

Annual Report: Budget Review

Board of Governors of the Federal Reserve System

2000

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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.

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 covered calendar years 1998 and 1999.

Given their current business needs, the Federal Reserve Banks will continue to maintain an annual budget cycle.

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 Coun-

cil. 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 that the nation's economy grows at a pace 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, financial holding companies (created under the Gramm–Leach–Bliley Act, enacted in November 1999), 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 payment 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 1999 Income and Expenditures

In carrying out its responsibilities in 1999, the Federal Reserve System incurred an estimated \$1.2 billion in net operating expenses. Total spending of an estimated \$2.4 billion was offset by an estimated \$1.2 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 \$28.2 billion in 1999. Earnings in excess of expenses, dividends, and surplus are transferred to the U.S. Treasury—in 1999 an estimated \$25.4 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 update the strategic plan for the next four years, and the second year is used to develop the budget for the next two years.

The two-year cycle begins in the fall (thus, for the 2000–01 budget, the fall 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 the appropriate 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 Committee on Board Affairs for final guidance, the Staff Planning Group updates the strategic plan, which is used to prepare a preliminary budget objective that identifies the level and allocation of resources needed to support the plan. The Committee on Board Affairs reviews the plan and preliminary budget objective, clarifies outstanding planning issues with the Staff Planning Group and division directors, and by summer of odd-numbered years submits the budget to the Board for its consideration. As part of this process, individual division budget objectives are prepared on the basis of Boardwide priorities and planning assumptions.

The divisions use the budget objective approved by the Board to complete their budgeting under the approved plan. The Board's Committee on Board Affairs, 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). Direct costs, such as those for salary, retirement, insurance, and travel are billed to the operational areas. Costs for data processing are also charged as a direct expense to each of the four areas according to actual usage (at prices derived from the cost of resources needed to provide the services

and 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 operations budget and a capital budget.

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.

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. As discussed more fully in chapter 2, the extraordinary items budget for 2000–01 consists of funds to support two periodic surveys, one on consumer finances and the other on small business finances, and some remaining century date change work.

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, also at an open meeting in November.

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 two 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 payment mechanism or in the Federal Reserve's ability to provide services.

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 also have a capital budget in addition to an operating budget and a special projects 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). 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

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 1999 the Federal Reserve conducted 517 examinations of state member banks and 1,427 inspections and 2,058 risk assessments of bank holding companies; it acted on 3,874 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 1999 the System conducted more than 495 compliance examinations, including 407 covering state member banks and 88 covering foreign banking organizations.

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 payment 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 receive deposits of currency and coin from depository institutions; and they identify counterfeits and destroy currency that is unfit for circulation. In 1999 the Reserve Banks received \$445.6 billion in currency and \$4.0 billion in coin from depository institutions, distributed \$554.6 billion in currency and \$5.8 billion in coin, and destroyed \$82.9 billion in unfit currency.

The Reserve Banks (along with their Branches and regional centers) also process checks for collection—approximately 18 billion commercial checks in 1999, with a total value of nearly \$15 trillion.

The Federal Reserve also plays a central role in the nation's payment mechanism through its wire funds transfer system, Fedwire. Through Fedwire, depository institutions can draw on their deposit accounts at the Reserve Banks and transfer funds anywhere in the country. In 1999, approximately

102.8 million transfers valued at about \$343 trillion were sent over the Fedwire funds transfer system, an average of \$3 million per transfer and \$1.4 trillion per day.

The Federal Reserve allows participants in private clearing arrangements to exchange and settle transactions on a net basis through deposit account balances. Users of net settlement services include check clearinghouse associations, automated clearinghouse (ACH) networks, credit card processors, automated teller machine networks, and national and regional funds transfer networks. The Reserve Banks provide settlement services to approximately 102 local and national private-sector clearing and settlement arrangements. In 1999 the Reserve Banks processed about 361,000 settlement entries for these arrangements.

The Federal Reserve currently processes settlement entries through one of three types of service: "settlement sheet"; Fedwire-based; and enhanced, which was introduced in March 1999. These services vary operationally and by timing of finality. The Reserve Banks will continue to offer the Fedwire-based settlement service. The settlement sheet service, however, will be phased out by year-end 2001, when all its participants must move to the enhanced service.¹

1. In the settlement sheet service, the settlement agent for a clearinghouse provides a settlement sheet to a Reserve Bank, which in turn posts net debit and credit entries to the accounts of the settling participants. The entries are provisional until the banking day after settlement.

In the Fedwire-based service, the clearinghouse uses a zero-balance settlement account to receive and send out Fedwire funds transfers to settle participants' obligations. These transfers are final when processed.

In the enhanced service, settlement files are submitted through a direct electronic connection with a Reserve Bank, and settlement is final on settlement day.

Approximately 27,700 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 1999 the Reserve Banks processed approximately 4.2 billion ACH transactions valued at about \$13.1 trillion; approximately 19 percent of the transactions were for the federal government, and the rest were for commercial establishments.

Reserve Banks provide securities services for the handling of book-entry (computer-based) securities and the physical collection of interest 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 1999 the Reserve Banks processed approximately 13.4 million securities transfers valued at \$179.5 trillion. The noncash collection service, through which maturing or called physical coupons and bonds are presented for collection, processed about 700,000 transactions in 1998 and about 600,000 transactions in 1999.

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

The Reserve Banks provide fiscal agency and depository services to the U.S. government. Through its deposit accounts at the Reserve Banks, the government issues checks, makes payments, and collects receipts. The Reserve Banks also process the government's Fedwire funds transfers and automated clearing-house payments and provide the Department of the Treasury with daily statements of account activity. Reserve Banks make claims on the Treasury and other government agencies for reimbursement

of the full cost of providing these services; reimbursement was received or is expected for all but a relatively small portion of the expenses claimed.

As fiscal agents, Reserve Banks provide the Treasury with services related to the federal debt. For example, Reserve Banks issue, service, and redeem marketable Treasury securities and savings bonds; they also process secondary market Fedwire securities transfers initiated by depository institutions.

The Reserve Banks operate two book-entry (computer-based) securities systems for the custody of Treasury securities—the Fedwire book-entry securities system and the Treasury Department's Treasury Direct. Almost all book-entry Treasury securities are maintained on Fedwire, which is also the nation's principal securities transfer mechanism; the remainder are maintained on Treasury Direct.

As depositories, Reserve Banks collect and disburse funds on behalf of the federal government. The Reserve Banks maintain the Treasury's funds account, accept deposits of federal taxes and fees, pay checks drawn on the Treasury's account, and make electronic payments on behalf of the Treasury. In 1999 the Treasury continued to encourage electronic payments to reduce payments made by check.

The Reserve Banks process the business tax payments received by the more than 10,000 depository institutions designated to perform this function. Institutions that receive the tax payments may place the funds in a Treasury tax and loan (TT&L) account or remit the funds to a Reserve Bank. The depository institutions place collateral with the Federal Reserve to secure TT&L deposits and other government deposits and investments.

The Reserve Banks also provide fiscal agency and depository services to other

domestic and international government agencies. Depending on the authority under which the services are provided, the Reserve Banks may maintain book-entry accounts of government agency securities; provide custody for the stock of unissued, definitive (physical) securities; maintain and update balances of outstanding book-entry and definitive securities for issuers; maintain funds accounts for government agencies; and provide various payment services, including the processing and destroying

of 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 2000, total operating expenses are budgeted at \$2,507.1 million, an increase from estimated 1999 expenses of 4.7 percent. Of this total, \$2,311.9 million is for the Reserve Banks, and \$195.2 million is for the Board of Governors (tables 1.1 and 1.2).¹ Revenue from priced services provided to depository institutions is expected to total \$925.5 million, or 36.9 percent of total budgeted operating expenses, resulting in net operating expenses of \$1,264.1 million.

Not included in the budget for operations are the expenses for a Reserve Bank special project, budgeted at \$14.0 million.² Also excluded is the cost of currency, budgeted at \$456.4 million for 2000, a decrease of 6.0 percent from the 1999 estimated cost of \$485.7 million.³ The distribution of expenses is similar to that in previous years, with the Reserve Bank's expenses

accounting for approximately three-fourths of the total (chart 1.1).

System employment (including staff for the special project) is budgeted at 25,408 for 2000, an increase of 269 from the estimated 1999 level (details are given in chapters 2 and 3.)

Net Expenses

The System expects to recover 49.6 percent of its budgeted 2000 operating expenses through revenue from priced services, other income, and claims for reimbursement. When these items are deducted from budgeted 2000 operating expenses, the net expenses of the System show an increase of 3.2 percent from estimated 1999 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 the long run, all direct and indirect costs of providing the services plus imputed costs, such as taxes that would

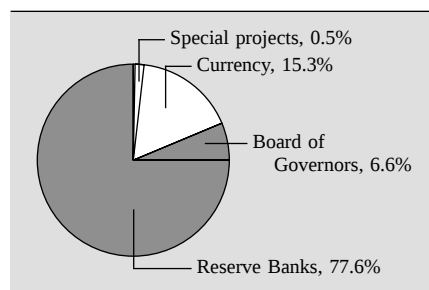
1. The Board of Governors now budgets on a two-year cycle (see chapter 2); in this chapter, 2000 values shown for the System and the Board reflect the approximate first-year effect of the Board's 2000–01 budget.

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 2000 concerns check-processing standardization and is described in chapter 3, in the section on services provided to depository institutions.

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.

Chart 1.1

Distribution of Expenses of the Federal Reserve System, 2000



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

have been paid and the return on capital that would have been earned had the services been provided by a private business. Table 1.3 provides details on projected revenue from priced services;

the constraints imposed on Federal Reserve budgets by the need to keep such services competitive and the calculation of fees are discussed in appendix A.

Table 1.1

Operating Expenses of the Federal Reserve System, Net of Receipts and Claims for Reimbursement, 1998–2000

Millions of dollars except as noted

Item	1998 actual	1999 estimate	2000 budget	Percentage change	
				1998 to 1999	1999 to 2000
Total System operating expenses	2,261.4	2,394.2	2,507.1	5.9	4.7
LESS					
Revenue from priced services	839.8	871.4	925.5	3.8	6.2
Other income	5.6	2.0	1.9	–64.3	–5.0
Claims for reimbursement ¹	223.7	296.1	315.6	32.4	6.6
EQUALS					
Net System operating expenses	1,192.3	1,224.7	1,264.1	2.7	3.2

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. Costs 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, 1998–2000

Millions of dollars except as noted

Entity and type of expense	1998 actual	1999 estimate	2000 budget	Percentage change	
				1998 to 1999	1999 to 2000
Reserve Banks ¹	2,075.3	2,198.6	2,311.9	5.9	5.2
Personnel	1,311.4	1,403.4	1,475.3	7.0	5.1
Nonpersonnel	763.9	795.2	836.6	4.1	5.2
Board of Governors ²	186.1	195.6	195.2	5.1	–.2
Personnel	130.0	133.1	139.6	2.4	4.9
Nonpersonnel	56.1	62.5	55.6	11.4	–11.0
Total System operating expenses	2,261.4	2,394.2	2,507.1	5.9	4.7
Personnel	1,441.4	1,536.5	1,614.9	6.6	5.1
Nonpersonnel	820.0	857.7	892.2	4.6	4.0
Special projects ³	3.8	.0	14.0	...	...
Currency ⁴	408.3	485.7	456.4	19.0	–6.0

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).

3. See text note 2.

4. See text note 3.

Table 1.3

Revenue from Priced Services, 1998–2000

Millions of dollars

Service	1998 actual	1999 estimate	2000 budget
Funds transfers and net settlement	94.5	70.7	65.9
Automated clearinghouse .	68.4	68.6	70.4
Commercial checks	651.8	708.9	768.0
Book-entry securities transfers	18.8	17.4	17.0
Noncash collection	3.6	3.0	2.0
Special cash services	2.7	2.9	2.1
Total	839.8	871.4	925.5

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

Claims for reimbursement are the expenses Reserve Banks incur in providing fiscal agency services to the Treasury and other government agencies.

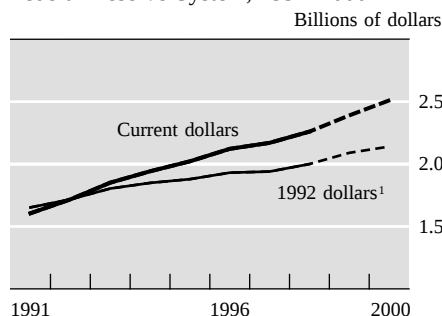
Sources and uses of funds are presented in appendix B and the audits of the System are listed in appendix C.

Trends in Expenses and Employment

From actual 1991 levels to budgeted 2000 amounts, the operating expenses of the Federal Reserve System (excluding special projects) have increased an average of 5.1 percent per year (2.9 percent per year when adjusted for inflation) (chart 1.2). Since 1991 the cumulative change for total System expenditures (including special projects) has been 56.4 percent, or an average of 5.1 percent per year (chart 1.3); over the same period, nondefense discretionary spending by the federal government has

Chart 1.2

Operating Expenses of the Federal Reserve System, 1991–2000



NOTE. For 1999, estimate; for 2000, budget (see also text note 1).

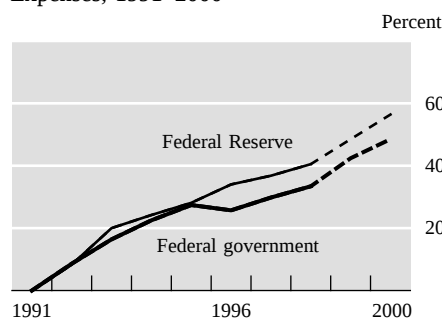
1. Calculated with the GDP price deflator.

shown cumulative growth of 48.5 percent, or an annual average of 4.5 percent. Over the 1991–2000 period, Federal Reserve System employment has increased 297, or 0.1 percent (chart 1.4).

