

Annual Report: Budget Review

Board of Governors of the Federal Reserve System

2002

Annual Report: Budget Review



Board of Governors of the Federal Reserve System

2002

March 2002

This publication is available from Publications Services, Board of Governors of the Federal Reserve System, Washington, DC 20551. It is also available on the Board's World Wide Web site, at <http://www.federalreserve.gov/>

Contents

Introduction

- 1 FEDERAL RESERVE BUDGET PROCESSES
AND OPERATIONAL AREAS
- 1 Summary of 2001 income and expenditures
- 1 Budget processes
- 4 Operational areas

The Budgets

Chapter 1

- 9 FEDERAL RESERVE SYSTEM
- 10 Net expenses
- 11 Trends in expenses and employment
- 12 2001 budget initiatives

Chapter 2

- 13 BOARD OF GOVERNORS
- 13 Overview of the budget
- 15 Operations budget by division and account classification
- 15 Operations budget by operational area
- 19 Capital budget
- 21 Positions
- 21 Trends in expenses and employment
- 23 Extraordinary items
- 24 Office of Inspector General

Chapter 3

- 25 FEDERAL RESERVE BANKS
- 26 2001 budget performance
- 28 The 2002 budget
- 31 Risks in the 2002 budget
- 32 2002 capital plan

Appendixes

Appendix A

- 37 SPECIAL CATEGORIES OF SYSTEM EXPENSE
- 37 Priced services
- 38 Capital outlays
- 38 Currency printing and circulation

Appendix B

- 43 SOURCES AND USES OF FUNDS

Appendix C

- 45 FEDERAL RESERVE SYSTEM AUDITS
- 45 Independent audit
- 45 General Accounting Office
- 46 Office of Inspector General

Appendix D

- 49 EXPENSES AND EMPLOYMENT
AT THE FEDERAL RESERVE BANKS
- 58 MAPS OF THE FEDERAL RESERVE SYSTEM

Introduction

Federal Reserve Budget Processes and Operational Areas

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

As the nation's central bank, the Federal Reserve has many, varied responsibilities: It acts to ensure 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 financial consumer protection laws.

The Federal Reserve System plays a major role in the nation's payment mechanism. The Reserve Banks distribute currency and coin; process

Fedwire, automated clearinghouse, and securities transfers; and process 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 2001 Income and Expenditures

In carrying out its responsibilities in 2001, the Federal Reserve System incurred an estimated \$1.4 billion in net operating expenses. Total spending of an estimated \$2.7 billion was offset by an estimated \$1.2 billion in revenue from priced services, reimbursements, and other income received from services provided to the Department of the Treasury.

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 \$30.5 billion in 2001. Earnings in excess of expenses, dividends, and surplus are transferred to the U.S. Treasury—in 2001 an estimated \$27.1 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

Beginning with the 1998–99 budget, the Board of Governors has operated on a two-year budget cycle and a four-year planning cycle. This multiyear process

allows the Board to define and implement long-term strategies across functional areas. Given their current business needs, the Federal Reserve Banks maintain an annual budget cycle.

The following sections give an overview of the separate budgets and budgeting processes followed by the Board of Governors and the Reserve Banks. The Federal Reserve System's intent in the development and publication of this document is to provide the reader with the assumptions and initiatives considered when the Federal Reserve System budgets were developed and approved by the Board of Governors. The information contained in this document reflects the budgets and other information provided to the Board for approval in December 2001.

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 2002–03 budget, the fall of 2000). 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. As part of this process, individual division budget objectives are prepared on the basis of Boardwide priorities and planning assumptions. 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 objective to the Board for its consideration.

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 the fall of the odd-numbered year.

The Board of Governors budgets its resources by division and accounts for its activities by division and across operational areas. 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 areas according to service-level agreements (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 depreci-

ates their value over appropriate periods instead of expensing them in the year of purchase. Hence, the Board has both an operations budget and a capital budget.

After the budget is approved by the Board, it is converted to an operating plan that allocates funding 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 a second 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 2002–03 consists of funds to support planning for two periodic surveys, one on consumer finances and the other on small business finances.

The Board's Office of Inspector General (OIG), in keeping with its statutory independence, prepares its 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 the fall.

