engraving and Printing | 26 | 30 | 15.4 |
| Reimbursement to the U.S. Treasury | 2,700 | 2,750 | 1.9 |
| **Total cost of currency** | **367,498** | **370,341** | **.8** |

*Table A.5*
Projected Cost of Printing New Notes, by Type of Note, 1998

| Type of currency | Number of notes (thousands) | Percentage of total notes | Cost per thousand notes (dollars) | Total cost (thousands of dollars) |
|---|---|---|---|---|
| New design | 3,676.8 | 40 | 53.50 | 196,708.8 |
| Threaded | 1,708.8 | 19 | 34.10 | 58,270.1 |
| Nonthreaded ($1 note) | 3,814.4 | 41 | 26.90 | 102,607.4 |
| **Total** | **9,200.0** | **100** | **38.87** | **357,586.2** |

among Federal Reserve offices. The 1998 budget provides $0.8 million for these shipments, or 100 percent more than estimated 1997 expenditures. The increase is in anticipation of the introduction of the Series 1996 $20 note, tentatively scheduled for fall 1998; extra shipments of $20 notes are expected in advance of the new note to maintain adequate inventories at each Federal Reserve office.

## Extended Custodial Inventory Program

The Federal Reserve established the extended custodial inventory (ECI) program in 1996 to facilitate the international introduction of the redesigned (Series 1996) $100 note. The Federal Reserve Bank of New York, which manages the program, maintains inventories of Series 1996 notes at several banks in selected locations abroad (currently London, Frankfurt, and Zurich). These banks verify and sort incoming deposits to assist in the repatriation and destruction of pre-1996 Series $100 notes, and they help develop an international market for the fit Series 1996 $100 notes.

The 1998 ECI budget is $175,000, 12.5 percent less than estimated 1997 expenditures. In 1998, the ECI program will increase the number of locations in the same three European cities from four to five. The program may be expanded in 1998 to other regions.

## Return of Storage Pallets

The BEP stores and ships currency on aluminum pallets. The pallets are also used in several Reserve Bank offices with automated currency vaults. The 1998 budget for returning empty pallets to the BEP is $30,000, or 15.4 percent more than estimated 1997 expenditures.

## Reimbursement to the Treasury

Unfit currency is canceled, destroyed, and accounted for according to procedures prescribed by the U.S. Treasury's Office of Currency Standards, and that office processes claims for redemption of damaged or mutilated currency. The Federal Reserve's 1998 currency budget includes $2.7 million to reimburse the Treasury for this service, a 3.9 percent increase over estimated 1997 expenses.

■

*Appendix B*

# Sources and Uses of Funds

The Federal Reserve System, in accordance with generally accepted accounting principles, accrues income and expenses and capitalizes acquisitions of assets whose useful lives extend over several years (see appendix A).

The System derives its income primarily from earnings on U.S. government securities that the Federal Reserve has acquired through open market operations, one of the tools of monetary policy. These earnings account for approximately 95 percent of current income (table B.1).

The current expenses of the Reserve Banks consist of their operating expenses and the costs of the earnings credits granted to depository institutions on clearing balances held with the Reserve Banks (table B.2). The Reserve Banks record extraordinary adjustments to current net income in a profit and loss account. The primary entries in the account are for gains or losses on the sale of U.S. government securities and for gains or losses on assets denominated in foreign currencies that result either from the sale of those assets or from their revaluation at market exchange rates.

The Reserve Banks maintain a surplus account to absorb unexpected losses, much as commercial establishments retain earnings. The Board of Governors requires that the surplus account at year-end be an amount equal to the capital paid in by the member banks. Since the end of 1964, the Board's policy has been to transfer to the U.S. Treasury all net income after paying the statutory dividend to member banks and the amount necessary to equate surplus to paid-in capital. The amount transferred is classified as interest on Federal Reserve notes. Such payments were $20.1 billion for 1996 and are estimated to be $20.7 billion for 1997. In addition to these payments, special transfers of surplus of $106 million on October 1, 1996, and $107 million on October 1, 1997, were statutorily required. ■

*Table B.1*

Income of the Federal Reserve System, 1996 and 1997

Millions of dollars

| Source | 1996 actual | 1997 estimate |
|---|---|---|
| Loans | 10.9 | 14.6 |
| U.S. government securities | 23,883.7 | 25,699.0 |
| Foreign currencies | 442.8 | 375.4 |
| Priced services | 787.2 | 789.1 |
| Other | 39.8 | 39.2 |
| **Total** | **25,164.3** | **26,917.2** |

## *Table B.2*

## Distribution of the Income of the Federal Reserve Banks, 1996 and 1997

Millions of dollars

| Item | 1996 actual | 1997 estimate |
|---|---|---|
| Current income [1] | 25,164 | 26,917 |
| LESS | | |
| *Current expenses of Reserve Banks* [2] | | |
| Operating expenses | 1,639 | 1,613 |
| Costs of earnings credits | 309 | 359 |
| EQUALS | | |
| Current net income | 23,216 | 24,946 |
| PLUS | | |
| Net additions to, or deductions from (–), current net income [3] | –1,639 | –2,577 |
| LESS | | |
| Cost of unreimbursed Treasury services [4] | 38 | 35 |
| *Assessments by the Board* | | |
| Board expenses | 163 | 174 |
| Cost of currency | 403 | 364 |
| *Other distributions* | | |
| Dividends paid to member banks [5] | 256 | 300 |
| Transfers to, or from (–), surplus [6,7] | 635 | 832 |
| EQUALS | | |
| **Payment to U.S. Treasury** [7] | **20,083** | **20,664** |

1. See table B.1.
2. Net of reimbursements due from the U.S. Treasury and other government agencies. Also reflects reductions in credits for net periodic pension cost amounting to $139.5 million in 1996 and $200.1 million in 1997.
3. This account is the same as that reported under the same name in the table "Income and Expenses of Federal Reserve Banks" in the Statistical Tables section of the Board's *Annual Report* and includes realized and unrealized gains on assets denominated in foreign currencies, gains on sales of U.S. government securities, and miscellaneous gains and losses.
4. The cost of services provided to the U.S. Treasury that are reimbursable under agreements with the Treasury and for which reimbursement is not anticipated.
5. The Federal Reserve Act requires the Federal Reserve to pay dividends to member banks at the rate of 6 percent of paid-in capital.
6. Each year, to provide a reserve against losses, the Federal Reserve transfers to its surplus account an amount sufficient to equate surplus to paid-in capital.
7. Does not reflect the special transfers of surplus from the Federal Reserve System to the Treasury: $106 million on October 1, 1996, and $107 million on October 1, 1997.