From 1991 through 2000, Federal Reserve System expenses have included numerous major initiatives to support its responsibilities. To maintain and improve the nation’s payment mechanism, the System has upgraded check and cash-

Chart 1.3

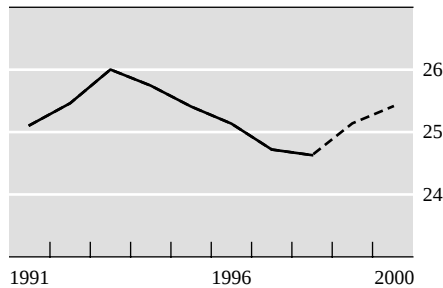
Cumulative Change in Federal Reserve System Expenses and Federal Government Expenses, 1991–2000



NOTE. Federal Reserve System expenses 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, 1991–2000
Thousands of persons



NOTE. Includes special projects. See also general note to chart 1.2.

processing equipment; led efforts—such as check image processing—to convert paper items to electronics; and implemented same-day settlement requirements.

The System played a major role in ensuring that the financial arena was prepared for the century date change event. Since 1991, funds have been devoted to maintaining the safety and soundness of financial institutions by expanding efforts in the supervision and regulation area. Funding has also been provided in this area to carry out legislative directives such as the Community Reinvestment Act and the Federal Deposit Insurance Corporation Improvement Act.

Across all areas, the System has upgraded its facilities and enhanced its automation capabilities, including the installation of the Fednet communications network and upgrades to local area networks and personal computers.

Expense growth over the past decade largely reflects costs necessary to centralize functions, such as the regionalization of various Treasury operations and the centralization of data processing and

communications at the Federal Reserve Information Technology office. Returns on these investments made during the past ten years and the reengineering efforts within each Reserve Bank are evident in the Federal Reserve System's moderate expense growth over the period. Total employment levels, which declined steadily from 1994 through 1998, also reflect these efforts.

Operational Areas

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.

2000 Budget Initiatives

Several major initiatives that affect System budgets will continue or begin in 2000:

- Installation of equipment and software to support the standardization of check processing, the image processing and archiving of commercial checks, and electronic access and delivery
- Consolidation of Treasury Direct and Treasury Tax and Loan processing
- Facilities repair and maintenance.

Partly offsetting the greater expenditures associated with these initiatives are the lower costs associated with staff reductions, which were made possible by several reengineering initiatives and programs to increase efficiency in Federal Reserve operations.

Table 1.4

Operating Expenses of the Federal Reserve System, by Operational Area, 1998–2000

Millions of dollars except as noted

Operational area and entity	1998 actual	1999 estimate	2000 budget	Percentage change	
				1998 to 1999	1999 to 2000
Monetary and economic policy	251.7	267.9	276.7	6.4	3.3
Reserve Banks	152.6	167.0	176.9	9.5	5.9
Board of Governors	99.1	100.9	99.8	1.8	–1.1
Services to the U.S. Treasury and other government agencies ¹	223.4	223.0	241.3	–.2	8.2
Services to financial institutions and the public	1,251.5	1,332.7	1,389.8	6.5	4.3
Reserve Banks	1,247.4	1,327.7	1,385.0	6.4	4.3
Board of Governors	4.1	4.9	4.9	19.7	–1.3
Supervision and regulation	534.7	570.6	599.4	6.7	5.0
Reserve Banks	451.9	480.8	508.8	6.4	5.8
Board of Governors	82.8	89.8	90.6	8.4	.9
Total	2,261.3	2,394.2	2,507.2	5.9	4.7
Reserve Banks	2,075.3	2,198.6	2,311.9	5.9	5.2
Board of Governors ²	186.1	195.6	195.2	5.1	–.2

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.

Chapter 2

Board of Governors

The 2000–01 budget for the Board of Governors provides \$387.6 million for operations, \$7.8 million for extraordinary items (projects of a unique nature), and \$6.6 million for the Office of Inspector General. The Board has authorized 1,705 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 1,734 positions is a decrease of 16 positions from the number authorized at the end of 1999.

Overview of the Budget Process

On a biennial basis, the Board and its staff undertake a process that includes strategic planning for the next four years and formulation of a budget for the next two years. For the 2000–03 planning period and the 2000–01 budget period, the Board-level Committee on Board Affairs, assisted by a senior-level Staff Planning Group (SPG), guided the process.

Each division director, working with his or her oversight committee, examined the division's operations to see how the mission, organization, and resources needed to be adjusted to enable the Board to carry out its mission more efficiently and effectively. The process reaffirmed the Board's mission, readjusted priorities to accomplish the mission, and identified lower-priority work that could be eliminated to fund some of the needed programmatic increases.

Planning

The planning materials prepared by the division directors were reviewed by the SPG. Beyond the Board's mission and goals, which remain unchanged, six main, or overarching, issues were identified and used in shaping resource decisions reflected in the recommended budget objective approved by the Committee on Board Affairs and the Board:

- Human resources and Board organization: These critical areas affect operations through compensation that attracts, rewards, and retains staff; management succession; professional development; and coordination of employee skills to stay abreast of the growing complexity of operations and improvements in technology
- Financial industry restructuring: The Board must focus its response to changing circumstances in the financial industry, the increasing concentration of financial institutions, and the growing importance of international financial activity to the Board's mission¹
- Assistance and support to foreign governments, central banks, and international organizations: These activities continue to grow in importance, requiring a greater commitment of resources and making heavier

1. Because of the uncertain nature of the outcome at the time the budget was prepared, no major adjustments were included for financial reform legislation.

demands on the time of key staff members

- Technology investments: Up-to-date and fully functioning technology remains critical to maintaining efficient operations, implementing appropriate monetary policy decisions in an increasingly complex environment, and identifying supervisory risks in the financial sector and the actions needed to limit them
- Communications with the public: The Board must take advantage of technology, particularly the web, to provide materials to the public that explain Board actions, policies, and objectives, and to provide available data useful for research and public policy debates
- Facilities: The Board must maintain safe facilities that foster efficient operations; continue necessary repairs to the Eccles Building, which is now more than sixty years old; and devise a strategy to reduce the long-term cost of space for the staff.

In the course of planning, divisions identified areas in which they anticipated the need for increased resources over the next four years. Though many areas for investment were worthwhile, the Committee on Board Affairs focused on initiatives related to the above overarching issues. For example, nearly three-fourths of the budget increment is for human resources issues such as a larger pool for cash awards; a placeholder for the 2000 and 2001 merit increases, promotions and other salary adjustments; a reduced number of vacant positions; and increased training.

Board Operations

The budget reflects difficult decisions affecting current operations, provides

additional resources where operations need to respond to changes in the financial environment, and supports key efforts to continue to attract and retain the first-rate staff needed to accomplish the Board's mission.

The budget reflects continued pressure to keep pace with rapid and significant changes in the national economy and the world financial system. Technological change, which increases the risks to the economy and provides the tools to understand and limit those risks, is profoundly affecting the skills required of staff members, the automation and communication systems, and the workload of the Board. The budget also reflects the Board's efforts to ensure that consumers are treated fairly as the financial system changes and to improve the efficiency of Reserve Bank oversight.

These changes require additional resources; hence, the two-year budget increase averages 4.9 percent per year. The increase is largely for personnel costs, which account for nearly three-fourths of the Board's operating budget, and investments in technology such as the Banking Organization National Desktop (BOND) project.

Extraordinary Items

Inclusion of certain periodic or one-time expenses in the Board's operations budget can result in undue volatility in the size of the budget. Therefore, funds for such extraordinary items are set apart from the operations budget. For 2000–01, \$7.8 million in operating funds has been budgeted for three extraordinary items: two major economic surveys and final reports and closeout efforts to modify or replace software to ensure continuity of operations after the century-date change (CDC). Because the CDC efforts decreased sharply in the 2000–01 period, this budget is approximately

\$15.2 million less than in the current period.

Office of Inspector General

The 2000–01 budget of \$6.6 million for the Office of Inspector General (OIG) is separate from the Board's. The OIG's budget is prepared in a manner that is administratively consistent with the preparation of the Board's operating budget. 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.

Highlights of the Budget

The 2000–01 budget represents an increase of \$35.4 million over the 1998–99 approved operating plan, an average increase of 4.9 percent per year (table 2.1). The discussion below highlights the major components of this increase as well as the primary offsetting decreases.

The largest force driving the increase in the budget is personnel related. The total number of positions decreased by sixteen from the current period (table 2.2); however, positions eliminated by technology improvements tend to

Table 2.1

Operating Expenses of the Board of Governors, by Division, Office, or Special Account, 1998–99 to 2000–01

Thousands of dollars except as noted

Division, office, or special account	1998–99 estimate ¹	2000–01 budget	Change	
			Amount	Percent
Board Members	8,793	8,466	–327	–3.7
Secretary	8,709	9,391	682	7.8
Research and Statistics	58,446	60,318	1,872	3.2
International Finance	21,065	22,712	1,648	7.8
Monetary Affairs	18,395	19,871	1,477	8.0
Banking Supervision and Regulation	55,939	58,710	2,771	5.0
Consumer and Community Affairs	15,597	17,770	2,172	13.9
Legal	16,578	17,597	1,019	6.1
Reserve Bank Operations and Payment Systems	31,090	33,453	2,362	7.6
Staff Director for Management	1,439	709	–730	–50.7
Management	18,819	21,491	2,672	14.2
Support Services	54,801	58,354	3,533	6.5
Information Technology (IT)	69,551	78,066	8,515	12.2
Publications Committee	2,733	3,059	326	11.9
Special projects	9,675	18,013	8,338	86.2
IRM income account ²	–39,375	–40,368	–993	2.5
Total, Board operations	352,254	387,611	35,357	10.0³
Extraordinary items	23,010	7,847	. . .	. . .
Office of Inspector General	6,419	6,578	159	2.5

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

1. For 1998, actual; for 1999, the remainder of the 1998–99 operating plan.

2. Income from various Board divisions for use of central information resources management (IRM) resources.

3. Average annual change from 1999 to 2001 is 4.9 percent for Board operations and 1.2 percent for the Office of Inspector General.

. . . Not applicable.

be less costly than those added to meet the changes outlined in the overarching issues. The placeholder amounts included in the budget for merit increases are significantly higher than the placeholders for the current biennium (4.4 percent and 4.0 percent in 2000 and 2001 respectively, compared with 3.8 percent and 3.5 percent in 1998 and 1999 respectively).² The larger amounts are in recognition of the need to keep the Board's salary structure aligned with appropriate labor markets.

2. The actual merit increases in 1998 and 1999 were 3.8 percent and 4.2 percent respectively. Savings from a larger number of vacant positions offset the added cost of the higher merit payments.

Higher grade levels are also affecting personnel costs. The higher grade levels reflect the market salaries for skills needed for more complex operations and special salary adjustments for critical professionals, such as financial economists. These increases also affect the benefit-related expenses that are tied to salary levels, such as the thrift plan and social security.

Finally, a portion of the increase comes from a one-time saving in 1999 from the buyout of the retiree health insurance plan and the transfer of the affected individuals' coverage to the Federal Employees Health Benefit Program.

In sum, increased spending on personnel services, including higher compen-

Table 2.2

Positions Authorized at the Board of Governors, by Division, Office, or Special Account, 1998–99 to 2000–01

Division, office, or special account	1998–99 authorized	2000–01 budget	Change
Board Members	34	34	0
Secretary	56	56	0
Research and Statistics	276	278	2
International Finance	115	119	4
Monetary Affairs	65	65	0
Banking Supervision and Regulation	224	220	–4
Consumer and Community Affairs	77	78	1
Legal	82	82	0
Reserve Bank Operations and Payment Systems	134	134	0
Staff Director for Management	2	2	0
Management	89	87	–2
Concern ¹	31	31	0
Support Services	231	213	–18
Information Technology (IT)	279	278	–1
Special projects	1	3	2
Subtotal	1,696	1,680	–16
Reimbursable IT support ²	25	25	0
Total, Board operations	1,721	1,705	–16
Office of Inspector General	29	29	0

1. EEO Concern (summer intern and youth) positions handled by the Management Division.

2. Positions in the Division of Information Technology 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.

sation packages designed to attract and retain highly skilled staff, account for \$25.9 million, or 73.3 percent, of the total budget increase.

The increase in the cost of goods and services, \$9.4 million, is largely due to increased operational expenses related to a number of projects. First, an additional \$3.0 million, or 8.5 percent of the total increase, funds further implementation of the BOND project. Second, rental expenses associated with the Eccles Building Infrastructure Enhancement project account for \$1.3 million, or 3.7 percent, of the overall increase. Finally, contractual expenses largely related to the pent-up demand for information technology services, restrained by Year 2000 policy decisions and the priority assigned to software remediation activities, are requiring an additional \$4.8 million. The remainder of the increase is associated with rate and volume adjustments.

Two major areas of budget decrease are in programs and depreciation. Program reductions worth \$2.2 million will allow added investment to support the overarching issues identified in planning. Depreciation expense declined \$2.9 million because of the change in the Board's capitalization policy that took effect on January 1, 1998. Other, smaller decreases come from changes in operations. For example, mailing costs are declining because of an improved ability to disseminate information to constituent groups through electronic distribution of documents and expansion of the Board's web site.

Risk Areas

Division directors identified items that could require significant additional resources during the 2000–01 period. These items are as follows:

- Passage of a financial modernization bill
- Some job families in which current compensation packages do not seem to be competitive in the job market
- Possible changes to the position vacancy rates used in developing the proposed salary budget and the resulting facility requirements should staffing patterns change
- A sharp increase in the rate of financial innovation.

Operations Budget by Division and Account Classification

The largest increase in the 2000–01 budget is in the area of personnel services (table 2.3). The budget for personnel services (salaries, retirement, and insurance) is \$25.9 million greater than the 1998–99 budget (an average increase of 4.9 percent per year). As the number of authorized positions is actually declining by sixteen during this period, this dollar increase is due to higher compensation levels necessary to attract and retain highly skilled staff members and a projected reduction in the number of vacant positions (table 2.2).