Reserve Banks

Each year the Federal Reserve Banks establish major operating goals for the coming year, devise strategies to attain those goals, estimate required resources, and monitor results. The process begins with development of a preliminary

budget projection, which is reviewed by the Board of Governors. Each Bank then develops its own budget. The budgets are reviewed at the Board by a committee of Governors—the Committee on Federal Reserve Bank Affairs—both individually and in the context of Systemwide issues and the plans of the other Banks. The budgets are then presented to the full Board of Governors for final action at an open meeting in December.

The Banks' budgets are structured in operational areas (described below), with support and overhead charged to these areas.

As is the case with the Board, the Banks, in accordance with generally accepted accounting principles, capitalize certain assets and depreciate their value over appropriate periods instead of expensing them in the year of purchase. Hence, the Banks have a capital budget in addition to an operating 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 these 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.

Beginning with the 2001 budget, significant structural changes have been made to PACS. As a result of these changes, some expenses were shifted to different operational areas, thus limiting the comparability of budget and expense data across certain years.

Operational Areas

In 2001 the Federal Reserve System accounted for costs using the following categories—monetary and economic policy, supervision and regulation of financial institutions, services to financial institutions and the public, services to the U.S. Treasury and other government agencies, and 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.

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. The Board and the FOMC use these analyses and projections in setting reserve requirements, setting the discount rate (which affects the cost of borrowing), and conducting open market operations. Staff members 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 com-

panies. 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 2001, the Federal Reserve conducted 534 examinations of state member banks (some of them jointly with state agencies) and 1,212 inspections and 2,626 risk assessments of bank holding companies; it acted on 2,696 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 2001, the System conducted 346 compliance examinations, including 291 covering state member banks and 55 covering foreign banking organizations. Procedures related to the Community Reinvestment Act were included in 219 of the compliance examinations.

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

Services to Financial Institutions and the Public

The Federal Reserve System plays a central role in the nation's 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 them 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 2001, the Reserve Banks received \$550.5 billion in currency and \$4.3 billion in coin from depository institutions, distributed an estimated \$599.6 billion in currency and \$5.8 billion in coin, and destroyed \$86.3 billion in unfit currency.

The Reserve Banks (along with their Branches and regional centers) also process checks for collection. In 2001, the Reserve Banks processed approximately 17 billion commercial checks for collection with a total value of nearly \$15 trillion.

The Federal Reserve also plays a central role in the nation's payment mechanism through its funds transfer system, Fedwire. Through Fedwire, depository institutions can draw on their reserves or clearing accounts at the Reserve Banks and transfer funds anywhere in the country. In 2001, approximately 112 million transfers valued at about \$424 trillion were sent over the Fedwire funds transfer system, an average of \$3.8 million per transfer and \$1.7 trillion per day.

The Federal Reserve allows participants in private clearing arrangements to exchange and settle transactions on a net basis through reserve or clearing account balances. Users of net settlement services include local check clearinghouse associations, automated clearinghouse (ACH) networks, and credit card processors. In 2001, the Federal Reserve's settlement sheet

service was phased out and all participating arrangements converted to the national Net Settlement Service (NSS). The Reserve Banks provide settlement services to approximately seventy local and national private-sector clearing and settlement arrangements. In 2001, the Reserve Banks processed more than 417,000 settlement entries for these arrangements.

The Federal Reserve's ACH service allows depository institutions to send or receive payments electronically instead of by check. Institutions use the ACH service for credit and debit transactions. In 2001, the Reserve Banks processed approximately 5.3 billion ACH transactions valued at about \$15.0 trillion; approximately 17 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 collection of physical interest coupons and miscellaneous items. The Fedwire securities transfer system enables the holders of Treasury and government agency securities to transfer the securities electronically to other institutions throughout the country. In 2001, the Reserve Banks processed approximately 15 million securities transfers valued at \$212 trillion, an average of \$14 million per transfer and \$846 billion per day. The noncash collection service, through which maturing or called coupons and bonds are presented for collection, processed about 379,000 transactions in 2001.

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 makes payments, issues checks, and collects receipts. The Reserve Banks also process Fedwire funds transfers and automated clearinghouse payments and provide the Department of the Treasury with daily statements of account activity. The Reserve Banks provide claims for reimbursement to the Treasury and other government agencies for 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 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, which is used by individuals.