*Appendix C*

# Federal Reserve System Audits

The Board of Governors, each of the Reserve Banks, and the Federal Reserve System as a whole are all subject to several levels of audit and review. At each Federal Reserve Bank, a full-time staff of auditors under the direction of a general auditor reports directly to the Bank's board of directors. The Board's Division of Reserve Bank Operations and Payment Systems, acting on behalf of the Board of Governors, regularly audits the financial operations of each of the Banks and periodically reviews all other Bank operations. In addition, the financial statements of the Reserve Banks are audited annually by an independent outside auditor.

The Office of Inspector General (OIG) conducts audits and investigations of the programs and operations of the Board and those Board functions delegated to the Federal Reserve Banks. The OIG retains an independent auditor each year to certify the fairness of the Board's financial statements and its compliance with laws and regulations affecting those financial statements.

## Independent Audit

The Board of Governors contracts with an external audit firm, currently Coopers and Lybrand L.L.P., for an annual financial audit of the combined Reserve Bank financial statements and the financial statements of each of the twelve Reserve Banks. The Reserve Banks are also audited by each Bank's internal audit function and by the Board's financial examiners.

## General Accounting Office

The 1978 passage of the Federal Banking Agency Audit Act (Public Law 95–320) brought most of the operations of the Federal Reserve System under the purview of the General Accounting Office (GAO). The GAO, which currently has 10 projects in various stages of completion, since 1979 has completed 159 reports on selected aspects of Federal Reserve operations (tables C.1 and C.2). The GAO has also involved the Federal Reserve in about 90 other reviews not directly related to the System and has terminated 54 others before completion. The reports are available directly from the GAO.

*Table C.1*
## Active GAO Projects Relating to the Federal Reserve

| Subject | Date initiated |
|---|---|
| Review of Treasury financial statements | 12-22-95 |
| On-line banking services | 10-16-96 |
| Risk-based capital | 11-6-96 |
| Electronic check presentment | 7-16-97 |
| North Carolina performance data for banks and thrifts | 8-8-97 |
| On-line banking effect | 8-28-97 |
| Year 2000 electronic data exchange problems | 10-20-97 |
| FR System's year 2000 efforts | 11-19-97 |
| SBA section 7(a) loans | 11-19-97 |
| Indiana bank closure | 12-1-97 |

*Table C.2*
## Completed GAO Reports Relating to the Federal Reserve System

| Report | Number | Date issued |
|---|---|---|
| Comparing Policies and Procedures of the Three Bank Regulatory Agencies | GGD-79-27 | 3-29-79 |
| Are OPEC Financial Holdings a Danger to U.S. Banks or the Economy? | EMD-79-45 | 6-11-79 |
| Federal Systems Not Designed to Collect Data on All Foreign Investments in U.S. Depository Institutions | GGD-79-42 | 6-19-79 |
| Considerable Increase in Foreign Banking in United States since 1972 | GGD-79-75 | 8-1-79 |
| Investment Policies, Practices and Performance of Federal Retirement Systems | FPCD-79-17 | 8-31-79 |
| Federal Supervision of Bank Holding Companies Needs Better, More Formalized Supervision | GGD-80-20 | 2-12-80 |
| The Federal Reserve Should Assure Compliance with the 1970 Bank Holding Company Act Amendments | GGD-80-21 | 3-12-80 |
| Federal Agencies' Initial Problems with the Right to Financial Privacy Act of 1978 | GGD-80-64 | 5-29-80 |
| Internal Auditing Can Be Strengthened in the Federal Reserve System | GGD-80-59 | 8-8-80 |
| Despite Positive Effects, Further Foreign Acquisitions of U.S. Banks Should Be Limited until Policy Conflicts Are Fully Addressed | GGD-80-66 | 8-26-80 |
| Federal Examinations of Financial Institutions: Issues That Need to Be Resolved | GGD-81-12 | 1-6-81 |
| Examinations of Financial Institutions Do Not Assure Compliance with Consumer Credit Laws | GGD-81-13 | 1-21-81 |
| Disappointing Progress in Improving Systems for Resolving Billions in Audit Findings | AFMD-81-27 | 1-23-81 |
| An Economic Overview of Bank Solvency Regulation | PAD-81-25 | 2-13-81 |
| Federal Reserve Security over Currency Transportation Is Adequate | GGD-81-27 | 2-23-81 |
| The Federal Structure for Examining Financial Institutions Can Be Improved | GGD-81-21 | 4-24-81 |
| Response to Questions Bearing on the Feasibility of Closing the Federal Reserve Banks | GGD-81-49 | 5-21-81 |
| Bank Secrecy Act Reporting Requirements Have Not Met Expectations, Suggesting Need for Amendment | GGD-81-80 | 7-23-81 |
| Federal Reserve Could Improve the Efficiency of Bank Holding Company Inspections | GGD-81-79 | 8-18-81 |
| Financial Institution Regulatory Agencies Should Perform Internal Audit Reviews of their Examination and Supervision Activities | GGD-82-5 | 10-19-81 |
| Information on Selected Aspects of Federal Reserve System Expenditures | GGD-82-33 | 2-12-82 |
| Federal Review of Intrastate Branching Can Be Reduced | GGD-82-31 | 2-24-82 |
| Despite Improvements, Recent Bank Supervision Could Be More Effective and Less Burdensome | GGD-82-21 | 2-26-82 |
| Issues to Be Considered while Debating Interstate Bank Branching | GGD-82-36 | 4-9-82 |
| The Federal Reserve Should Move Faster to Eliminate Subsidy of Check-Clearing Operations | GGD-82-22 | 5-7-82 |