The 2000–01 budget for goods and services is \$9.4 million greater than the 1998–99 budget (also an average increase of 4.9 percent per year). Much of the increase in the area of goods and services is attributable to a \$4.8 million (9.8 percent per year) increase in contractual professional services associated with outsourcing the cafeteria services, purchasing additional economic data, providing technical assistance with the Daylight Overdraft Reporting and Pricing System, and obtaining contractual support for various information technology initiatives. Increases in programming efforts on the BOND project account for \$3.0 million.

Table 2.3

Operating Expenses of the Board of Governors, by Account Classification,
1990–91 to 2000–01

Thousands of dollars except as noted

Account classification	1990–91	1992–93	1994–95	1996–97
<i>Personnel services</i>				
Salaries	143,130	169,265	190,210	211,005
Retirement	9,662	13,366	15,564	18,015
Insurance	11,429	14,407	16,862	19,196
Subtotal	164,222	197,039	222,637	248,215
<i>Goods and services</i>				
Travel	6,864	8,453	9,399	9,391
Postage and shipping	2,347	2,327	2,483	2,261
Telecommunications	3,364	3,665	4,168	4,367
Printing and binding	2,238	2,237	2,866	2,829
Publications	406	2,212	2,976	2,544
Stationery and supplies	1,668	1,635	1,755	1,756
Software	4,529	5,615	6,453	7,865
Furniture and equipment	1,521	2,442	2,497	2,568
Rentals	–282	3,156	7,202	8,648
Books and subscriptions	1,187	1,451	1,913	1,904
Utilities	3,388	3,683	4,145	3,995
Building repairs and alterations	1,945	3,402	3,273	2,996
Furniture and equipment repairs and maintenance	3,734	4,072	4,198	3,285
Contingency Processing Center	427	465	206	0
Contractual professional services	5,355	9,666	13,797	19,438
Tuition, registration, and membership fees ...	1,273	1,823	2,394	2,311
Subsidies and contributions	1,168	1,504	1,433	1,299
Depreciation	11,489	12,574	14,347	17,683
Other	–4,635	–8,309	–16,175	–18,502
Subtotal	47,986	62,074	69,330	76,638
Total, Board operations	212,208	259,113	291,967	324,853
Extraordinary items	0	0	0	4,196
Office of Inspector General	227	780	239	5,975

Partially offsetting these increases are program reductions in various areas throughout the Board. These include specialized activities in the Division of Banking Supervision and Regulation, cafeteria services, streamlined operations in the Management Division, attrition in the Office of the Secretary, and administrative reductions in the Division of Information Technology (table 2.1).

Savings in support-related areas include a reduction in postage and shipping expenses due to increased use of the Internet and intranet for information sharing, lower depreciation costs

following the 1998 raising of the capitalization threshold, and increased income from other government agencies and Reserve Banks for information technology services.

Operations Budget by Operational Area

The Board's operations budget supports four broadly defined areas of operation: monetary and economic policy, supervision and regulation, services to financial institutions and the public, and System policy direction and oversight (tables 2.4 and 2.5).

Table 2.3
Continued

Thousands of dollars except as noted

Account classification	1998–99 estimate	2000–01 budget	Average annual change (percent)	
			1998–2001	1990–2001
<i>Personnel services</i>				
Salaries	224,267	246,103	4.8	5.6 ¹
Retirement	19,204	21,147	4.9	8.1
Insurance	14,313	16,444	7.2	3.7
Subtotal	257,784	283,694	4.9	5.6
<i>Goods and services</i>				
Travel	10,477	11,194	3.4	5.0
Postal and shipping	2,106	1,716	–9.7	–3.1
Telecommunications	5,484	6,164	6.0	6.2
Printing and binding	2,281	2,608	6.9	1.5 ¹
Publications	2,817	2,297	–9.7	... ¹
Stationery and supplies	1,972	2,062	2.3	2.1 ¹
Software	10,419	10,521	.5	8.8
Furniture and equipment	8,111	8,632	3.2	19.0 ²
Rentals	8,986	10,422	7.7	... ¹
Books and subscriptions	1,954	2,109	3.9	5.9
Utilities	4,418	4,619	2.2	3.1
Building repairs and alterations	3,145	3,635	7.5	6.5
Furniture and equipment repairs and maintenance	3,708	4,273	7.4	1.4
Contingency Processing Center	200	0	...	...
Contractual professional services	23,345	28,145	9.8	18.0
Tuition/registration and membership fees	3,000	3,412	6.6	10.4
Subsidies and contributions	1,418	1,482	2.2	2.4
Depreciation	20,865	17,939	–7.3	4.6
Other	20,234	17,312	–7.5	14.1
Subtotal	94,470	103,917	4.9	8.0
Total, Board operations	352,254	387,611	4.9	6.2
Extraordinary items	23,010	7,847	...	...
Office of Inspector General	6,419	6,758	1.2	40.0

1. 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 1990–2001 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 1990–2001 change meaningless.

2. Beginning in 1998 the threshold 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.

Monetary and Economic Policy

The 2000–01 budget for monetary and economic policy is \$163.9 million, an increase of \$12.2 million, or an average of 4.0 percent per year more than the 1998–99 operating plan. Activities in this operational area include the Board’s

monitoring and analysis of developments in the money and credit markets, the setting of reserve requirements, the approval of changes in the discount rate, and other activities related to managing the nation’s monetary policy. The entire increase is associated with higher costs of personnel, including the addi-

tion of four positions in the Division of International Finance to meet the expanding need for risk assessment and analysis.

Beyond the increase tied to personnel services are initiatives in the Division of Research and Statistics to collect more

data related to developments in financial markets; gain a better understanding of embodied technological change; expand the sectoral productivity database; and further assess credit bureau data. These initiatives are all funded by reductions, primarily in automation support.

Table 2.4

Expenses of the Board of Governors for Operational Areas, Extraordinary Items, and Office of Inspector General, 1998–99 to 2000–01

Thousands of dollars except as noted

Activity	1998–99 estimated	2000–01 budget	Change	
			Amount	Percent
Monetary and economic policy	151,633	163,878	12,245	8.1
Supervision and regulation	129,622	148,864	19,242	14.8
Services to financial institutions and the public	6,811	7,907	1,096	16.1
System policy direction and oversight	64,187	66,962	2,775	4.3
Total, Board operations	352,253	387,611	35,358	10.0
Extraordinary items	23,010	7,847	...	...
Office of Inspector General	6,419	6,578	159	2.5

NOTE. See notes to table 2.1.

... Not applicable.

Table 2.5

Positions Authorized at the Board of Governors for Operational Areas, Support and Overhead, and Office of Inspector General, 1998–99 to 2000–01

Activity	1998–99 estimate	2000–01 budget	Change
Monetary and economic policy	426	432	6
Supervision and regulation	384	381	–3
Services to financial institutions and the public ..	22	22	0
System policy direction and oversight	173	173	0
Support and overhead	691	672 ¹	–19
Subtotal	1,696	1,680	–16
Reimbursable IT support ²	25	25	0
Total, Board operations	1,721	1,705	–16
Office of Inspector General	29	29	0

1. Includes positions for 17 youth, 10 worker trainees, and 4 summer interns.

2. Positions in the Division of Information Technology 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.

Supervision and Regulation

The 2000–01 budget for supervision and regulation is \$148.9 million, an increase of \$19.2 million, or an average of 7.2 percent per year more than the 1998–99 operating plan. Activities in this area include working with other federal and state financial authorities to ensure safety and soundness in the operation of financial institutions, stability in the financial markets, and fair and equitable treatment of consumers in their financial transactions. The budget, as described below, enhances supervisory activities such as continuous monitoring, inspection, and examination of banking organizations to assess their condition and their compliance with relevant laws and regulations.

The percentage increase for this operational area is greater than the percentage for the overall budget. Besides the normal factors affecting compensation in each of the operational areas, new work approved in the current budget period, such as the BOND project in the Division of Banking Supervision and Regulation, is having a significant effect. The processing of applications will be enhanced through investment in the Application Information System.

This operational area has also been successful in filling many positions that were vacant for long periods in 1998 following the voluntary retirement incentive program. It has been able to do so in part because of compensation adjustments within key job families to improve retention and assist with recruiting. Thus, in the Division of Banking Supervision and Regulation, the vacancy rate has decreased. The number of positions in the Consumer Affairs area has increased, and the investment in software to better analyze data gathered under the Community Reinvestment Act and the

Home Mortgage Disclosure Act continues to be substantial.

Services to Financial Institutions and the Public

The 2000–01 budget for oversight of Reserve Bank services to financial institutions and the public is \$7.9 million, an increase of \$1.1 million, or an average of 7.7 percent a year more than the 1998–99 operating plan. This operational area provides support to, and oversight of, the Federal Reserve Banks and Branches—specifically, evaluation of the operational and pricing performance for the check-payment activities of the Reserve Banks; oversight of the electronic payments mechanism; and annual evaluation of the Federal Reserve System’s currency, coin, and food coupon operations. The increase reflects new software development for managing the currency operations and a lower projected rate of vacancies in key programs analyzing payment system risk.

System Policy Direction and Oversight

The 2000–01 budget for System policy direction and oversight is \$67.0 million, an increase of \$2.8 million, or an average of 2.1 percent per year more than the 1998–99 operating plan. This operational area covers oversight and direction of Board and Reserve Bank programs. It includes programs that directly support Board members in carrying out their oversight function for Reserve Bank operations, budgeting and accounting, financial examinations, audit and operations reviews, and automation and communications. Salary increases are the largest single factor in the higher costs of this area, which are tempered by

lower costs associated with changes in oversight policy.

Capital Budget

The Board's 2000–01 capital budget is \$23.8 million, an increase of \$3.8 million from the 1998–99 operating plan. Of this total, \$12.0 million is for regular operations, an increase of \$0.4 million above the 1998–99 level. This portion of the budget supports continued improvements in office automation and major upgrades to the information infrastructure, including a major cable upgrade to enhance bandwidth and communication speeds. Funds are also provided for the restoration of aging facilities such as restrooms; mail distribution and central file storage systems; heating, ventilation, and air conditioning systems; and other, smaller facilities projects.

The remaining \$11.8 million is for continuation of the Eccles Building Infrastructure Enhancement Project. The \$3.4 million increase over expenditures in 1998–99 is due to the phased nature of the project, which began in July 1999. The project, which is extending the building's useful life, enhancing fire safety systems, replacing piping and voice and data cabling, and making other related repairs, is scheduled for completion in 2002.

Positions

The overall position authorization for the Board decreased by 16, primarily in overhead and support areas, from the approved 1998–99 budget, to a total of 1,705 positions.

Reductions in support-related areas include a significant number in Support Services due to faster-than-anticipated consolidation of the duplicating, publications, and cafeteria functions, reflecting reorganizations and changes in business

practices to increase efficiency. Reductions are projected for the Division of Information Technology and the Management Division as part of their planning initiatives to increase efficiency and effectiveness. Finally, reductions in the Division of Banking Supervision and Regulation have been proposed to accommodate shifting priorities.

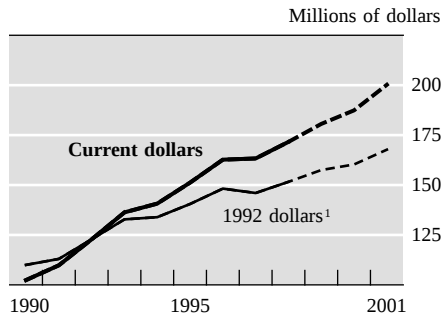
These decreases are partially offset by an increase of seven positions in the core mission areas. Two positions have been added in the Division of Research and Statistics to expand its analysis of financial markets data and to continue development of a sectoral productivity database. Four economist positions have been added in the Division of International Finance to meet the expanding need for risk assessment and analysis in the monetary policy and research areas to enable the Board to keep current on the rapid changes in the financial industry both domestically and abroad. An analyst position has been added in the Division of Consumer and Community Affairs to handle a growing volume of consumer complaints and a shift to a more risk-focused approach to consumer compliance examinations.

Trends in Expenses and Employment

The rate of increase in the 2000–01 budget, 4.9 percent on an annual basis, is slightly higher than the 4.1 percent rate in the 1998–99 biennium. The projected annual rate of increase over the 1990–91 to 2000–01 period averages 6.2 percent (table 2.3; see also charts 2.1–2.5). The main cause of the larger increase over the entire period is the net increase in positions, higher salary and benefit costs, and an increasingly sophisticated automation system required to manage a sharp increase in the volume and complexity of the Board's

Chart 2.1

Operating Expenses of the Board of Governors, 1990–2001



Year	Millions of dollars	
	Current dollars	1992 dollars ¹
1990	102.4	110.0
1991	109.8	113.0
1992	122.8	122.8
1993	136.3	132.8
1994	140.7	133.9
1995	151.2	140.5
1996	162.7	148.2
1997	163.3	146.0
1998	171.6	151.6
1999	180.6	157.5
2000	187.4	160.3
2001	200.2	167.7

NOTE. For 1999, estimate; for 2000–01, budget. Excludes the Office of Inspector General and extraordinary items. The annual values for 1998–99 and 2000–01 are the approximate calendar-year effects of the respective two-year budgets.

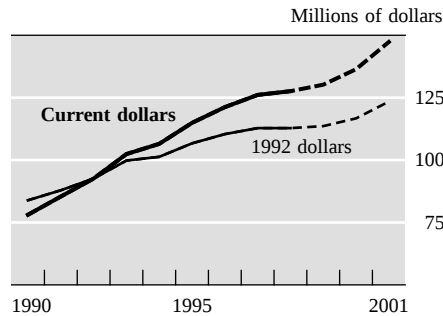
1. Calculated with the GDP price deflator.

workload. The higher increase from the last budget results from a larger merit component (4.4 percent for 2000 versus 3.5 percent for 1999), major software development costs for the supervision and regulation function, and a smaller volume of savings from administrative actions and programmatic reductions.

Approximately three-fourths of the Board's operating expenses are for personnel; consequently, analysis of trends is heavily tied to staffing levels. From 1990 to 2001, the number of authorized positions for Board opera-

Chart 2.2

Expenses for Personnel Services at the Board of Governors, 1990–2001



NOTE. See notes to chart 2.1.

