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FEDERAL RESERVE SYSTEM

SECOND QUARTER REPORT ON PRICED SERVICES

Quarter Ended June 30, 1984

Table 1

Pro Forma Balance Sheet
For Priced Services
Federal Reserve System
June 30, 1984
(in millions)

| | | |
|---|---|---|
| Short-term assets | | |
| Imputed reserve requirements on clearing balances | $ 160.0 | |
| Investment in marketable securities | 1,173.4 | |
| Receivables | 50.9 | |
| Materials and supplies | 4.6 | |
| Prepaid expenses | 3.0 | |
| Net items in process of collection (float) | 282.8 | |
| Total short-term assets | | $1,674.7 |
| Long-term assets | | |
| Premises | 169.7 | |
| Furniture and equipment | 99.5 | |
| Leases and leasehold improvements | 2.3 | |
| Total long-term assets | | 271.4 |
| Total assets | | $1,946.1 |
| Short-term liabilities | | |
| Clearing balances | $1,333.4 | |
| Balances arising from early credit of uncollected items | 282.8 | |
| Short-term debt | 58.5 | |
| Total short-term liabilities | | $1,674.7 |
| Long-term liabilities | | |
| Obligations under capital leases | 0.4 | |
| Long-term debt | 86.2 | |
| Total long-term liabilities | | 86.6 |
| Total liabilities | | 1,761.2 |
| Equity | | 184.8 |
| Total liabilities and equity | | $1,946.1 |

Details may not add to totals due to rounding.

Accompanying notes are an integral part of these financial statements.

Table 2

Pro Forma Income Statement for Priced Services
Federal Reserve System
(in millions)

| | For three months ending June 30, 1984 | | For six months ending June 30, 1984 | |
|---|---|---|---|---|
| Income: | | | | |
| Services provided to depository institutions | | $144.4 | | $284.2 |
| Expenses: | | | | |
| Production expenses | $112.1 | | $223.1 | |
| Less: Board approved subsidies | 1.6 | 110.5 | 3.1 | 219.9 |
| Income from operations | | 33.9 | | 64.2 |
| Imputed costs: | | | | |
| Interest on float | 4.6 | | 17.1 | |
| Interest on short-term debt | 0.8 | | 1.6 | |
| Interest on long-term debt | 2.2 | | 4.4 | |
| Sales taxes | 1.2 | | 2.4 | |
| FDIC insurance | 0.3 | 9.1 | 0.6 | 26.1 |
| Income from operations after imputed costs | | 24.7 | | 38.2 |
| Other income and expenses: | | | | |
| Investment income | 31.7 | | 59.6 | |
| Earnings credits | 30.1 | 1.7 | 56.5 | 3.2 |
| Income before income taxes | | 26.4 | | 41.3 |
| Imputed income taxes | | 10.2 | | 16.0 |
| Net income | | $16.2 | | $25.4 |
| Memo: | | | | |
| Targeted return on equity | | $ 6.0 | | $11.9 |

Details may not add to totals due to rounding.

Accompanying notes are an integral part of these financial statements.

## Notes to the Financial Statements

Balance Sheet (Table 1)

Federal Reserve assets are classified as short- or long-term. Short-term assets represent assets such as cash and due from balances, marketable securities, receivables, materials and supplies, prepaid expenses, and items in the process of collection. Long-term assets are primarily fixed assets such as premises and equipment.

The imputed reserve requirement on clearing balances and investment in marketable securities reflect the Federal Reserve's treatment of clearing balances maintained on deposit with Reserve Banks by depository institutions. For balance sheet and income statement presentation, clearing balances are reported comparable to reporting of compensating balances held by respondent institutions with correspondents.

Net items in the process of collection is the amount of float used to calculate additions to the cost base subject to recovery. Thus, it is the difference between cash items in the process of collection, including checks, coupons, securities and ACH transactions, and deferred availability cash items. Therefore, the asset item on the balance sheet corresponds to the amount of float that the Federal Reserve must recover through fees to satisfy the Monetary Control Act. Conventional accounting procedures would call for the gross amount of cash items and deferred availability items to be included on a balance sheet. However, because the gross amounts have no implications for income or costs and no implications for the PSAF calculation, they are not reflected on the pro-forma balance sheet.