*Table C.2*
Continued

| Report | Number | Date issued |
|---|---|---|
| Information about Depository Institutions' Ancillary Activities Is Not Adequate for Policy Purposes | GGD-82-57 | 6-1-82 |
| Bank Merger Process Should Be Modernized and Simplified | GGD-82-53 | 8-16-82 |
| An Analysis of Fiscal and Monetary Policies | PAD-82-45 | 8-31-82 |
| Bank Examination for Country Risk and International Lending | ID-82-52 | 9-2-82 |
| Credit Insurance Disclosure Provisions of the Truth-in-Lending Act Consistently Enforced Except When Decisions Appealed | GGD-83-3 | 10-25-82 |
| Survey of Investor Protection and the Regulation of Financial Intermediaries | GGD-83-30 | 7-13-83 |
| Financial Institutions Regulatory Agencies Can Make Better Use of Consumer Complaint Information | GGD-83-13 | 8-25-83 |
| Expediting Tax Deposits Can Increase the Government's Interest Earnings | GGD-84-14 | 11-21-83 |
| Unauthorized Disclosure of the Federal Reserve's Monetary Policy Decision | GGD-84-40 | 2-3-84 |
| Federal Financial Institutions Examination Council Has Made Limited Progress toward Accomplishing Its Mission | GGD-84-4 | 2-3-84 |
| Control Improvements Needed in Accounting for Treasury Securities at the Federal Reserve Bank of New York | AFMD-84-10 | 5-2-84 |
| Statutory Requirements for Examining International Banking Institutions Need Attention | GGD-84-39 | 7-11-84 |
| Supervisory Examinations of International Banking Facilities Need to Be Improved | GGD-84-65 | 9-30-84 |
| An Examination of Concerns Expressed about the Federal Reserve's Pricing of Check-Clearing Activities | GGD-85-9A | 1-14-85 |
| Difficulties in Evaluating the Effectiveness of the Community Reinvestment Act | OCE-86-1 | 11-4-85 |
| International Coordination of Bank Supervision: The Record to Date | NSIAD-86-40 | 2-6-86 |
| Implementation of the Export Trading Company Act of 1982 | NSIAD-86-42 | 2-27-86 |
| Information on Independent Public Accountant Audits of Financial Institutions | GGD-84-44FS | 4-21-86 |
| An Analysis of Two Types of Pooled Investment Funds | GGD-86-63 | 5-12-86 |
| How the Markets Are Developed and How They Are Regulated | GGD-86-26 | 5-15-86 |
| U.S. Banking Supervision and International Supervisory Principles | NSIAD-86-93 | 7-25-86 |
| Financial Institution Regulators' Compliance Examination | GGD-86-94 | 8-1-86 |
| The Market's Structure, Risks, and Regulation | GGD-86-80BR | 8-20-86 |
| Dealer Views on Market Operations and Federal Reserve Securities Transfer System | GGD-86-147FS | 9-29-86 |
| Questions about the Federal Reserve's Securities Transfer System | GGD-87-15BR | 10-20-86 |
| Federal Reserve Board Opposition to Credit Card Interest Rate Limits | GGD-87-38BR | 4-7-87 |
| Insulating Banks from the Potential Risk of Expanded Activities | GGD-87-35 | 4-14-87 |
| The Federal Reserve Response Regarding Its Market-Making Standard | GGD-87-55FS | 4-21-87 |
| Change in Fees and Deposit Account Interest Rates since Deregulation | GGD-87-70 | 7-13-87 |
| An Examination of Views Expressed about Access to Brokers' Services | GGD-88-8 | 12-18-87 |
| Issues Related to Repeal of the Glass–Steagall Act | GGD-88-37 | 1-22-88 |
| Preliminary Observations on the October 1987 Crash | GGD-88-38 | 1-26-88 |
| Supervision of Overseas Lending Is Inadequate | NSIAD-88-87 | 5-5-88 |
| Competitive Concerns of Foreign Financial Firms in Japan, the United Kingdom and the United States | NSIAD-88-171 | 6-2-88 |
| Administrative Expenses at FHLBB and FRB for 1985 and 1986 | AFMD-88-33 | 6-15-88 |
| Government in the Sunshine Act Compliance at Selected Agencies | GGD-88-97 | 7-20-88 |
| Trends in Commercial Bank Performance, December 1976–June 1987 | GGD-88-106BR | 7-28-88 |
| U.S. Commercial Banks' Securities Activities in London | NSIAD-88-238 | 9-8-88 |
| Lending to Troubled Sectors | GGD-88-126BR | 9-26-88 |
| Government Check-Cashing Issues | GGD-89-12 | 10-7-88 |

*Table C.2*
Completed GAO Reports Relating to the Federal Reserve System—Continued