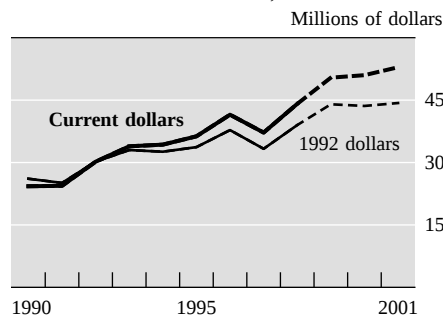
tions rose from 1,570 to 1,705, a net increase of 135, or 8.6 percent.

Automation changes to provide sophisticated analytical tools to staff members, manage larger data sets, and provide information to the public over the Board's web site required a net increase of 32 positions over the 1990–2001 period. Automation—accompanied by a decline in clerical tasks and a sharp increase in positions requiring higher technical and analytical skills—also resulted in major changes in the composition of the Board's staff.

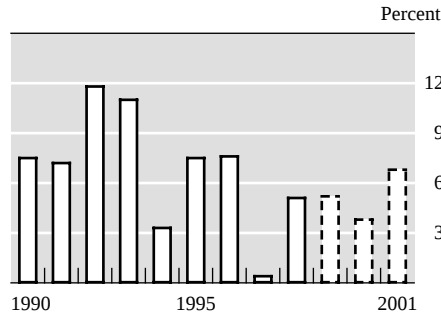
Changes in banking, frequently associated with automation enhancements,

Chart 2.3

Expenses for Goods and Services at the Board of Governors, 1990–2001



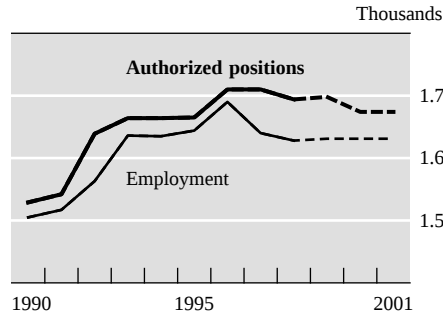
NOTE. See notes to chart 2.1.

Chart 2.4Annual Change in Operating Expenses
of the Board of Governors, 1990–2001

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

increased the complexity of safety and soundness activities and caused an increase of 51 positions over the period. Increased attention to consumer issues, including collection and analysis of data collected under the Home Mortgage Disclosure Act and Community Reinvestment Act, added 35 positions. Increasing complexity of monetary policy issues resulted in an increase of 34 positions. Oversight of Reserve Bank operations became more complex resulting in an increase 12 positions. These increases were partially offset by a decline of 29 administrative and support positions resulting from capital investments, improved efficiency, and outsourcing.

While the number of positions at the Board has fluctuated during the 1990 to 2001 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 decreased approximately 1 percentage point over the period as a result of administrative actions to limit these costs for health insurance and other benefits.

Chart 2.5Employment and Authorized Positions
at the Board of Governors, 1990–2001

Year	Employment	Authorized positions
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	1,628	1,694
1999	1,631	1,698
2000	1,631	1,674
2001	1,631	1,674

NOTE. Year-end data. Excludes summer intern and youth positions as well as positions for the Office of Inspector General. These positions number 60 for 2000 and 2001. Includes 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.

Extraordinary Items

The Board's extraordinary items budget provides \$7.8 million for three projects. The first, a survey of consumer finances (\$5.5 million), will provide financial data for various policy analysis and monetary policy purposes. This effort reflects the Board's interest in improving the quality of economic data by obtaining information on the income, assets, debts, pensions, employment, use of financial services, savings behavior,

and other characteristics of U.S. households. Cross-categorization of the data will allow important statistical observations useful in a wide variety of economic studies.

The second project is the completion of a survey of small business finances (NSSBF), begun in 1999 for data as of year-end 1998 (\$1.2 million). The purpose of the survey is to gather data from small businesses on their financial relationships, credit experiences, lending terms and conditions, income and balance sheet information, location and types of financial institutions used, and other firm characteristics. The NSSBF is used in analyzing the competitive effect of bank mergers, in benchmarking other data series (such as the noncorporate sector of the flow-of-funds statistics), and in writing the quinquennial small

business report mandated by section 227 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996. It is also used for research and policy analysis of a wide variety of issues in small business finances.

Last, the extraordinary items budget provides \$1.2 million to complete bringing the Board's software into compliance with the century date change. These funds are for completion of system monitoring over the leap year day (February 29); work related to the event management activities in January; and decommissioning test facilities and equipment that are no longer needed. Over the past three years, funds for this project, which have totaled \$17.6 million, have been used to remediate, test, and implement Year 2000 versions of the Board's information systems. ■

Chapter 3

Federal Reserve Banks

The final budgets of the twelve Reserve Banks for 2000 total \$2,325.9 million, an increase of \$127.3 million, or 5.8 percent, from 1999 estimated expenses.¹ When the cost of the check standardization special project is excluded from the 2000 budget, the Reserve Bank budgets total \$2,311.9 million, an increase of \$113.3 million, or 5.2 percent, from the 1999 estimate (table 3.1). The Reserve Banks' 2000 budgets are above the 1999 approved budget by \$166.7 million, or 7.7 percent. The budget increase, as detailed later in this chapter, is largely a result of the full-year effect of factors that created a net 1999 expense overrun of \$39.4 million.

Approximately 54 percent of Reserve Bank expenses in the 2000 budget are offset by priced service revenues, reimbursable claims for services provided to the U.S. Treasury and other agencies, and income from funds settlement fees associated with the transfer of Treasury securities. Priced service revenues are budgeted to increase 6.2 percent because of higher check volumes and price increases. Reimbursable claims will increase 6.6 percent, primarily because of transition costs

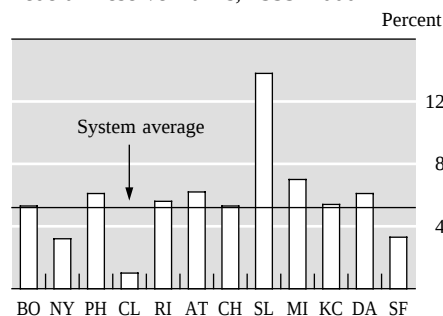
associated with the Treasury Direct consolidation initiative.

The total Reserve Bank increase of \$113.3 million provides funding for each District's salary administration and benefit programs, District projects and centralized operations, and various System-defined factors, including check standardization, check imaging, and the installation in several Districts of a check-adjustment system based on local-area-network (LAN) computer technology.

At individual Reserve Banks, 2000 budgeted expenses exceed 1999 estimated expenses by 1.0 percent to 13.8 percent (chart 1.1). The variation among Districts reflects a movement toward centralization of functions and the degree to which a District supports Treasury projects and System factors. For example, St. Louis will become the consolidation site for the Treasury Investment Program during 2000. Also, Treasury Direct operations will be

Chart 3.1

Change in Operating Expenses of the Federal Reserve Banks, 1999–2000



NOTE. Excludes special project. For 1999, estimate; for 2000, budget.

1. Excludes capital outlays. Includes expenses budgeted by Federal Reserve Information Technology (FRIT) and the System's Office of Employee Benefits (OEB); expenses from these entities have been charged to the Reserve Banks, as appropriate, and included in their budgets. Because of their unique roles within the System, FRIT and the OEB have prepared their own budgets. Data for FRIT are included in this document; the OEB's staffing level of 36 ANP and proposed capital budget of \$2.7 million are not discussed further here.

consolidated at the Boston, Minneapolis, and Dallas Banks.

The average number of personnel (ANP) projected to be employed during 2000 at the Reserve Banks and FRIT is 23,751, an increase of 265 ANP, or 1.1 percent, from 1999 estimated staff levels (table 3.2).² The expected increase

of 240 ANP, or 1.0 percent, in Reserve Bank employment is largely the annualized effect of 1999 staff additions and, to a lesser extent, initiatives planned for 2000. FRIT employment is expected to increase 25 ANP, or 4.0 percent, resulting from several initiatives, including expanded services to FRB New York,

2. The term *average number of personnel* describes levels and changes in employment at the Reserve Banks. ANP is the average number of employees in terms of full-time positions for the

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.

Table 3.1

Expenses of the Federal Reserve Banks, Net of Receipts and Claims for Reimbursement, 1999–2000

Millions of dollars except as noted

Item	1999 estimate	2000 budget	Change	
			Amount	Percent
Operations	2,198.6	2,311.9	113.3	5.2
Special project ¹	.0	14.0	...	...
Total	2,198.6	2,325.9	127.3	5.8
LESS				
Revenue from priced services	871.4	925.5	54.1	6.2
Other income	2.0	1.9	-.1	-5.0
Claims for reimbursement	296.1	315.6	19.5	6.6
EQUALS				
Net expenses	1,029.1	1,082.9	53.8	5.2

NOTE. See text note 1; see also notes to table 1.1, chapter 1.

1. Check-processing standardization.

Table 3.2

Employment at the Federal Reserve Banks, 1999–2000

Average number of personnel except as noted

Item	1999 estimate	2000 budget	Change	
			Amount	Percent
Operations	22,867	23,107	240	1.0
Federal Reserve Information Technology	620	644	25	4.0
Total	23,487	23,751	265	1.1
Special project ¹	0	5	...	...
Total	23,487	23,756	270	1.1

NOTE. See notes to table 3.1. See text note 2 for definition of average number of personnel.

1. Includes Federal Reserve Information Technology.

the check standardization project, and modernization of the production environment (for expenses and ANP by District and by operational area, see appendix D, tables D.1 through D.4).

1999 Budget Performance

The Reserve Banks estimate that 1999 expenses will be \$2,198.6 million, an increase of \$39.4 million, or 1.8 percent, from the approved 1999 budget of \$2,159.2 million and an increase of \$121.6 million, or 5.9 percent, above 1998 actual expenses. ANP for 1999 is estimated at 22,867, an increase of 216 ANP, or 1.0 percent, from the approved 1999 level (tables 3.3, D.5, and D.6).

Estimated 1999 expenses at eleven of the twelve Banks are above the approved 1999 budgets by amounts ranging from 0.9 percent in Philadelphia to 4.0 percent at Kansas City. New York is estimating its 1999 expenses to be \$0.8 million, or 0.2 percent, below budget (table D.5).

Unanticipated volume increases in the check and currency areas are contributing \$43.6 million to the 1999 overrun. The check service accounts for the majority of the expense overrun and is 249 ANP over budget. System-processed check volumes are estimated to increase

about 3.5 percent over budget, with percentage volume growth in the double digits in both Philadelphia and Kansas City. The increase in volume is attributable to several factors, including market-based pricing, new product offerings, and the withdrawal of some correspondent banks from the check processing service. The Reserve Banks have estimated that 1999 check revenues will fully cover all check costs.

The currency service has also experienced unforeseen volume increases. Additional shifts to process the currency and increased supply and shipping costs are contributing 62 ANP and \$9.9 million to the overrun. The rise in currency paying and receiving volumes, which are now expected to be 12 percent higher than budgeted, is due in part to the Board's decision to reduce backlogs to less than ten days to ensure that Reserve Banks were prepared to handle year-end processing demands.

Expenses related to century date change (Y2K) initiatives throughout the System are estimated to be \$39.4 million, \$10.3 million higher than approved 1999 budget levels. The main factor behind this overrun is an increase in overtime related to testing. The number of weekends that depository institutions tested with a Reserve Bank was greater than budgeted.

Table 3.3

Budget Performance of the Federal Reserve Banks, Operational Expenses and Employment, 1999

Item	1999 budget	1999 estimate	Change	
			Amount	Percent
Operating expenses (millions of dollars)	2,159.2	2,198.6	39.4	1.8
Employment (average number of personnel)	22,651	22,867	216	1.0

NOTE. See notes to table 3.2.

The 1999 estimate includes another Y2K project—the creation of strategic inventory locations (SILs) in the fall of 1999 for the precautionary storage of currency. The Districts estimate that the unbudgeted expenses for shipping, insurance, and other costs related to establishing the SILs will add \$4.9 million to 1999 expenses.

The final factor contributing to the overall increase in 1999 expenses is lower-than-anticipated capitalized software costs related to internally developed applications. Beginning in 1999, Reserve Banks began to capitalize costs related to certain software development projects. Delays in a number of projects throughout the System are estimated to add \$3.7 million to 1999 expenses, with a corresponding reduction in capital projects.

Partially offsetting these overruns are lower-than-anticipated occupancy costs in the New York District (\$3.6 million) and, over the System as a whole, an estimated net underrun of \$1.1 million in expenses related to the check-imaging initiative.

Factors Affecting the 2000 Budget

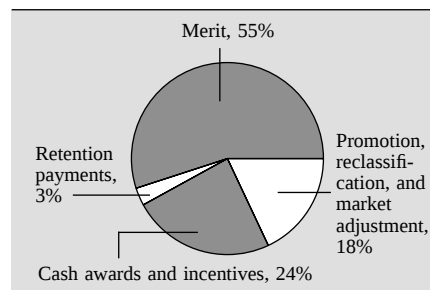
Personnel expenses, which include both salaries and benefits, represent 64 percent of Reserve Bank expenses and are the principal source of the year-over-year budget increase. Reserve Bank budgets include \$80.3 million to fund salary administration programs (merit increases, promotions, and so on) for officers and employees (table D.7).³ The budgets include average merit increases of

4.4 percent for officers and 4.2 percent for employees, totaling \$44.2 million, or 55 percent, of the total salary administration budget (chart 3.2). Promotions, reclassifications, and market adjustments represent \$14.1 million; retention payments represent \$2.4 million; and officer and employee cash awards and incentive payments represent \$19.6 million. The merit and other salary-related expenses are in line with trends in both the public and private sectors.

Officer turnover (including retirement) continues to be low, with five Banks projecting no turnover in 2000. The remaining Banks project officer turnover in a range from 2.0 percent (Minneapolis) to 7.4 percent (San Francisco). Employee turnover in 2000 is projected to range from 8.5 percent (Chicago) to 14.7 percent (Cleveland). Banks are reporting higher turnover in checks and some professional and technical areas. Turnover in the information technology area appears to have stabilized in 1999 and is expected to remain low in 2000. In 2000, however, continuing market pressures will increase the risk of losing employees with critical skills. As a result, the Banks plan greater

Chart 3.2

Components of Salary Administration at the Federal Reserve Banks, 2000



NOTE: See text note 3.