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 Fedwire and automated clearinghouse payments on behalf of the Treasury. In 2001, the Treasury continued to encourage electronic payments to reduce payments made by check.

The Reserve Banks, as fiscal agents and depositories of the United States, collect federal taxes and invest excess Treasury balances with depository institutions. Any depository institution can accept tax deposits and immediately remit them to the Treasury. Approximately 1,200 depository institutions accept tax proceeds as investments and pay interest on the funds until the Treasury calls the balances. These investments and other funds held at depository institutions must be collateralized at all times.

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. At the System level, the expenses for these activities are considered overhead and are therefore allocated across the other operational areas. At the Board level, these expenses are not treated as overhead nor allocated to other operational areas. ■

The Budgets

Chapter 1

Federal Reserve System

For 2002, total operating expenses are budgeted at \$2,801.4 million, an increase from estimated 2001 expenses of 4.5 percent. Of this total, \$2,580.2 million is for the Reserve Banks, and \$221.2 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 \$954.4 million, or 34.1 percent of total budgeted operating expenses. This revenue, combined with claims for reimbursement and other income, results in projected net operating expenses of \$1,538.1 million.² The budget includes

\$12.4 million for a Reserve Bank special project.³

Not included in the budget for operations is the cost of currency, budgeted at \$376.8 million for 2002, an increase of 9.7 percent from the estimated 2001 cost of \$343.5 million.⁴ The distribution of expenses is similar to that in previous

1. The Board of Governors budgets on a two-year cycle (see chapter 2); in this chapter, 2002 values shown for the System and the Board reflect the approximate first-year effect of the Board's 2002–03 budget.

2. *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, which include the transfer of funds between depository institutions and the Treasury.

3. Special projects are relatively costly, short-term research and development efforts that are expected to benefit both the System and the banking industry as a whole. The special project covers part of the costs of the check-processing modernization project (see chapter 3).

4. The Federal Reserve pays for 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.

Table 1.1

Operating Expenses of the Federal Reserve System, Net of Receipts and Claims for Reimbursement, 2000–2002

Millions of dollars except as noted

Item	2000	2001 (estimated)	2002 (budgeted)	Percent change	
				2000 to 2001	2001 to 2002
Total System operating expenses	2,470.7	2,681.1	2,801.4	8.5	4.5
LESS					
Revenue from priced services	922.8	951.8	954.4	3.1	.3
Other income	1.0	1.1	1.0	10.0	–10.0
Claims for reimbursement ¹	302.4	292.2	307.9	–3.4	5.4
EQUALS					
Net System operating expenses	1,244.5	1,436.0	1,538.1	15.4	7.1

NOTE. Components may not sum to totals and may not yield percentages shown because of rounding.

Operating expenses include costs for special projects and exclude capital outlays.

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 and Currency, 2000–2002

Millions of dollars except as noted

Expense	2000	2001 (estimated)	2002 (budgeted)	Percent change	
				2000 to 2001	2001 to 2002
Reserve Banks ¹	2,281.5	2,461.8	2,580.2	7.9	4.8
Personnel	1,462.3	1,568.3	1,651.8	7.3	5.3
Nonpersonnel	819.3	893.5	928.4	9.1	3.9
Board of Governors ²	189.1	219.3	221.2	16.0	.8
Personnel	137.6	158.4	163.0	15.1	2.9
Nonpersonnel	51.5	60.9	58.2	18.2	–4.5
Total System operating expenses	2,470.7	2,681.1	2,801.4	8.5	4.5
Personnel	1,599.9	1,726.7	1,814.8	7.9	5.1
Nonpersonnel	870.8	954.4	986.6	9.6	3.4
Currency ³	423.4	343.5	376.8	–18.9	9.7

NOTE. See general note to table 1.1.

1. Includes costs for special projects. For detailed information on Reserve Bank expenses, see chapter 3.

2. Includes extraordinary items and expenses of the Office of Inspector General. See also chapter 2.

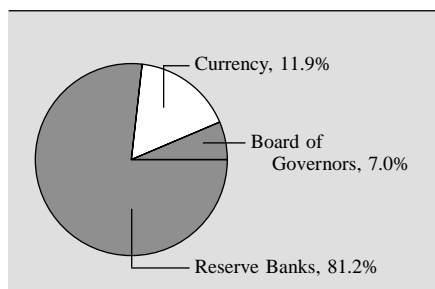
3. See text note 4 and appendix A.

years, with the Reserve Bank's expenses accounting for more than 80 percent of the total (chart 1.1).