| Report | Number | Date issued |
|---|---|---|
| Conflict of Interest: Abuses in Commercial Banking Institutions | GGD-89-35 | 1-27-89 |
| Competitive Fairness Is an Elusive Goal | GGD-89-61 | 5-12-89 |
| Independent Audits Needed to Strengthen Internal Control and Bank Management | AFMD-89-25 | 5-31-89 |
| Information on the System's Check Collection Service | GGD-90-17 | 12-15-89 |
| Oversight of Critical Banking Systems Should Be Strengthened | IMTEC-90-14 | 1-14-90 |
| Activities of Securities of Bank Holding Companies | GGD-90-48 | 3-14-90 |
| The Stock, Options, and Futures Markets Are Still at Risk | GGD-90-33 | 4-11-90 |
| Update on U.S. Commercial Banks' Securities in London | NSIAD-90-98 | 5-7-90 |
| U.S. Financial Services' Competitiveness under the Single Market Program | NSIAD-90-99 | 5-21-90 |
| Limited Public Demand for New Dollar Coin or Elimination of Pennies | GGD-90-88 | 5-23-90 |
| Oversight of Automation Used to Clear and Settle Trades Is Uneven | IMTEC-90-47 | 7-12-90 |
| The Government's Exposure to Risks | GGD-90-97 | 8-15-90 |
| Office of Inspector General Operations at Financial Regulatory Agencies | AFMD-90-55FS | 8-24-90 |
| Additional Reserves and Reform Needed to Strengthen the Fund | AFMD-90-100 | 9-11-90 |
| More Transaction Information and Investor Protection Measures Are Needed | GGD-90-114 | 9-14-90 |
| Issues Relating to Banks Selling Insurance | GGD-90-113 | 9-25-90 |
| Implementation of Risk-Based Capital Adequacy Standards | NSIAD-91-80 | 1-25-91 |
| Overview of Six Foreign Systems | NSIAD-91-104 | 2-22-91 |
| Deposit Insurance: A Strategy for Reform | GGD-92-26 | 3-4-91 |
| Bank Supervision: Prompt and Forceful Regulatory Actions Needed | GGD-91-69 | 4-15-91 |
| Many Federal Agencies Collect and Disseminate Information | NSIAD-91-173 | 5-1-91 |
| Money Laundering: The U.S. Government Is Responding to the Problem | NSIAD-91-130 | 5-16-91 |
| A Framework for Limiting the Government's Exposure to Risks | GGD-91-90 | 5-22-91 |
| Treasury Tax and Loan Activity at Two Troubled Banks | AFMD-91-87 | 9-12-91 |
| OCC's Supervision of the Bank of New England Was Not Timely or Forceful | GGD-91-128 | 9-16-91 |
| Bank Holding Company Securities Subsidiaries' Market Activities Update | GGD-91-131 | 9-20-91 |
| Time Limits on Holding Deposits Generally Met but More Oversight Needed | GGD-91-132 | 9-30-91 |
| Legislation Needed to Strengthen Bank Oversight | AFMD-92-19 | 10-21-91 |
| Contracting Practices with Data Processing Servicers | GGD-92-19 | 2-5-92 |
| Challenges to Harmonizing International Capital Standards Remain | GGD-92-41 | 3-10-92 |
| Assessing the Need to Regulate Additional Financial Activities | GGD-92-70 | 4-21-92 |
| Call Report Automation | IMTEC-92-60R | 5-28-92 |
| Flexible Accounting Rules Lead to Inflated Financial Reports | AFMD-92-52 | 6-1-92 |
| Cross-Border Information Sharing Is Improving, but Obstacles Remain | GGD-92-110 | 7-28-92 |
| Changes in Collateral Practices Could Reduce the Federal Government's Risk of Loss | AFMD-92-54 | 9-14-92 |
| Initial Assessment of Certain BCCI Activities in the U.S. | GGD-92-96 | 9-30-92 |
| Appraisal Reform: Implementation Status and Unresolved Issues | GGD-93-19 | 10-30-92 |
| Bank and Thrift Criminal Fraud: The Federal Commitment Could Be Broadened | GGD-93-48 | 1-8-93 |
| FRB Examinations and Inspections Do Not Fully Assess Bank Safety and Soundness | AFMD-93-13 | 2-16-93 |
| Improvements Needed in Examination Quality and Regulatory Structure | AFMD-93-15 | 2-16-93 |
| Personnel Engaged in Public and Congressional Affairs in Federal Agencies | GGD-93-71FS | 3-8-93 |
| Credit Availability Guidance | GGD-93-15R | 3-30-93 |
| Treasury Automation: Automated Auction May Not Achieve Benefits or Operate Properly | IMTEC-93-28 | 4-27-93 |
| IRS Can Improve the Federal Tax Deposit System | AFMD-93-40 | 4-28-93 |
| Funding Foreign Bank Examinations | GGD-93-35R | 5-4-93 |
| Preliminary Information Related to a Futures Transaction Fee | GGD-93-108 | 5-17-93 |

*Table C.2*
Continued

| Report | Number | Date issued |
|---|---|---|
| The Business Environment in the United States, Japan, and Germany | GGD-93-124 | 8-9-93 |
| Regulatory Impediments to Small Business Lending Should Be Removed | GGD-93-121 | 9-7-93 |
| Recent Developments in Foreign Exchange Markets | GGD-93-154 | 9-24-93 |
| Benefits and Risks of Removing Regulatory Restrictions | GGD-94-26 | 11-2-93 |
| Regulatory Burden: Recent Studies, Industry Issues, and Agency Initiatives | GGD-94-28 | 12-13-93 |
| Strengthening the Framework for Supervising International Banks | GGD-94-68 | 3-21-94 |
| Insider Problems and Violations Indicate Broader Management Deficiencies | GGD-94-88 | 3-30-94 |
| U.S. Credit Card Industry: Competitive Developments Need to be Closely Monitored | GGD-94-23 | 4-28-94 |
| Better Guidance Is Needed for Real Estate Evaluations | GGD-94-144 | 5-24-94 |
| Treasury Securities Auction | AIMD-94-165R | 8-25-94 |
| Divergent Loan Loss Methods Undermine Usefulness of Financial Reports | AIMD-95-8 | 10-31-94 |
| Interstate Banking: Experiences in Three Western States | GGD-95-35 | 12-30-94 |
| Lessons Learned from Resolving First City Bancorporation of Texas | GGD-95-37 | 3-15-95 |
| Investment of Trust Assets in Bank Proprietary Mutual Funds | GGD-95-21 | 3-16-95 |
| Status Report on the Initiative to Improve Economic Statistics | GGD-95-98 | 7-7-95 |
| Mandated Studies to Review Costly Bank and Thrift Failures | GGD-95-126 | 7-31-95 |
| Differences in Screening Bank Executives | GGD-95-181R | 8-17-95 |
| Banks' Securities Activities: Oversight Differs Depending on Activity and Regulator | GGD-95-214 | 9-21-95 |
| Mutual Funds: Impact on Bank Deposits and Credit Availability | GGD-95-230 | 9-22-95 |
| Bank Mutual Funds: Sales Practices and Regulatory Issues | GGD-95-210 | 9-27-95 |
| Challenges Remain to Successfully Implement CRA | GGD-96-23 | 11-28-95 |
| Foreign Banks: Assessing Their Role in the U.S. Banking System | GGD-96-26 | 2-7-96 |
| Federal Reserve Banks: Internal Control, Accounting, and Auditing Issues | AIMD-96-5 | 2-9-96 |
| Mexico's Financial Crisis: Origins, Awareness, Assistance, and Initial Efforts to Recover | GGD-96-56 | 2-23-96 |
| Counterfeit U.S. Currency Abroad: Issues and U.S. Deterrence Efforts | GGD-96-11 | 2-26-96 |
| Money Laundering: A Framework for Understanding U.S. Efforts Overseas | GGD-96-105 | 5-24-96 |
| Federal Reserve System: Current and Future Challenges Require Systemwide Attention | GGD-96-128 | 6-17-96 |
| Fair Lending: Federal Oversight and Enforcement Improved but Some Challenges Remain | GGD-96-145 | 8-13-96 |
| Federal Reserve Banks: Inaccurate Reporting of Currency at the Los Angeles Branch | AIMD-96-146 | 9-30-96 |
| Implementation of the Foreign Bank Supervision Enhancement Act of 1991 | GGD-96-187 | 9-30-96 |
| Financial Derivatives: Actions Taken or Proposed since May 1994 | GGD-AIMD-97-8 | 11-1-96 |
| Inspectors General: Mandated Studies to Review Costly Bank and Thrift Failures | GGD-97-4 | 11-7-96 |
| Regulatory Burden: Measurement Challenges and Concerns Raised by Selected Companies | GGD-97-2 | 11-18-96 |
| Bank Oversight Structure: U.S. and Foreign Experience May Offer Lessons for Modernizing U.S. Structure | GGD-97-23 | 11-20-96 |
| Implementation of FDICIA's Prompt Regulatory Action Provisions | GGD-97-18 | 11-21-96 |
| Bank Regulatory Structure: Japan | GGD-97-5 | 12-27-96 |
| Bank Data: Material Loss of Oversight Information from Interstate Banking Is Unlikely | GGD-97-49 | 3-26-97 |
| The Commodity Exchange Act: Legal and Regulatory Issues Remain | GGD-97-50 | 4-7-97 |
| Treasury's Plan to Study Genuine and Counterfeit U.S. Currency Abroad | NSIAD-97-104 | 4-11-97 |
| Bank Oversight: Few Cases of Tying Have Been Detected | GGD-97-58 | 5-8-97 |