3. Salary administration represents the budgeted funds that are available to increase compensation to officers and employees in the coming year. It does not include adjustments for changes in staffing levels, turnover and lag in hiring, and overtime.

use of variable pay, retention incentives, and other monetary and nonmonetary rewards for key officers and employees.

Retirement and other benefit expenses, which account for 13 percent of Reserve Bank budgets, are anticipated to increase \$18.3 million, or 6.3 percent, in 2000. The primary factors include increases in salary-related benefits such as social security and employee thrift plan contributions, which are directly related to the increased number of ANP. Other contributing factors include higher postretirement and postemployment valuations, which are directly related to changes in actuarial assumptions. Employer costs for health and dental plans are also budgeted to increase in 2000.

The 2000 budgets are also being affected by several other initiatives at

the Reserve Banks (table 3.4). Many of these initiatives are the same as those identified as factors influencing the 1999 budget overrun. For example, the full-year effect of the dramatic increases in check volume this year are reflected in salary, benefit, equipment, and depreciation costs in the 2000 budgets. Projects in their infancy in 1999, such as check standardization and enterprisewide check adjustments, will demand much greater resources in 2000, while century date change and SIL costs in 2000 are projected to be lower.

Priced Services Provided to Depository Institutions

Factors affecting the budget for services provided to depository institutions include standardization of the check-

Table 3.4

Changes in Expense and Employment for Major Initiatives at the Federal Reserve Banks, 1999–2000

Millions of dollars except as noted

Initiative	1999 estimate	2000 budget	Change	
			Amount	Average number of personnel
<i>Priced services provided to depository institutions</i>				
Check standardization	12.6	20.9	8.3	34
Enterprisewide check adjustment	2.4	4.3	1.9	12
Commercial check imaging (total)	23.3	27.1	3.9	30
<i>Reimbursable services</i>				
Treasury Direct consolidation	18.7	24.2	5.5	81
Treasury Tax and Loan consolidation	5.7	6.5	.8	–1
Imaging for government agencies (total)	13.7	16.1	2.4	22
<i>Central bank services</i>				
Strategic inventory location	4.9	3.1	–1.7	0
<i>Cross-functional areas (incremental costs)</i>				
Century date change				
Federal Reserve Banks	9.7	3.9	–5.8	–31
Federal Reserve Information Technology	4.9	1.7	–3.3	–21
Total	95.9	107.8	11.9	126

NOTE. See notes to table 3.2.

processing hardware and software, enterprisewide check adjustments, and commercial check imaging.

Check-Processing Standardization

The Reserve Banks plan to undertake a multiyear initiative to standardize check hardware and software, consolidate processing at FRIT, and develop common applications that all Reserve Banks will use. Some of the benefits of this effort will be improved delivery of checks, greater flexibility to address volume shifts, better contingency, and lower ongoing operating costs. The increase in the 2000 budgets represents costs for the recently approved directive to use a single-platform strategy. The costs associated with this effort have been segregated in a System project and a special project.

The check standardization System project was established to capture and track expenses associated with the standardization and conversion to a single operating platform. System project expenses reflecting incremental increases of \$8.3 million and 34 ANP are included in the 2000 budget.

In addition to these expenses, a check standardization special project has been established to capture excess capacity and unique transition-related expenses during the conversion. The budget for the 2000 check standardization special project is \$14.0 million and 5 ANP.

Enterprisewide Check Adjustments

Expenses included in the budget associated with implementing the Enterprisewide Check Adjustment System are \$4.3 million and 25 ANP, an increase of \$1.9 million and 12 ANP from 1999 estimated expenses. These costs are to establish a centrally staffed function to manage the day-to-day operations for

this nationwide, standard, LAN-based application for check adjustments. Additional costs for personnel, software licensing, and maintenance have been included in the budget. Installation is currently projected to be completed by the end of 2000.

Commercial Check Imaging

Equipment, software, and staff expenses associated with commercial check image services are projected to be \$27.1 million in 2000, an increase of \$3.9 million and about 30 ANP above 1999 estimates. The 2000 budget includes funding to support commercial check pilot projects in the Utica and Helena offices, as well as costs incurred in the other Districts to support increased customer demand and implementation of the national commercial image archive.

Reimbursable Services

Factors affecting the budget for reimbursable services include the consolidation of support for Treasury Direct, changes in the Treasury Tax and Loan system, and the introduction of imaging for government agencies. Costs in these three areas are fully reimbursable.

Treasury Direct Consolidation

The processing of requests from the public to purchase Treasury securities through the Treasury Direct program will be consolidated in three Districts . . .

The three Districts have budgeted \$12.3 million in 2000 for the equipment costs and 182 ANP associated with this project. Budgets for the Districts losing Treasury Direct operations include staff reductions for 2000 totaling 56 ANP. The cost

savings resulting from these staff reductions are partially offset by budgeted retention incentives necessary to ensure a smooth transition. Processing at all sites will continue until the three consolidation sites are fully operational. Further ANP reductions are expected upon the completion of the transition, tentatively planned for December 2000.

Consolidation of Treasury Tax and Loan Operations

The consolidation of the operations supporting the Treasury Investment Program (TIP) and Paper Tax System (PATAX) at the St. Louis Reserve Bank will replace the existing TT&L software and staff at all Reserve Banks. TIP is a centralized application that will be used to manage the Treasury's tax receipts that are invested in depository institutions. TIP and PATAX, to be implemented in 2000, will improve capabilities for monitoring investment activity and monitoring collateral and make the tax-collection process fully electronic. The 2000 budget includes an increase of 20 ANP in St. Louis, which is offset by a reduction of 21 ANP in the other Reserve Banks. When centralized processing is fully implemented in 2000, additional ANP reductions are expected.

Imaging for Government Agencies

Imaging projects for government agencies total \$12.6 million in 2000 and include the imaging and archiving of government checks and EZ Clear savings bonds. The 2000 budget also includes \$3.5 million and 22 ANP associated with the postal money order image project. Production implementation of the money order project has been deferred from 1999 to the second quarter of 2000.

Central Bank Services

The largest factor affecting the budget for central bank services is the Y2K-related strategic inventory location (SIL) project. The project created seventy-nine supplemental cash-storage sites apart from Reserve Bank offices to facilitate cash access for depository institutions around the time of the century date change, should circumstances demand it. The Reserve Bank budgets for 2000 provide \$3.1 million to cover SIL-related transportation, storage, and insurance fees through the first quarter of 2000, when the sites were closed.

Cross-Functional Areas

The largest factor affecting the budgets for the cross-functional areas is the century date change effort. Reserve Banks and FRIT have included \$13.0 million and 102 ANP in their 2000 budgets for both reallocated and incremental resources related to Y2K issues. The 102 ANP is a decrease of 387 ANP, or 79.2 percent, from 1999 estimated staffing levels. The Y2K-related staff included in the 2000 budgets was available to address potential problems and to complete administrative duties to bring the century date change project to a close during the first quarter of 2000. Funds for the final stages of retention and incentive programs are also included in the 2000 budgets.

The reallocated staff resources that had been dedicated to the Y2K effort will be deployed to address demands for other information technology projects. Incremental Y2K costs are budgeted to decline \$5.8 million at the Reserve Banks and \$3.3 million at FRIT. Incremental staff associated with this initiative will decline 52 ANP from

1999 estimates, of which 31 are located in the Reserve Banks and 21 at FRIT.

Risks in the 2000 Budget

Reserve Banks have noted several common risks associated with the 2000 budgets. First, key projects for the Treasury could create budget uncertainties. Modifications to implementation and consolidation schedules or application requirements could affect costs for software, equipment, and human resources.

The System's check standardization project may present significant risk for the 2000 budget as well. When scheduling for the project is completed, several Districts may find they are facing higher-than-budgeted expenses in 2000, particularly if the implementation schedule is accelerated.

Finally, the market for skilled employees remains very tight. Initiatives that are contingent upon successful staffing efforts present additional uncertainties in the 2000 budget.

2000 Capital Plan

The 2000 capital budgets submitted by the Reserve Banks and FRIT total \$514.3 million, an increase of \$132.1 million from the 1999 estimated levels. The budget includes \$469.3 million for the Banks and \$45.0 million for FRIT. As in previous years, the 2000 capital budgets developed by the Reserve Banks and FRIT include funding for projects that support the strategic direction outlined in the Banks' plans. These strategic goals include improving operational efficiency and effectiveness, improving services to Bank customers, and providing a safe, high-quality work environment. In support of these strategies, the 2000 budget includes four major categories of capital outlays—buildings

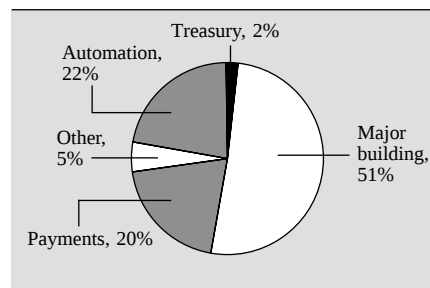
and facilities, automation, payment services, and Treasury-related initiatives (chart 3.3; see tables D.8 and D.9 for details by District and asset classification).

Buildings and Facilities

The proposed capital budget includes an estimated \$260.0 million for the modernization or replacement of physical facilities and replacement or upgrading of critical systems. Of the total building-related expenses, \$183.4 million (70.5 percent) is attributable to eight initiatives with budgets greater than \$4.0 million. These include two in the Atlanta District (new Atlanta and Birmingham buildings), one in the San Francisco District (Phoenix cash facility), one in the Dallas District (new Houston building), three in the New York District (improvements at 33 Maiden Lane and restorations and renovations at the main building), and one in the St. Louis District (check department renovations). The Kansas City District has also budgeted for a facility space evaluation project for the head office. In addition to the larger projects described, funding is also provided for the replacement of routine

Chart 3.3

Major Capital Projects at the Federal Reserve Banks, 2000



NOTE. Includes Federal Reserve Information Technology.

building-related equipment and the replacement of furniture and fixtures.

Automation

The proposed capital budget includes \$110.6 million in funding for major automation initiatives. These projects do not include the automation components of building, payments, or Treasury-related initiatives that are discussed separately. The strategic directions outlined in the individual Bank budgets include enhanced technological capabilities, the continued implementation of LAN technology, the development of common office environments and web-based applications, and various enhancements and replacements that were deferred to ensure Y2K preparedness.

Aside from the \$45.0 million included for FRIT, the automation total includes \$22.7 million in funding for major software application development, enhancements, and purchases. New York's Transaction Processing System initiative (\$2.7 million) and the Statistics and Reserves System (\$1.9 million) for all the Districts, as well as a number of smaller projects, contribute to software outlays.

The largest share of the remaining funds supports the Districts' distributed technology strategies and replacement of personal computers. Nearly all Banks are operating under a three-year replacement strategy and continue to convert applications from the mainframe to a LAN environment and, to a lesser extent, web-based solutions.

Payment System Improvements

The 2000 capital budget includes \$105.3 million for initiatives related to payment system improvements. These initiatives include the acquisition and installation of high-speed check imaging

equipment, replacements for check reader-sorters and endorsers, the ongoing development of a common check platform and related applications, the implementation of the enterprisewide check adjustment system, and settlement-related initiatives.

Treasury-Related Initiatives

Major Treasury-related initiatives account for \$11.6 million of the capital budget. These projects include \$4.1 million related to the Treasury Direct consolidation, \$1.5 million for the continued development of the EZ-Clear Savings Bond Image and Archive Retrieval System, and \$1.1 million for the Savings Bond Architecture Project. In addition to these major initiatives, funding is also included for the continued development of the system for Intragovernmental Payment and Collection, the Automated Standard Application for Payments, and the TIP and PATAX applications.

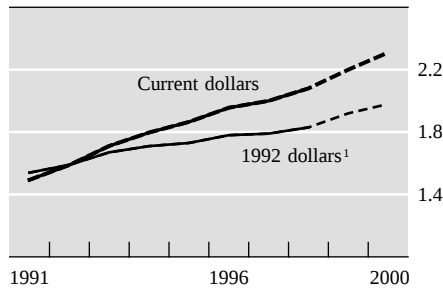
Trends in Expenses and Employment

Over the ten years ending with the 2000 budget, Reserve Bank expenses have increased an average of 5.0 percent per year (chart 3.4), and the average number of employees at the Reserve Banks (including FRIT) has increased 160, from 23,596 in 1991 to 23,756 in 2000 (chart 3.5). Over the five years ending with the 2000 budget, Reserve Bank expenses have increased an average of 4.4 percent per year when special projects are excluded, and 4.0 percent when special projects are included. Overall, expenses have been affected during this five-year period by increases in check and cash volumes, higher retirement and benefits costs, and information technology requirements,

Chart 3.4

Operating Expenses of the
Federal Reserve Banks, 1991–2000

Billions of dollars



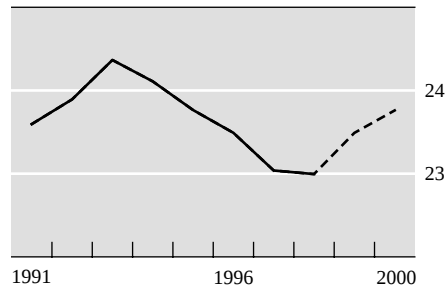
NOTE. Excludes special projects. For 1999, estimate; for 2000, budget.

1. Calculated with the GDP price deflator.

Chart 3.5

Employment at the
Federal Reserve Banks, 1991–2000

ANP, in thousands



NOTE. Includes Federal Reserve Automation Services and special projects. For 1999, estimate; for 2000, budget. See text note 2 for definition of ANP.

including the century date change initiative.