The following table depicts the Federal Reserve's float performance and float recovery. The amount of float recovered through per-item fees is valued at the Federal funds rate. The value of this float is then added to the cost base subject to recovery for each appropriate service.

Float Recovery
Federal Reserve Banks
Second Quarter 1984
(Daily average figures in millions)

| | |
|---|---|
| Total adjusted float | $568.9 |
| Unrecovered float 1/ | 105.4 |
| Float subject to recovery | 463.5 |
| Float recovered through "as of" adjustments 2/ | 286.8 |
| Float recovered through direct charges 2/ | 119.4 |
| Float recovered through per-item fees 3/ | 57.3 |

Long-term assets that are reflected on the balance sheet have been allocated to priced services using a direct determination basis. This approach was adopted along with other changes in calculating the PSAF for 1984. The direct determination method utilizes the Federal Reserve's Planning and Control System (PACS) to identify assets used solely in priced services and to apportion assets used jointly in the provision of different services to priced and non-priced services. Included in long-term assets are leases which have been capitalized and which are related to priced services. Additionally, resulting from changes to the PSAF methodology for 1984, an estimate of the assets of the Board of Governors related to the development of priced services has been included in long-term assets in the premises account.

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1/ Includes float generated in providing services to government agencies or in other central bank services and float not recovered as a result of the ACH subsidy and the phase-in of other float recovery.

2/ Interterritory check float may be recovered from depositing institutions through adjustments to the institution's reserve or clearing balance or by valuing the float at the Federal funds rate and billing the institution directly.

3/ This float is valued at the Federal funds rate and has been added to the cost base subject to recovery in the second quarter.

A matched-book capital structure for those assets that are not "self-financing" has been used to determine the liability and equity amounts. Short-term assets are financed with short-term debt. Long-term assets are financed with long-term debt and equity in a proportion equal to the ratio of long-term debt and equity of the bank holding companies used in the private sector adjustment model.

Other short-term liabilities include clearing balances maintained at Reserve Banks and deposit balances arising from float. Other long-term liabilities consist of obligations on capital leases.

System Income Statement (Table 2)

The income statement reflects the income and expenses for priced services. Included in these amounts are Board approved subsidies, imputed float costs, imputed financing costs, and the income and cost related to clearing balances.

Income reflects charges to depository institutions for priced services. This income is realized through one of two methods: direct charges to an institution's deposit account or charges against accumulated earnings credits. Expenses include production expenses and the expenses of Board staff working directly on the development of priced services that amounted to $0.5 million in the second quarter of 1984.

Board approved subsidies consist of a program established for the commercial automated clearinghouse service. The incentive pricing program established for the ACH service provides for fee structures designed to recover an increasing share of expenses. In 1984, ACH revenues are intended to recover 60 percent of costs plus the private sector adjustment. This incentive pricing program is being phased out with complete elimination planned in 1985.

Imputed float costs include the value of float that was intended to be recovered, either explicitly or through per-item fees, during the second quarter of 1984 for the commercial check, automated clearinghouse, noncash coupon collection, and book-entry securities transfer services. Also included in imputed costs is the interest on short and long-term debt used to finance priced service assets through the PSAF and the sales taxes and FDIC insurance which the Federal Reserve would have paid had it been a private sector firm.

Other income and expenses are comprised of income on clearing balances and the cost of earnings credits granted to depository institutions. In calculating the earnings credits paid on clearing balances, the Federal Reserve takes into account the fact that reserve requirements would be applied to compensating balances held at correspondent banks. Had the reserve adjustment to earnings credits been in place in the second quarter, and assuming no resulting shift in clearing balances, the expenses of earnings credits would have been about $28.0 million with a resulting increase in net clearing balance income of $2.1 million and an increase in net income of $1.3 million to $17.7 million.

Imputed income taxes are calculated at the effective tax rate used in the PSAF calculation applied to the net income before taxes.

The targeted return on equity represents the after-tax rate of return on equity that the Federal Reserve would have earned based on a model of bank holding companies.