*Table C.2*
Continued

| Report | Number | Date issued |
|---|---|---|
| Foreign Banks: Opportunities Exist to Enhance Supervision Programs as Implementation Proceeds | GGD-97-80 | 5-9-97 |
| Four Financial Crises in the 1980s | GGD-97-96 | 5-21-97 |
| Payments, Clearance, and Settlement: A Guide to the Systems, Risks, and Issues | GGD-97-73 | 6-20-97 |
| International Financial Crises: Efforts to Anticipate, Avoid, and Resolve Sovereign Crises | GGD-NSIAD-97-168 | 7-7-97 |
| Federal Reserve Banks: Internal Controls Over Cash at Atlanta, Los Angeles, and Philadelphia Banks | AIMD-97-127 | 8-28-97 |
| Foreign Banks: Internal Control and Audit Weaknesses in U.S. Branches | GGD-97-181 | 9-29-97 |
| OTC Derivatives: Additional Oversight Could Reduce Costly Sales Practice Disputes | GGD-98-5 | 10-2-97 |
| Information on Private Banking and Its Vulnerability to Money Laundering | GGD-98-19R | 10-30-97 |

*Table C.3*
Completed OIG Audit Reports Relating to the Federal Reserve System, 1997

| Report | Number | Month issued |
|---|---|---|
| Audit of the Administrative Systems Automation Project | A9609 | February |
| Audit of the FFIEC's Financial Statements (years ended 12-31-96 and 12-31-95) | A9701 | March |
| Audit of the Board's Financial Statements (years ended 12-31-96 and 12-31-95) | A9700 | March |
| Inquiry Regarding Delays in Depositing Check Payments for Board Publications | P9718 | March |
| Assistance to Financial Statement Audit of the Federal Reserve Employee Benefits System (years ended 12-31-96 and 12-31-95) | A9706 | May |
| Audit of the Fixed Assets Management Process (Advisory Letter) | A9705 | June |
| Audit of New Currency (joint letter with Inspector General of the Treasury Department) | A9612 | June |
| Audit of the Division of Banking Supervision and Regulation's Distributed Processing Environment | A9610 | June |
| Monitoring of the PeopleSoft Payroll and Benefits System Implementation (Advisory Letter) | P9620 | June |
| Business Process Review of Travel Administration | A9702 | July |
| Audit of the Federal Reserve System's Enforcement Activities | A9613 | October |
| Audit of the Board's Business Resumption and Contingency Planning Process (Advisory Letter) | A9708 | October |
| Audit of the Division of Consumer and Community Affairs' Distributed Processing Environment | A9704 | December |

## Office of Inspector General

The Board's Office of Inspector General functions in accordance with the Inspector General Act of 1978, as amended. The OIG plans and conducts audits and investigations of the programs and operations of the Board and its delegated functions at the Federal Reserve Banks. The OIG also reviews existing and proposed legislation and regulations for economy and efficiency. It recommends policies, and it supervises and conducts activities that promote economy and efficiency and that prevent and detect waste, fraud, and abuse in Board and Board-delegated programs and operations. In addition, it coordinates its efforts with other governmental and nongovernmental agencies to promote economy and efficiency and to detect and prevent fraud and abuse in activities administered or financed by the Board. The OIG keeps the Congress and the

Chairman of the Board fully informed about serious abuses and deficiencies and about the status of any corrective actions.

During 1997, the OIG publicly reported on thirteen audits (table C.3) and conducted a number of follow-up and other reviews. In addition, the OIG closed seven investigations and performed numerous legislative and regulatory reviews. ■

*Appendix D*

# *Expenses and Employment at the Federal Reserve Banks*

*Table D.1*

## Operating Expenses of the Federal Reserve Banks, by District, 1997 and 1998

Thousands of dollars except as noted

| District | 1997 estimate | 1998 budget | Change | |
|---|---|---|---|---|
| | | | Amount | Percent |
| Boston | 138,391 | 143,620 | 5,229 | 3.8 |
| New York | 427,145 | 437,029 | 9,884 | 2.3 |
| Philadelphia | 104,088 | 107,196 | 3,108 | 3.0 |
| Cleveland | 120,747 | 122,869 | 2,123 | 1.8 |
| Richmond | 152,298 | 158,140 | 5,842 | 3.8 |
| Atlanta | 185,665 | 192,194 | 6,528 | 3.5 |
| Chicago | 212,273 | 210,927 | −1,347 | −.6 |
| St. Louis | 99,095 | 102,138 | 3,043 | 3.1 |
| Minneapolis | 104,065 | 103,998 | −77 | −.1 |
| Kansas City | 125,880 | 124,017 | −1,863 | −1.5 |
| Dallas | 124,593 | 127,955 | 3,361 | 2.7 |
| San Francisco | 217,317 | 224,600 | 7,283 | 3.4 |
| **Total, all Districts** | **2,011,557** | **2,054,672** | **43,114** | **2.1** |
| *Special project* | | | | |
| Automation Consolidation | 34,691 | 4,650 | −30,041 | −86.6 |
| **Total** | **2,046,248** | **2,059,321** | **13,073** | **.6** |

NOTE. Excludes capital outlays.