Since 1996, overall staff levels have increased 198 ANP. Staff increased in services provided to financial institutions and the public (417 ANP), primarily as a result of increases in the volume of processed checks. Support services also increased (185 ANP), primarily because of needs in the information technology area. Partially

offsetting the increases are reductions to staff in the supervision and regulation area (163 ANP), services to the Treasury and other government agencies (148 ANP), overhead services (90 ANP), and the monetary and economic policy service (3 ANP). These staff reductions have been due largely to consolidation of operations and increased operational efficiencies throughout the System. ■

Part II

Special Analysis

Chapter 4

The Gramm–Leach–Bliley Act

In recent decades, financial markets here and abroad had advanced well beyond the structures assumed by U.S. banking laws. The growing divergence between markets and laws created new challenges for U.S. financial institutions in their efforts to serve customers and compete in world markets, forcing them to devise costly and inefficient ways to meet market demands. The Gramm–Leach–Bliley Act of 1999 (Public Law 106-102) provides long-needed reform of the U.S. financial regulatory system: It recognizes market pressures that have been building for many years, creates the necessary legal and supervisory framework for accommodating further evolution, and minimizes the need for U.S. institutions to adapt their efforts to outmoded law.

Legislative Overview

The Gramm–Leach–Bliley Act is wide ranging, creating ways for traditional bank holding companies and foreign banks to expand into a host of new insurance and securities activities and for insurance and securities firms to enter commercial banking. Moreover, it does so in a relatively expeditious way, avoiding many of the regulatory procedures that would have been required in the past.

For a bank holding company to become a financial holding company (FHC) and be eligible to engage in new activities, the act requires that all U.S. depository institutions controlled by the holding company be well capitalized and well managed and have satisfactory ratings issued under the Community Reinvestment Act. Foreign banks that

operate U.S. branches or agencies or that own or control U.S. commercial lending companies and wish to become FHCs must meet capital and management standards that, in the judgment of the Federal Reserve, are “comparable” to those imposed on U.S. banks.

The legislation also provides institutions flexibility in structuring their activities by allowing them a choice of conducting certain financial activities within subsidiaries of commercial banks or through direct nonbank subsidiaries of the holding company. Subsidiaries of banks may engage in all financial activities permissible to FHCs, including securities underwriting and dealing, except those that involve insurance underwriting, merchant banking, or real estate investment or development. The act makes even merchant banking more broadly permissible in FHCs, and merchant banking might become permissible for subsidiaries of banks in five years if both the Federal Reserve and the Treasury agree with that approach.¹

In permitting expanded powers for financial institutions, the Congress saw the need for adequate supervisory oversight and also for potentially greater overlap in regulatory jurisdictions. Accordingly, it assigned to the Federal Reserve the role of “umbrella supervisor,” that is, supervisor for all U.S. financial holding companies, and gave it authority to establish minimum capital

1. Merchant banking is an activity in which a financial institution invests in a corporation, taking up to full ownership and usually a seat on the board of directors, but does not engage in its day-to-day management.

requirements for these firms. The act preserved for U.S. functional regulators the responsibility for the entities they oversee. The Securities and Exchange Commission, for example, will continue to set prudential and operating rules for its registered brokers and dealers, and the self-regulatory organizations such as the New York Stock Exchange and the National Association of Securities Dealers will continue to supervise and examine the activities of their respective members. Likewise, state insurance commissions will continue to set rules for insurance companies chartered in their states and monitor and enforce compliance with the standards.

Federal Reserve supervisors will not interfere with, or unnecessarily duplicate, the efforts of the functional regulators and will rely as much as possible on their reports and on public information. The role of other U.S. bank regulators remains unchanged, and the Federal Reserve will continue to coordinate with them its oversight of holding companies.

The Federal Reserve's objective as umbrella supervisor will be to understand the holding company's group-wide, or consolidated, financial condition, to insure that companies have adequate information systems and internal controls in place, and to identify emerging threats to banks arising from their nonbank affiliates.

Issues and Implementation

The Gramm–Leach–Bliley Act, along with the implementing regulations and supervisory policies, may materially transform the U.S. financial system. By validating affiliations between banks and diversified financial services firms, the legislation sets the stage for improving the competitiveness and efficiency of financial markets and providing a broader array of financial products to

consumers. With the flexibility introduced by the new legislation—together with the workings of time, technology, and innovation—one can expect world financial markets and institutions a decade from now to look much different from the way they do today. Whether the new landscape will be fruitful for institutions and consumers depends a great deal on how well government and industry develop regulations and define new strategies for competing effectively in the years ahead.

Market discipline declines as protection against risk is perceived to rise; hence, market discipline cannot prevail while noninsured creditors believe that their funds are not at risk in banks and their affiliates. Preventing the extension of such a distortion by preventing the extension of the federal safety net to more institutions remains an important consideration for the Federal Reserve as it constructs supervisory and regulatory policies under financial reform. The federal safety net gives banks the special benefits of access to federal deposit insurance and to the Federal Reserve's clearing process and discount window. Extending that access could distort market incentives and practices through the enlargement of the risks of moral hazard and thereby expose U.S. taxpayers to the kind of dangers realized a decade or more ago during the thrift institutions crisis.

The Federal Reserve has sought to address the risks associated with any extension of the safety net by separating the conduct of new activities as much as reasonably possible from insured depositories and by providing a framework for adequate supervision of financial holding companies. Such efforts will contribute to the market discipline necessary to make supervision most effective.

Determining the right mix of active government oversight and market dis-

cipline has become more difficult as financial markets and institutions have grown larger and more complex. In fulfilling its role of umbrella supervisor, the Federal Reserve must look across the entire financial holding company to adequately assess its risk management process and financial condition. Fortunately, the diversification that comes with the greater size and range of activities of today's large financial institutions has improved the ability of these firms to withstand shocks and has probably reduced the likelihood that one or more of them will fail. On the other hand, the increased size of these institutions has likewise increased the potential damage to the whole financial system that might come from the failure of just one of them.

Supervisory Coordination

The supervision of FHCs requires the Federal Reserve to coordinate its policies and actions with functional and other financial regulators in this country and abroad. In the past year or so, the countries represented on the Basel Committee of Banking Supervision agreed to structure their financial oversight programs around three so-called pillars: sound capital standards, effective supervision, and market discipline fueled by adequate public disclosures.²

Capital Standards

Regarding capital standards and foreign banks, the Gramm–Leach–Bliley Act requires the Federal Reserve to apply standards “comparable” to those applied to U.S. firms and requires institutions to

meet *more* than the minimum standards of financial strength. While the Board is sensitive to concerns about extending U.S. standards extraterritorially, it must also provide a “level playing field” for competition in this country, recognizing material differences in the structure and composition of foreign bank balance sheets and in the effective capital requirements of home country supervisors.

The approach that the Federal Reserve has taken for foreign banks reflects the wide variety of factors that should be considered in assessing capital adequacy, such as the composition of various debt and equity accounts, accounting standards, long-term debt ratings, and whether home country supervisors practice consolidated, comprehensive supervision. This potentially case-by-case approach for foreign banks should provide the flexibility necessary to address different banking and operating structures in a manner equitable to all.

Effective Supervision and Risk Management

While all banks must adhere to minimum regulatory capital standards, a more fundamental and growing need is for them to better understand the scope of their economic risks. The astute management of risk is most important among large, complex banking organizations, whose activities and innovative practices have evolved beyond those envisioned in the current regulatory capital standard, the 1988 Basel Capital Accord. For these institutions, in particular, the accord—even with its subsequent amendments—may not provide a sufficient measure of capital adequacy.

Only through the continued progress of the banking industry in managing underlying economic risks can the Federal Reserve and other regulators of

2. The member countries are the Group of Ten: Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom, and the United States.

internationally active banks make corresponding progress in developing regulatory capital standards that are more sensitive to such risks. As with most major initiatives, the banking and regulatory community must work together toward a solution.

The Federal Reserve conducts much of its regulatory work in this area through the Basel Committee on Banking Supervision. In 1999 the committee issued for comment a proposed amendment to the 1988 Basel accord that would make greater use of external credit ratings and provide more consistent treatment of collateral, guarantees, and other protective measures by which banks mitigate risk. It also agreed to pursue an alternative approach for capital standards that would build upon banks' internal credit ratings of borrowers and counterparties and other aspects of their internal credit risk models. In an effort to spur this process and otherwise strengthen risk management techniques, the Federal Reserve has told large U.S. bank holding companies and state member banks that their internal assessments of economic risks and capital adequacy will be closely evaluated during supervisory reviews.

Market Discipline and Disclosure

Market discipline, conveyed through credit ratings, funding costs, stock performance, and other factors, can help greatly in controlling risk in large, complex institutions. By making use of market judgments as potential early warning signals—particularly in the case

of large, publicly traded institutions—supervisors may be able to strengthen their performance while intruding less into the activities of banks and bank holding companies.

Generating market discipline, however, requires the disclosure of relevant information. Although regulatory agencies can help, the banking and investing community should require institutions to provide continually improving measures of risk and substantive discussions of their risk management processes. Heavy reliance on the supervisory process and regulatory standards, alone, cannot suffice.

Conclusion

Implementing the new Gramm–Leach–Bliley Act, developing and maintaining better capital standards, and providing prudential oversight to a growing and increasingly diverse U.S. financial system present many challenges for the years ahead. Financial institutions and their regulators must remain flexible and innovative in dealing with rapidly changing markets and financial products. Large banking organizations and financial holding companies, in particular, must be willing to meet high standards of soundness and disclosure and improve their ability to assess risk in step with the burgeoning complexity of the marketplace. The potential benefits from financial reform should be substantial, but they will be so only if both government and industry work together to keep the system sound. ■

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 Federal Reserve's 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 clearing balances and amounts deferred to depository institutions for items deposited for collection with the Reserve

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.

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 2000

In 1999 the Board approved a 2000 private sector adjustment factor for Reserve Bank priced services of

Table A.1

Pro Forma Balance Sheet for Federal Reserve Priced Services, 1998 and 1999

Millions of dollars

Item	1999	2000
ASSETS		
<i>Short-term assets</i>		
Imputed reserve requirement on clearing balances	757.7	762.2
Investment in marketable securities	6,819.6	6,859.5
Receivables ¹	69.1	74.2
Materials and supplies ¹	4.1	3.4
Prepaid expenses ¹	20.2	21.4
Items in process of collection	3,470.7	3,804.2
Total short-term assets	11,141.4	11,524.9
<i>Long-term assets</i>		
Premises ^{1,2}	386.6	411.7
Furniture and equipment ¹	150.3	180.1
Leasehold improvements and long-term prepayments ¹	21.1	64.2
Prepaid pension costs ¹	...	599.8
Total long-term assets	558.1	1,255.8
Total assets	11,699.5	12,780.7
LIABILITIES		
<i>Short-term liabilities</i>		
Clearing balances and balances arising		
from early credit of uncollected items	7,557.3	7,621.7
Deferred-credit items	3,470.7	3,804.2
Short-term debt ³	93.4	99.0
Total short-term liabilities	11,141.4	11,524.9
<i>Long-term liabilities</i>		
Postemployment and retirement benefits ¹	...	238.3
Long-term debt ³	207.6	400.9
Total long-term liabilities	207.6	639.2
Total liabilities	11,349.0	12,164.1
Equity ³	350.5	616.6
Total liabilities and equity	11,699.5	12,780.7

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 2000 and \$.04 million for 1999.

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

... Not applicable

\$192.6 million, an increase of \$76.8 million, or 66.3 percent, from the PSAF of \$115.8 million targeted for 1999.

Asset Base

The value of Federal Reserve assets to be used in providing priced services in

Table A.2

Derivation of the Private Sector Adjustment Factor (PSAF), 1999 and 2000

Millions of dollars except as noted

Item	1999	2000
PSAF COMPONENTS		
<i>Assets to be financed</i> ¹		
Short-term	93.4	99.0
Long-term ²	558.1	1,017.5
Total	651.4	1,116.5
<i>Weighted average costs (percent)</i>		
Capital structure ³		
Short-term debt	14.8	9.0
Long-term debt	31.7	35.8
Equity	53.5	55.1
Financing rates and costs ³		
Short-term debt	5.1	5.1
Long-term debt	6.6	6.6
Pretax return on equity ⁴	23.5	23.3
Weighted average long-term cost of capital	17.2	16.7
Tax rate (percent)	32.0	31.5
REQUIRED PSAF RECOVERIES		
<i>Capital costs</i> ⁵		
Short-term debt	4.8	5.0
Long-term debt	13.7	26.5
Equity	82.4	143.7
Total	100.8	175.2
<i>Other costs</i>		
Sales taxes	8.7	10.3
Assessment for federal deposit insurance	2.8	2.9
Expenses of Board of Governors	3.4	4.2
Total	14.9	17.4
Total PSAF recoveries		
Millions of dollars	115.8	192.6
As a percentage of capital	17.8	17.3
As a percentage of expenses ⁶	18.2	28.0

1. Calculated with the "direct determination of assets" method.

2. Consists of total priced long-term assets, including the priced portion of Federal Reserve Information Technology assets less, for 2000 only, liabilities for postemployment and retirement benefits.

3. All short-term assets are assumed to be financed with short-term debt. Of the total 1999 long-term assets, 37.2 percent are assumed to be financed with long-term debt and 62.8 percent with equity; for 2000 the proportions are . The data are 39.4 percent with long-term debt and 60.6 percent with equity.

4. The pretax rate of return on equity is based on the average after-tax rate 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 five years to yield the pretax return on equity for use in the PSAF.

5. Systemwide expenses for priced services, less shipping, were budgeted at \$636.9 million for 1999 and \$687.0 million for 2000.

2000 is estimated at \$12,780.7 million (table A.1). The value of assets assumed to be financed through debt and equity in 2000 is \$1,116.5 million, an increase of \$465.1 million, or 71.4 percent, from 1999 (table A.2). More than three fourths of this increase results from including net pension assets (prepaid pension costs less postemployment and retirement liabilities) of \$361.5 million in priced assets to be financed through PSAF, with building projects in two Districts and check standardization and imaging initiatives accounting for the remaining increase.

Cost of Capital and Taxes and Other Imputed Costs

For 2000, a pretax rate of return on equity of 23.3 percent, or \$143.7 million, is planned. Other required PSAF recoveries for 2000—imputed sales taxes, the imputed FDIC insurance assessment, and Board expenses—total \$17.4 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.