System employment (including staff for the special project) is budgeted at 25,241 for 2002, an increase of 314 from the estimated 2001 level (details are given in chapters 2 and 3).

Chart 1.1

Distribution of Expenses of the Federal Reserve System, 2002



NOTE. See text notes 1 and 4.

Net Expenses

The System expects to recover 45.1 percent of its budgeted 2002 operating expenses through revenue from priced services, other income, and claims for reimbursement. When these items are deducted from budgeted 2002 operating expenses, the net expenses of the System show an increase of 7.1 percent from estimated 2001 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 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

*Table 1.3***Revenue from Priced Services, 2000–2002**

Millions of dollars

Service	2000	2001 (estimated)	2002 (budgeted)
Funds transfers and net settlement	64.6	63.0	56.1
Automated clearinghouse ..	71.7	76.4	66.4
Commercial checks	763.3	789.2	805.3
Book-entry securities transfers	18.5	19.0	22.8
Noncash collection	2.4	2.0	1.5
Special cash services	2.2	2.2	2.3
Total	922.8	951.8	954.4

calculation of fees are discussed in appendix A.

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

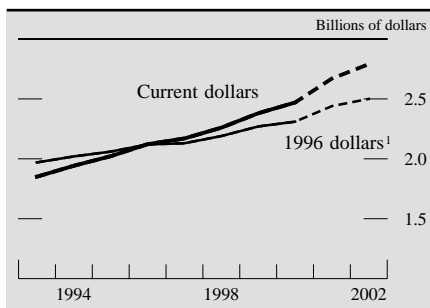
Sources and uses of funds are presented in appendix B, and the audits of the System are listed in appendix C.

Trends in Expenses and Employment

From actual 1993 levels to budgeted 2002 amounts, the operating expenses

Chart 1.2

Operating Expenses of the Federal Reserve System, 1993–2002

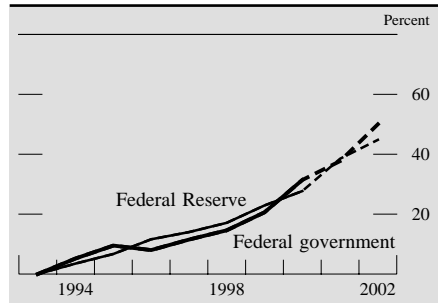


NOTE. For 2001, estimated; for 2002, budgeted.

1. Calculated with the GDP price deflator.

Chart 1.3

Cumulative Change in Federal Reserve System Expenses and Federal Government Expenses, 1993–2002



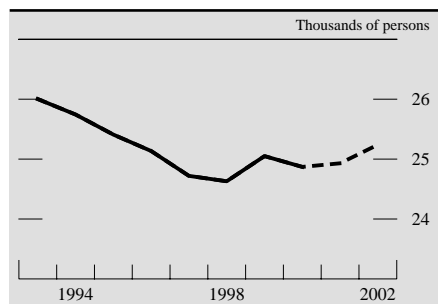
NOTE. Federal government expenses are discretionary spending less expenditures on defense. See also general note to chart 1.2.

of the Federal Reserve System (including special projects) have increased an average of 4.2 percent per year (2.2 percent per year when adjusted for inflation) (chart 1.2). Over the same period, nondefense discretionary spending by the federal government has increased an annual average of 4.6 percent (chart 1.3). Over the 1993–2002 period, Federal Reserve System employment has decreased 761 (chart 1.4).

From 1982, when the transition to the requirements of the Monetary Control

Chart 1.4

Employment in the Federal Reserve System, 1993–2002



NOTE. See general note to chart 1.2.