## *Table D.2*
## Employment at the Federal Reserve Banks, by District, 1997 and 1998

Average number of personnel except as noted[1]

| District | 1997 estimate | 1998 budget | Change | |
|---|---|---|---|---|
| | | | Amount | Percent |
| Boston | 1,231 | 1,233 | 3 | .2 |
| New York | 4,129 | 3,917 | –212 | –5.1 |
| Philadelphia | 1,259 | 1,246 | –13 | –1.0 |
| Cleveland | 1,400 | 1,325 | –75 | –5.4 |
| Richmond | 2,074 | 2,085 | 11 | .5 |
| Atlanta | 2,323 | 2,335 | 12 | .5 |
| Chicago | 2,187 | 2,105 | –81 | –3.7 |
| St. Louis | 1,196 | 1,212 | 16 | 1.3 |
| Minneapolis | 1,271 | 1,201 | –70 | –5.5 |
| Kansas City | 1,577 | 1,509 | –68 | –4.3 |
| Dallas | 1,527 | 1,516 | –12 | –.8 |
| San Francisco | 2,498 | 2,472 | –27 | –1.1 |
| **Total, all Districts** | **22,672** | **22,156** | **–516** | **–2.3** |
| Federal Reserve Automation Services | 549 | 598 | 49 | 8.9 |
| **Total** | **23,221** | **22,754** | **–467** | **–2.0** |

1. See chapter 3, note 2, for definition of average number of personnel.

## *Table D.3*
## Expenses of the Federal Reserve Banks, by Operational Area, 1997 and 1998

Thousands of dollars except as noted

| Operational area | 1997 estimate | 1998 budget | Change | |
|---|---|---|---|---|
| | | | Amount | Percent |
| Monetary and economic policy | 144,712 | 152,699 | 7,987 | 5.5 |
| Services to the U.S. Treasury and other government agencies | 212,010 | 220,939 | 8,929 | 4.2 |
| Services to financial institutions and the public | 1,214,810 | 1,226,243 | 11,433 | .9 |
| Supervision and regulation | 440,025 | 454,791 | 14,767 | 3.4 |
| **Total** | **2,011,557** | **2,054,672** | **43,115** | **2.1** |
| MEMO[1] | | | | |
| Support | 743,973 | 764,230 | 20,257 | 2.7 |
| Overhead | 527,616 | 534,870 | 7,255 | 1.4 |

1. These costs are included in the expenses by operational area. Support refers to activities, such as data processing, whose costs can be charged to users according to the amount of use. Overhead refers to activities, such as auditing, whose costs are charged according to the users' shares of total direct costs.

## *Table D.4*

## Expenses of the Federal Reserve Banks for Salaries of Officers and Employees, by District, 1997 and 1998

Thousands of dollars except as noted

| District | 1997 estimate | 1998 budget | Change | |
|---|---|---|---|---|
| | | | Amount | Percent |
| Boston | 57,210 | 59,588 | 2,378 | 4.2 |
| New York | 211,891 | 216,994 | 5,102 | 2.4 |
| Philadelphia | 50,584 | 52,426 | 1,842 | 3.6 |
| Cleveland | 52,011 | 50,246 | −1,765 | −3.4 |
| Richmond | 76,625 | 80,914 | 4,289 | 5.6 |
| Atlanta | 83,467 | 87,305 | 3,839 | 4.6 |
| Chicago | 96,838 | 96,390 | −448 | −.5 |
| St. Louis | 44,634 | 47,360 | 2,726 | 6.1 |
| Minneapolis | 48,531 | 48,237 | −294 | −.6 |
| Kansas City | 60,112 | 59,717 | −395 | −.7 |
| Dallas | 60,312 | 62,140 | 1,828 | 3.0 |
| San Francisco | 115,809 | 120,660 | 4,851 | 4.2 |
| **Total** | **958,025** | **981,978** | **23,953** | **2.5** |

## *Table D.5*

## Factors in the Change from 1997 to 1998 in the Salaries of Officers and Employees of the Federal Reserve Banks, by District

Percentage points

| District | Merit adjustment | Structure adjustment | Promotion and reclassification | Change in staffing | Turnover and lag[1] | Overtime | Other | Total change |
|---|---|---|---|---|---|---|---|---|
| Boston | 3.4 | .2 | .8 | .0 | .3 | −.5 | .0 | 4.2 |
| New York | 4.1 | .3 | .9 | −2.0 | −.3 | −.7 | .1 | 2.4 |
| Philadelphia | 3.9 | .3 | .7 | −.1 | −1.0 | −.2 | .0 | 3.6 |
| Cleveland | 3.7 | .0 | .4 | −5.5 | −1.3 | −.8 | .1 | −3.4 |
| Richmond | 3.9 | .3 | 1.0 | 2.1 | −.9 | −.8 | .0 | 5.6 |
| Atlanta | 3.5 | .3 | 1.0 | 1.1 | −.7 | −.6 | .0 | 4.6 |
| Chicago | 3.5 | .0 | 1.0 | −3.6 | −.9 | −.6 | .1 | −.5 |
| St. Louis | 3.8 | .2 | .8 | 2.7 | −.5 | −.9 | .0 | 6.1 |
| Minneapolis | 3.7 | .0 | .5 | −3.7 | −.6 | −.5 | .0 | −.6 |
| Kansas City | 4.0 | .6 | 1.1 | −3.0 | −1.6 | −1.8 | .0 | −.7 |
| Dallas | 3.4 | .3 | .4 | −.1 | −.4 | −.6 | .0 | 3.0 |
| San Francisco | 4.1 | .1 | .9 | −.5 | −.1 | −.3 | .0 | 4.2 |
| **Total** | **3.8** | **.2** | **.8** | **−1.2** | **−.6** | **−.6** | **.1** | **2.5** |

1. Turnover is the replacement of a departing employee with one having a lower pay grade. Lag is the time during which a position remains vacant.