Currency Printing and Circulation

The Department of the Treasury's Bureau of Engraving and Printing 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). Under authority delegated by the Board, the Director of the Division of Reserve Bank Operations and Payment Systems submits an order for new currency to the Bureau of Engraving and Printing each July. Upon reviewing the order, the bureau establishes a billing rate for new currency, which the Board's staff uses to prepare the annual budget for new currency. Once the Board establishes the currency budget, it assesses the Federal Reserve

Table A.3

Currency in Circulation, New Notes Issued, and Notes Destroyed, 1999

Millions of pieces

Dollar denomination	Notes in circulation ¹	New notes issued ²	Notes destroyed
1	7,536	3,865	3,767
2	602	25	4
5	1,799	866	694
10	1,620	788	616
20	5,804	2,744	1,736
50	1,294	426	183
100	3,862	879	257
Total	22,516	9,593	7,257

1. As of December 31, 1999.

2. Does not include additions to inventory at the Reserve Banks.

Banks through an accounting procedure similar to that used in assessing the Banks for the Board's operating expenses.

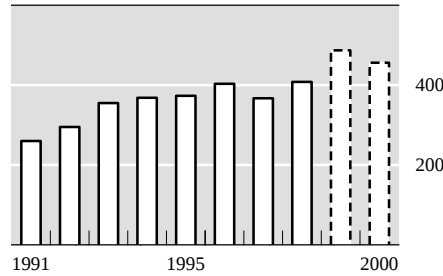
Estimated currency expenditures for 1999 total \$485.7 million, which is \$14.4 million, or 2.9 percent, less than the budgeted amount (table A.4). Note production in the fourth quarter of 1999 is estimated to have been 332.0 million notes less than originally budgeted because Reserve Bank inventories reached the desired Year 2000 precautionary levels by October 1. The 2000 budget for new currency is \$456.4 million, or 6.0 percent less than the 1999 estimated expenditures (chart A.1).

Printing of Federal Reserve Notes

Because of the 1999 buildup of precautionary currency inventories, the Board limited the print order for the 2000 budget to 9.0 billion notes, which represents a minimum-efficiency production schedule for the BEP. The budget for printing the 9.0 billion new notes is \$437.0 million, or 95.7 percent of the total 2000 currency budget. For January through September (the calendar 2000 portion of the federal government's

Chart A.1

Federal Reserve Budget for Supplying U.S. Currency, 1991–2000
Millions of dollars



NOTE: For 1999 estimate; for 2000, budget.

fiscal 2000, production is set at 7.0 billion notes. The Board's staff estimates that for October through December 2000, production could be 2.0 billion notes.

The BEP charges the Board separately for each of the three types of currency produced: unthreaded (\$1s), New Currency Design (NCD) without optical-varying ink (\$5s), and NCD with optical-varying ink (\$10s, \$20s, \$50s, and \$100s) (table A.5).² The average price

2. The color of optical-varying ink varies between green and black as the angle at which it is viewed changes.

Table A.4

Federal Reserve Costs of Supplying Currency, 1999 and 2000

Thousands of dollars except as noted

Item	1999 estimate	2000 budget	Percentage change
Printing of new Federal Reserve notes	465,097	436,984	-6.0
Shipment of new notes by Bureau of Engraving and Printing	13,016	9,900	-23.9
Intra-System shipment of fit notes	1,579	4,000	153.3
Counterfeit deterrence research	3,446	2,800	-18.8
Return of currency pallets to Bureau of Engraving and Printing ¹	6	30	400.0
Reimbursement to the U.S. Treasury's Office of Currency Standards	2,523	2,700	7.0
Total cost of currency	485,667	456,414	-6.0

1. Pallets, on which the BEP stores and ships currency to Reserve Bank offices, facilitate efficient handling

and storage of the notes. The pallets remain at the Reserve Bank offices until the currency is paid into circulation.

Table A.5

Projected Cost of Printing New Notes, by Type of Note, 2000

Type of currency	Number of notes (millions)	Percentage of total notes	Cost per thousand notes (dollars)	Total cost (thousands of dollars)
Unthreaded (\$1s)	4,832.0	54	35.35	170,811
New Currency Design ¹				
\$5s	678.4	8	60.20	40,840
\$10s, \$20s, \$50s, \$100s	3,462.4	39	65.08	225,333
Total	8,972.8	100	47.23	436,984

1. All NCD denominations except \$5s carry optical-varying ink (see text note 2).

charged to the Board by the BEP for producing all three types of notes will increase 10.4 percent in 2000, from \$42.77 per thousand notes printed to \$47.23. During 2000, 42.6 percent of the notes produced will be NCDs, and the remaining 53.9 percent will be unthreaded.

The billing rate for each type blends the costs of producing the notes at the Washington, D.C., and Fort Worth, Texas, facilities of the BEP. The average billing cost in 2000 is higher relative to the number of notes printed because this is the first year that the BEP will print NCD \$5s and \$10s.

Shipment of Currency

The budget provides funds for shipments from the BEP and between Reserve Bank offices. Primarily because of a lower volume of note production in 2000, the budget for currency transportation from the BEP to Reserve Banks is \$9.9 million, or 24 percent less than 1999 estimated expenses.

Intra-System shipments are used to move currency from offices with excess fit currency to offices that would otherwise require new currency from the BEP. Ten Reserve Banks requested \$50 or \$100 notes when they submitted their fiscal 2000 print orders to the

Board; because the BEP is not printing \$50 and \$100 notes in fiscal 2000, these ten Reserve Banks will need to obtain these denominations from other Reserve Banks. As a result, The 2000 budget for currency shipments between Reserve Banks is \$4.0 million, or 153 percent greater than 1999 estimated expenses.

Counterfeit Deterrence Research

In December 1999 an international steering group decided to recommend approving the second phase of the three-year counterfeit deterrence research project. The 2000 budget includes a \$2.8 million placeholder to fund the second phase.

Treasury's Office of Currency Standards

The Treasury's Office of Currency Standards (OCS) develops standards for the cancellation, destruction, and accounting of unfit currency at the Federal Reserve Banks. In turn, as a public service, the BEP processes claims for the redemption of damaged or mutilated currency that is turned over to the Reserve Banks. The 2000 currency budget includes \$2.7 million to reimburse the Treasury for OCS 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 \$26.6 billion for 1998 and are estimated to be \$25.4 billion for 1999.

Table B.1

Income of the Federal Reserve System,
1998 and 1999

Millions of dollars

Source	1998 actual	1999 estimate
Loans	8.8	11.1
U.S. government securities ...	26,842.4	28,216.1
Foreign currencies	435.2	224.8
Priced services	816.0	835.9
Other	47.0	58.9
Total	28,149.4	29,346.8

Table B.2

Distribution of the Income of the Federal Reserve Banks, 1998 and 1999

Millions of dollars

Item	1998 actual	1999 estimate
Current income ¹	28,149	29,347
LESS		
<i>Current expenses of Reserve Banks</i> ²		
Operating expenses	1,487	1,531
Costs of earnings credits	346	321
EQUALS		
Current net income	26,316	27,495
PLUS		
Net additions to, or deductions from (-), current net income ³	1,914	-526
LESS		
Cost of unreimbursed Treasury services ⁴	8	8
<i>Assessments by the Board</i>		
Board expenses	178	214
Cost of currency	409	485
<i>Other distributions</i>		
Dividends paid to member banks ⁵	343	374
Transfers to, or from (-), surplus ⁶	732	479
EQUALS		
Payment to U.S. Treasury	26,561	25,410

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 \$288.4 million in 1998 and \$366.8 million in 1999.

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.

*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 PricewaterhouseCoopers 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 9 projects in various stages of completion, since 1979 has completed 178 reports on selected aspects of Federal Reserve operations (tables C.1 and C.2). The GAO has also involved the Federal Reserve in about 99 other reviews not directly related to the System and has terminated 56 others before completion. The reports are available directly from the GAO.

Table C.1

Active GAO Projects Relating to the Federal Reserve, Year-End 1999

Subject	Date initiated
Banking agencies' risk-based examinations	1-27-99
President's Working Group on Financial Markets	3-11-99
U.S. government's financial statements in FY 1999	5-13-99
CFTC reauthorization	7-15-99
Security protection of government officials	7-29-99
Impact of the euro for the United States	9-10-99
Securities day trading	9-10-99
Rules governing S-corporations on community banks	12-1-99
Long-Term Capital Management follow-up	12-1-99

Table C.2

Completed GAO Reports Relating to the Federal Reserve System, 1999

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

Table C.2
Continued

Report	Number	Date issued
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
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

Table C.2

Completed GAO Reports Relating to the Federal Reserve System—Continued

Report	Number	Date issued
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
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

Table C.2
Continued

Report	Number	Date issued
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
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

Table C.2

Completed GAO Reports Relating to the Federal Reserve System—Continued

Report	Number	Date issued
Bank Oversight Structure: U.S. and Foreign Experience May Offer Lessons for Modernizing U.S. Structure	GGD-07-23	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
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
Electronic Banking: Experiences Reported by Banks in Implementing On-line Banking	GGD-98-34	1-15-98
Regulatory Oversight of Offshore Private Banking Activities	GGD-98-154	6-29-98
Year 2000 Computing Crisis: Actions Needed on Electronic Data Exchanges	AIMD-98-124	7-1-98
Experience With Electronic Check Presentment	GGD-98-145	7-14-98
Risk-Based Capital: Regulatory and Industry Approaches to Capital and Risk	GGD-98-153	7-20-98
High-Loan-To-Value Lending: Information on Loans Exceeding Home Value	GGD-98-169	8-13-98
Live Loan Checks: Information on Unsolicited Consumer Loans.....	GGD-98-176	8-14-98
Year 2000 Computing Crisis: Federal Reserve Is Acting to Ensure Financial Institutions Are Fixing Systems But Challenges Remain..	AIMD-98-248	9-17-98
Federal Reserve Banks: Areas for Improvements in Computer Controls ..	AIMD-99-5	10-14-98
The Results Act: Observations on the Federal Reserve's 1998-99 Biennial Performance Plan	GGD-99-9R	11-9-98
Regulatory Burden: Some Agencies' Claims Regarding Lack of Rulemaking Discretion Have Merit	GGD-99-20	1-18-99
Year 2000 Computing Crisis: Federal Reserve Has Established Effective Year 2000 Management Controls for Internal Systems Conversion	AIMD-99-78	4-9-99
Year 2000: Financial Institution and Regulatory Efforts to Address International Risks	GGD-99-62	4-27-99
Electronic Banking: Enhancing Federal Oversight of Internet Banking Activities	GGD-99-91	7-16-99
Federal Reserve Banks: Areas for Improvement in Computer Controls ..	AIMD-99-245	8-13-99
Federal Reserve Board: Merger Process Needs Guidelines for Community Reinvestment Issues	GGD-99-180	9-24-99
International Finance: Actions Taken to Reform Financial Sectors in Asian Emerging Markets	GGD-99-157	9-28-99
Long Term Capital Management: Regulators Need to Focus Greater Attention on Systemic Risks	GGD-00-3	10-29-99
Large Bank Mergers: Fair Lending Review Could be Enhanced With Better Coordination	GGD-00-16	11-3-99

Table C.3

Completed OIG Audit Reports Relating to the Federal Reserve System, 1999

Report	Number	Month issued
Interim Assessment of the Board's Year 2000 Readiness Activities (Advisory Letter) ¹	. . .	January
Audit of the Board's Academic Assistance Program	A9811	February
Audit of the Federal Reserve's Implementation of the Community Reinvestment Act	A9810	March
Joint Review of the Federal Financial Institutions Examination Council's (FFIEC's) Training Program	A9808	March
Audit of the Federal Reserve Employee Benefits System's Financial Statements (year ended 12-31-98)	A9902	March
Audit of the Board's Reports Clearance Process (Advisory Letter)	A9812	May
Audit of the Board's Financial Statements and Financial Audit Report (year ended 12-31-98)	A9901	May
Audit of the FFIEC's Financial Statements (year ended 12-31-98)	A9901	May

1. The fourth such assessment that consolidated information from separate audits of the three components of the Board's response to the Year 2000 problem: oversight of financial institution efforts by the Division of Banking Supervision and Regulation (A9713), Board

systems (A9803), and monitoring of Reserve bank efforts by the Division of Reserve Bank Operations and Payment Systems (A9807).

. . . Not applicable.

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 nongovern-

mental 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 1999, the OIG publicly reported on eight audits, reviews, and assessments (table C.3) and conducted a number of follow-up reviews to evaluate actions taken on earlier recommendations. In addition, the OIG informally provided Board management with suggestions for improvements to the century date change program. The OIG also 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, 1999 and 2000

Thousands of dollars except as noted

District	1999 estimate	2000 budget	Change	
			Amount	Percent
Boston	119,283	125,597	6,314	5.3
New York	447,901	462,234	14,333	3.2
Philadelphia	112,442	119,350	6,908	6.1
Cleveland	131,173	132,514	1,341	1.0
Richmond	171,337	181,017	9,680	5.6
Atlanta	254,482	270,313	15,832	6.2
Chicago	223,278	235,202	11,924	5.3
St. Louis	113,674	129,353	15,679	13.8
Minneapolis	110,192	117,876	7,685	7.0
Kansas City	136,184	143,542	7,359	5.4
Dallas	135,392	143,654	8,262	6.1
San Francisco	243,267	251,258	7,991	3.3
Total, all Districts	2,198,603	2,311,910	113,307	5.2
<i>Special project</i>				
Check standardization	0	13,995	. . .	. . .
Total	2,198,603	2,325,905	127,302	5.8

NOTE. See notes to table 3.1, chapter 3.

. . . Not applicable.