## *Table D.6*
## Capital Outlays of the Federal Reserve Banks, by District, 1997 and 1998

Thousands of dollars except as noted

| District | 1997 estimate | 1998 budget | Change | |
|---|---|---|---|---|
| | | | Amount | Percent |
| Boston | 15,330 | 12,463 | –2,867 | –18.7 |
| New York | 36,053 | 78,721 | 42,668 | 118.3 |
| Philadelphia | 9,635 | 6,362 | –3,273 | –34.0 |
| Cleveland | 41,826 | 40,443 | –1,384 | –3.3 |
| Richmond | 14,688 | 12,928 | –1,760 | –12.0 |
| Atlanta | 27,276 | 38,114 | 10,837 | 39.7 |
| Chicago | 16,106 | 18,186 | 2,080 | 12.9 |
| St. Louis | 10,748 | 12,117 | 1,369 | 12.7 |
| Minneapolis | 45,438 | 5,787 | –39,651 | –87.3 |
| Kansas City | 6,879 | 7,398 | 519 | 7.5 |
| Dallas | 8,042 | 5,044 | –2,980 | –37.1 |
| San Francisco | 19,730 | 29,090 | 9,360 | 47.4 |
| **Total, all Districts** | **251,733** | **266,653** | **14,919** | **5.9** |
| Federal Reserve Automation Services | 33,004 | 44,146 | 11,142 | 33.8 |
| **Total** | **284,737** | **310,798** | **26,061** | **9.2** |

## *Table D.7*
## Budget Performance of the Federal Reserve Banks, Operating Expenses, by District, 1997

Thousands of dollars except as noted

| District | 1997 budget | 1997 estimate | Change | |
|---|---|---|---|---|
| | | | Amount | Percent |
| Boston | 132,180 | 138,391 | 6,211 | 4.7 |
| New York | 424,390 | 427,145 | 2,755 | .6 |
| Philadelphia | 103,765 | 104,088 | 323 | .3 |
| Cleveland | 119,852 | 120,747 | 894 | .7 |
| Richmond | 152,560 | 152,298 | –261 | –.2 |
| Atlanta | 184,192 | 185,665 | 1,474 | .8 |
| Chicago | 213,222 | 212,273 | –948 | –.4 |
| St. Louis | 96,901 | 99,095 | 2,194 | 2.3 |
| Minneapolis | 104,157 | 104,065 | –92 | –.1 |
| Kansas City | 124,917 | 125,880 | 964 | .8 |
| Dallas | 125,811 | 124,593 | –1,218 | –1.0 |
| San Francisco | 215,272 | 217,317 | 2,045 | .9 |
| **Total, all Districts** | **1,997,216** | **2,011,557** | **14,341** | **.7** |
| *Special project* | | | | |
| Automation Consolidation | 34,667 | 34,691 | 24 | .1 |
| **Total** | **2,031,883** | **2,046,248** | **14,365** | **.7** |

NOTE. Excludes capital outlays.

## *Table D.8*
## Budget Performance of the Federal Reserve Banks, Employment, by District, 1997

Average number of personnel except as noted[1]

| District | 1997 budget | 1997 estimate | Change | |
|---|---|---|---|---|
| | | | Amount | Percent |
| Boston | 1,241 | 1,231 | –10 | –.8 |
| New York | 4,067 | 4,129 | 62 | 1.5 |
| Philadelphia | 1,254 | 1,259 | 5 | .4 |
| Cleveland | 1,438 | 1,400 | –38 | –2.6 |
| Richmond | 2,078 | 2,074 | –4 | –.2 |
| Atlanta | 2,299 | 2,323 | 24 | 1.0 |
| Chicago | 2,244 | 2,187 | –57 | –2.5 |
| St. Louis | 1,210 | 1,196 | –14 | –1.1 |
| Minneapolis | 1,263 | 1,271 | 8 | .6 |
| Kansas City | 1,607 | 1,577 | –30 | –1.9 |
| Dallas | 1,545 | 1,527 | –18 | –1.1 |
| San Francisco | 2,463 | 2,498 | 35 | 1.4 |
| **Total, all Districts** | **22,709** | **22,672** | **–37** | **–.2** |
| Federal Reserve Automation Services | 549 | 549 | 0 | 0 |
| **Total** | **23,258** | **23,221** | **–37** | **–.2** |

1. See chapter 3, note 2, for definition of average number of personnel.

## *Table D.9*
## Operating Expenses of the Federal Reserve Banks, by Operational Area, 1993–98

Thousands of dollars except as noted

| Year | Monetary and economic policy | Services to the U.S. Treasury and other government agencies | Services to financial institutions and the public | Supervision and regulation | Total |
|---|---|---|---|---|---|
| 1993 | 114,617 | 193,621 | 1,076,914 | 326,334 | 1,711,486 |
| 1994 | 120,869 | 209,453 | 1,105,140 | 361,458 | 1,796,920 |
| 1995 | 128,303 | 216,790 | 1,127,320 | 392,294 | 1,864,707 |
| 1996 | 138,649 | 215,609 | 1,177,444 | 424,402 | 1,956,104 |
| 1997 estimate | 144,712 | 212,010 | 1,214,810 | 440,025 | 2,011,557 |
| 1998 budget | 152,699 | 220,939 | 1,226,243 | 454,791 | 2,054,672 |
| MEMO | | | | | |
| Average annual change (percent) | 5.9 | 2.7 | 2.6 | 6.9 | 3.7 |

NOTE. Excludes special project.

*Table D.10*

## Employment at the Federal Reserve Banks, by Operational Area, 1993–98

Average number of personnel except as noted[1]

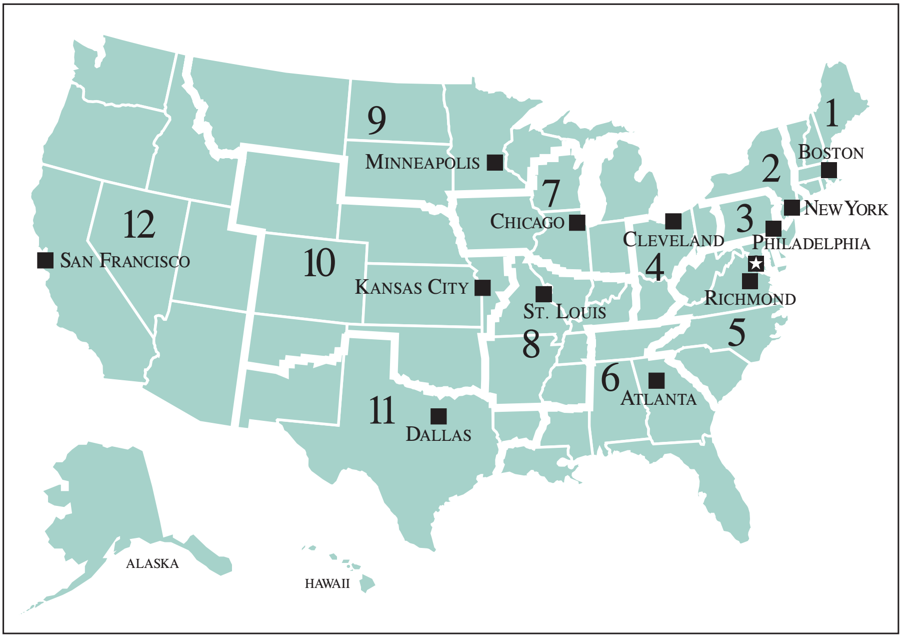
| Year | Monetary and economic policy | Services to the U.S. Treasury and other government agencies | Services to financial institutions and the public | Supervision and regulation | Support[2] | Overhead[2] | Total |
|---|---|---|---|---|---|---|---|
| 1993 | 751 | 1,780 | 8,609 | 2,910 | 4,762 | 5,182 | 23,995 |
| 1994 | 729 | 1,754 | 8,301 | 3,079 | 4,603 | 5,162 | 23,627 |
| 1995 | 737 | 1,683 | 8,209 | 3,073 | 4,511 | 4,949 | 23,162 |
| 1996 | 734 | 1,542 | 8,083 | 3,111 | 4,538 | 4,901 | 22,909 |
| 1997 estimate | 720 | 1,469 | 7,958 | 3,022 | 4,640 | 4,863 | 22,672 |
| 1998 budget | 724 | 1,397 | 7,773 | 2,953 | 4,535 | 4,773 | 22,156 |
| MEMO | | | | | | | |
| Average annual change (percent) | –.7 | –4.7 | –2.0 | .3 | –1.0 | –1.6 | –1.6 |