Table D.2

Employment at the Federal Reserve Banks, by District, 1999 and 2000

Average number of personnel except as noted

District	1999 estimate	2000 budget	Change	
			Amount	Percent
Boston	1,235	1,308	73	5.9
New York	3,835	3,654	-182	-4.7
Philadelphia	1,264	1,287	23	1.8
Cleveland	1,364	1,381	18	1.3
Richmond	2,141	2,195	54	2.5
Atlanta	2,676	2,762	86	3.2
Chicago	2,160	2,163	2	.1
St. Louis	1,285	1,324	39	3.0
Minneapolis	1,232	1,270	38	3.1
Kansas City	1,593	1,614	21	1.3
Dallas	1,549	1,635	86	5.5
San Francisco	2,533	2,515	-18	-.7
Total, all Districts	22,867	23,107	240	1.0
Federal Reserve Information Technology (FRIT)	620	644	25	4.0
District and FRIT Total	23,487	23,751	265	1.1
<i>Special project</i>				
Check standardization	0	5	...	...
Total	23,487	23,756	270	1.1

NOTE. See notes to table 3.2, chapter 3.

... Not applicable.

Table D.3

Operating Expenses of the Federal Reserve Banks, by Operational Area, 1995–2000

Thousands of dollars except as noted

Operational area	1995	1996	1997	1998	1999 estimate	2000 budget	Average annual change (percent)
Monetary and economic policy	128,303	138,649	144,103	152,580	167,022	176,908	6.6
Services to the U.S. Treasury and other government agencies	216,790	215,609	207,079	223,414	223,008	241,269	2.2
Services to financial institutions and the public							
Nonpriced ¹	437,210	509,279	524,325	530,120	531,731	550,436	4.7
Priced	690,110	668,166	690,744	717,284	796,005	834,539	3.9
Supervision and regulation	392,294	424,402	436,392	451,859	480,836	508,759	5.3
Total	1,864,707	1,956,104	2,002,643	2,075,256	2,198,602	2,311,910	4.4

1. Includes government check and postal money order services, which are fully reimbursable.

Table D.4

Employment at the Federal Reserve Banks, by Operational Area, 1995–2000

Average number of personnel except as noted

Operational area	1995	1996	1997	1998	1999 estimate	2000 budget	Average annual change (percent)
Monetary and economic policy	737	734	718	712	719	731	–.2
Services to the U.S. Treasury and other government agencies	1,683	1,543	1,438	1,410	1,331	1,395	–3.7
Services to financial institutions and the public	8,209	8,083	7,954	8,106	8,403	8,500	.7
Supervision and regulation	3,074	3,111	2,980	2,886	2,943	2,948	–.8
Support	4,511	4,537	4,572	4,561	4,699	4,722	.9
Overhead	4,949	4,901	4,821	4,722	4,772	4,811	–.6
Total	23,162	22,909	22,483	22,369	22,867	23,107	.0

NOTE. See notes to tables D.2 and D.3.

Table D.5

Budget Performance of the Federal Reserve Banks, Operating Expenses, by District, 1999

Thousands of dollars except as noted

District	1999 budget	1999 estimate	Change	
			Amount	Percent
Boston	117,984	119,283	1,334	1.1
New York	448,748	447,901	–846	–.2
Philadelphia	111,473	112,442	969	.9
Cleveland	126,283	131,173	4,889	3.9
Richmond	166,190	171,337	5,147	3.1
Atlanta	247,232	254,482	7,250	2.9
Chicago	219,156	223,278	4,122	1.9
St. Louis	112,452	113,674	1,222	1.1
Minneapolis	108,556	110,192	1,636	1.5
Kansas City	130,888	136,184	5,296	4.0
Dallas	132,699	135,392	2,693	2.0
San Francisco	237,599	243,267	5,668	2.4
Total, all Districts	2,159,222	2,198,603	39,381	1.8

NOTE. See general note to table 3.1, chapter 3.

*Table D.6*Budget Performance of the Federal Reserve Banks,
Employment, by District, 1999

Average number of personnel except as noted

District	1999 budget	1999 estimate	Change	
			Amount	Percent
Boston	1,235	1,235	0	.0
New York	3,833	3,835	3	.1
Philadelphia	1,254	1,264	10	.8
Cleveland	1,366	1,364	-2	-.2
Richmond	2,130	2,141	11	.5
Atlanta	2,612	2,676	64	2.4
Chicago	2,159	2,160	2	.1
St. Louis	1,265	1,285	20	1.6
Minneapolis	1,216	1,232	17	1.4
Kansas City	1,535	1,593	59	3.8
Dallas	1,500	1,549	49	3.3
San Francisco	2,549	2,533	-15	-.6
Total, all Districts	22,652	22,867	216	1.0

NOTE. See notes to table 3.2, chapter 3.

Table D.7

Salary Administration Expenses of the Federal Reserve Banks for Officers and Employees, by District, 2000

Thousands of dollars except as noted

District	Merit	Promotion and reclassification	Market adjustment	Cash awards	Incentive payments	Retention payments	Total	
							Amount	As a share of total personnel expense (percent)
Boston	2,525	859	418	395	817	0	5,014	7.3
New York	9,599	1,592	1,149	3,802	731	155	17,028	7.0
Philadelphia	2,189	419	163	643	395	330	4,138	6.9
Cleveland	2,400	351	65	779	453	123	4,171	6.9
Richmond	3,638	1,059	1,075	1,271	279	128	7,451	7.6
Atlanta	4,703	941	618	1,602	298	40	8,202	6.9
Chicago	4,265	1,494	400	1,301	452	150	8,062	7.2
St. Louis	2,014	262	80	708	274	344	3,681	6.4
Minneapolis	2,047	274	79	698	148	0	3,245	5.8
Kansas City	2,862	904	425	966	265	352	5,775	7.9
Dallas	2,556	270	207	812	158	172	4,175	5.7
San Francisco	5,375	824	220	1,485	874	649	9,428	6.7
Total	44,174	9,249	4,899	14,462	5,143	2,443	80,370	6.9
Federal Reserve Information Technology	1,923	206	0	170	545	472	3,315	7.1

NOTE. See text note 3, chapter 3, for definition of salary administration.

Merit: The amount of budgeted salary expense that reflects the cumulative effect of planned salary increases based on performance.

Promotions and reclassifications: The amount of budgeted salary expense that reflects the cumulative effect of salary increases for individuals as a result of grade promotions and reclassifications resulting from a job evaluation.

Market adjustment: The amount of budgeted salary expense to bring individual salaries to the minimum of grade range or to better align salaries with the market.

Cash awards: The amount of other personnel expense that represents payments for awards in recognition of exceptional achievements.

Incentive payments: The amount of other personnel expense that represents payments for the achievement of predetermined goals.

Retention payments: The amount of other personnel expense that represents payments to employees based upon contractual agreement with the Bank. Generally used to retain staff in "hot market" jobs or positions critical to the success of the Bank.

Table D.8

Capital Outlays of the Federal Reserve Banks, by District, 1999 and 2000

Thousands of dollars except as noted

District	1999 estimate	2000 budget	Change	
			Amount	Percent
Boston	11,990	19,623	7,633	63.7
New York	85,613	68,888	-16,725	-19.5
Philadelphia	9,483	11,048	1,565	16.5
Cleveland	21,423	70,485	49,062	229.0
Richmond	23,215	14,617	-8,598	-37.0
Atlanta	108,222	135,015	26,793	24.8
Chicago	18,360	35,969	17,609	95.9
St. Louis	17,434	17,816	382	2.2
Minneapolis	9,013	4,674	-4,339	-48.1
Kansas City	8,079	14,000	5,921	73.3
Dallas	9,346	41,383	32,037	342.8
San Francisco	29,919	35,740	5,821	19.5
Total, all Districts	352,098	469,258	117,160	33.3
Federal Reserve Information Technology	31,685	45,048	13,363	42.2
Total	383,783	514,306	130,523	34.0

Table D.9

Capital Outlays of the Federal Reserve Banks, by Asset Classification, 1999 and 2000

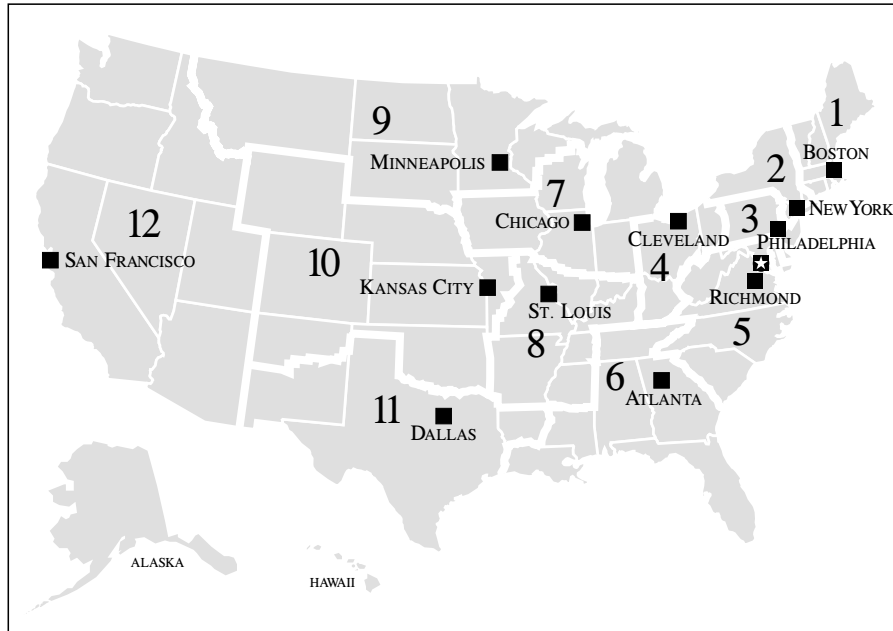
Thousands of dollars except as noted

Asset classification	1999 estimate	2000 budget	Change	
			Amount	Percent
Data processing and data communications equipment	118,921	137,254	18,333	15.4
Furniture, furnishings, and fixtures ...	27,828	27,915	88	.3
Other equipment	21,737	17,652	-4,086	-18.8
Land and other real estate	5,088	32,312	27,224	535.0
Building	121,792	172,057	50,266	41.3
Building machinery and equipment ..	20,430	29,479	9,050	44.3
Leashold improvements	18,714	3,709	-15,005	-80.2
Software	49,273	93,928	44,655	90.6
Total	383,783	514,306	130,523	34.0

NOTE. Includes Federal Reserve Information Technology.

*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

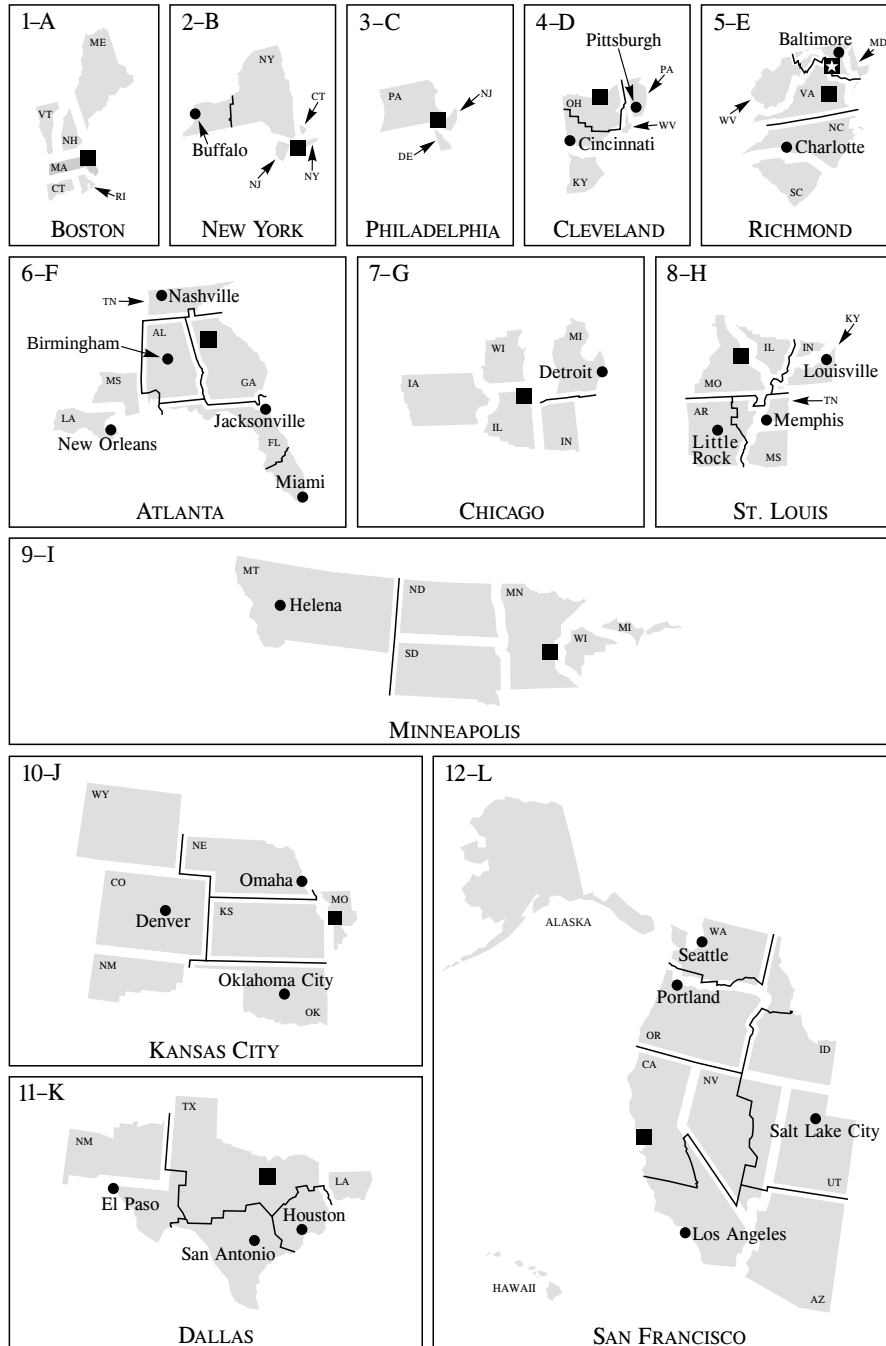
NOTE

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 1999.



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