1. Excludes special project and Federal Reserve Automation Services. See chapter 3, note 2, for definition of average number of personnel.

2. See table D.3, note 1, for definition.

# *Maps of the Federal Reserve System*

# The Federal Reserve System




LEGEND

*Both pages*

- ■ Federal Reserve Bank city
- ✪ Board of Governors of the Federal Reserve System, Washington, D.C.

*Facing page*

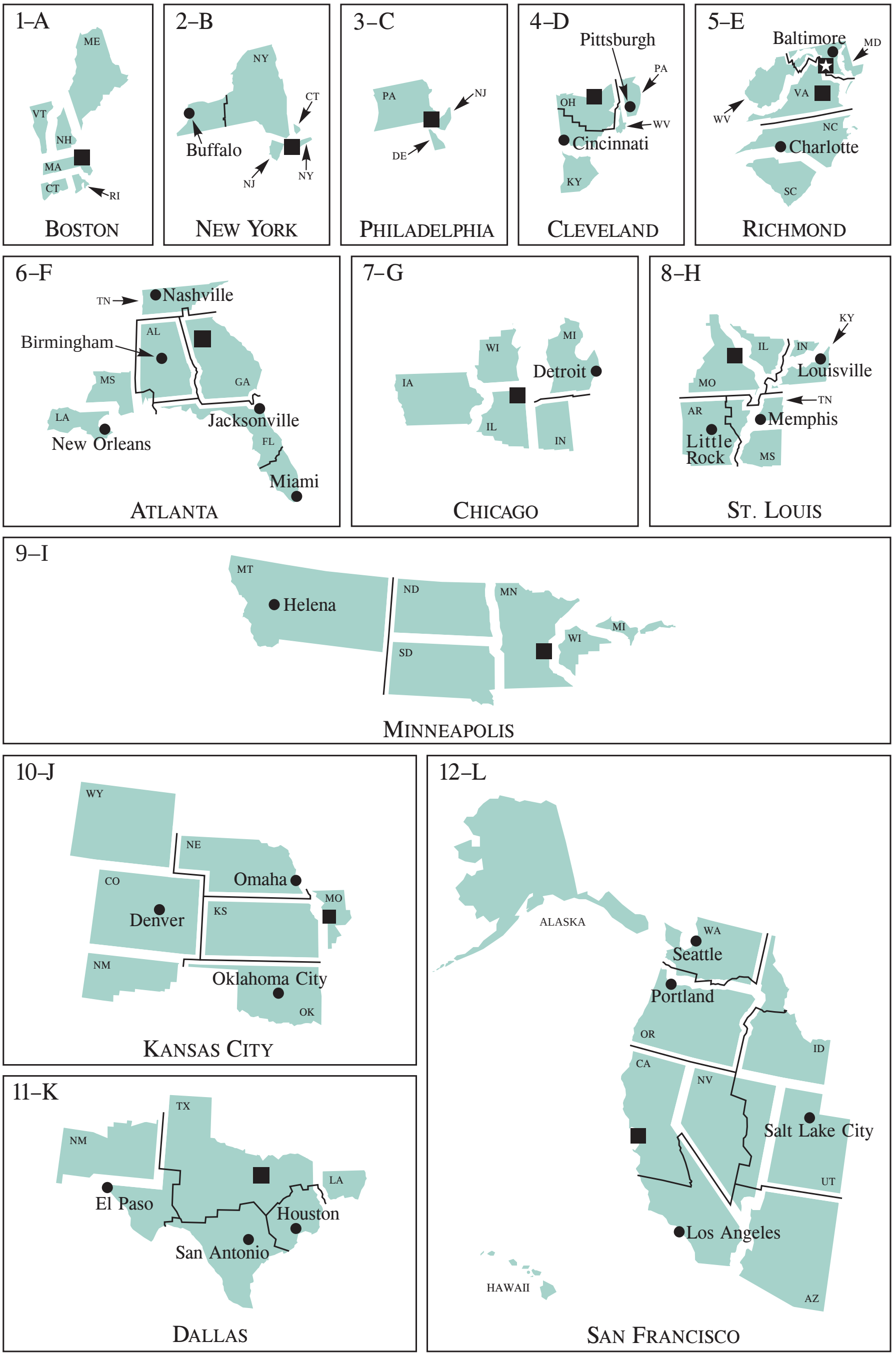
- • Federal Reserve Branch city
- — Branch boundary

NOTE

The Federal Reserve officially identifies Districts by number and Reserve Bank city (shown on both pages) and by letter (shown on the facing page).

In the 12th District, the Seattle Branch serves Alaska and the San Francisco Bank serves Hawaii.

The System serves commonwealths and territories as follows: The New York Bank serves the Commonwealth of Puerto Rico and the U.S. Virgin Islands; the San Francisco Bank serves American Samoa, Guam, and the Commonwealth of the Northern Mariana Islands. The maps show the boundaries within the System as of year-end 1997.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Baltimore
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VA
WV
NC
Charlotte
SC
Richmond
6–F
TN
Nashville
Birmingham
AL
GA
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Jacksonville
New Orleans
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Miami
Atlanta
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