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

The Expedited Funds Availability Act requires the Federal Reserve to issue regulations to ensure the prompt availability of funds and the expeditious return of checks. The act became effective in 1988 and resulted in staff increases throughout the System in 1988 and 1989. From 1991 through 1998, spending on bank supervision expanded to meet the increase in the number and complexity of examinations and the enhanced supervision requirements for foreign institutions, problem institutions, the Financial Institutions Reform, Recovery, and Enforcement Act of

1989, and the Federal Deposit Insurance Corporation Improvement Act of 1991. The System partially offset these increases by reducing staff in other operational areas, mainly in services to the U.S. Treasury and in services to financial institutions and the public.

Employment for 2002 is projected to grow by 314, largely because of plans to increase security staff.

2002 Budget Initiatives

In 2002, several major initiatives will continue to affect System budgets. As discussed in more detail in chapter 3, security enhancement and check modernization are the primary drivers of the overall System budget. In addition, the Banks will continue to work on projects on behalf of the Treasury.

Partly offsetting this increase in spending are the lower costs associated with consolidations in the wholesale and ACH areas as well as staff reductions due to the continuing efforts to improve productivity and streamline operations. ■

Chapter 2

Board of Governors

The 2002–03 budget for the Board of Governors consists of \$455.0 million for operations, \$1.5 million for extraordinary items (projects of a unique nature), and \$7.8 million for the Office of Inspector General. The Board has authorized 1,741 staff positions for operational areas and 29 positions for the Office of Inspector General; no positions are required for the extraordinary items.

Overview of the Budget

On a biennial basis, the Board and its senior staff undertake a planning and budgeting process that results in a strategic plan for the next four years and a budget for the next two years. For the 2002–05 planning period and the 2002–03 budget period, the Committee on Board Affairs, assisted by a senior-level Staff Planning Group (SPG) and staff in the Program Analysis and Budget Section of the Management Division, 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 readjusted priorities to accomplish the mission, and identified important but lower priority work for elimination in order to fund some of the higher priorities. In August 2001, the Board approved a budget objective to implement those planning decisions, and budgets were submitted in early September. The terrorist actions of September

11 resulted in significant revisions to those budget submissions.

Planning

The Staff Planning Group reviewed the planning materials submitted by the Board's divisions and offices and identified major issues that are anticipated to have Boardwide significance over the planning period. These issues are reflected in the resource decisions of the Committee on Board Affairs that form the basis of the budget. They will also serve as the basis for the 2002–03 Performance Plan prepared as part of the Board's voluntary compliance with the Government Performance and Results Act. Here are the major issues:

- *Management and staffing.* Recruiting and retaining staff were once again raised as issues of significant concern in a number of divisions. In addition, because a significant number of senior staff are eligible for retirement, management succession planning and organizational structure is a top priority.
- *Board organization.* A comprehensive review of Reserve Bank oversight activities, including a reexamination of the legal requirements for oversight, could result in a more efficient, effective, and consistent approach.
- *Information technology.* In line with planning guidance, divisions reexamined their information technology spending to ensure that high-priority items are fully funded while lower-priority items are either reduced or eliminated. Doing so held information technology spending at current levels.

- *Physical plant.* The 2001 purchase of a new building will significantly lower office space costs.
- *External and internal factors.* The work of the Board will continue to be affected by environmental factors over which the Board has little or no control. The Board and its staff must stand ready to adjust priorities as necessary to deal with economic events, often unforeseen and rapidly developing, and their effects on monetary, supervisory, and regulatory policymaking.

Major Initiatives

To address these major planning issues, the budget includes the following major initiatives and projects for the 2002–03 period.

- *Attraction and retention of staff.* Initiatives to improve the Board's ability to attract and retain staff include the variable pay program for economists, attorneys, and officers; an increase in the employee cash award program; a 4.6 percent merit increase for 2002; and an estimated 4.0 percent merit increase for 2003.
- *Employee benefits.* A major increase in health insurance rates is being funded, as are initiatives to increase the transportation subsidy, increase the Board match for deferred compensation, and fund costs associated with the revised leave policy.
- *Workload.* New positions and a reduction in the number of vacant positions in specific divisions in response to increased workloads, new security concerns, and implementation of the compensation initiatives will all affect salary liability.
- *Information technology.* After a comprehensive review of requirements and priorities, the various

divisions are reallocating information technology resources among projects. Central IT support was funded at the current level except for increases to enhance disaster recovery.

- *Physical plant.* In line with the Board's earlier strategic plan, a building purchased in 2001 has significantly reduced the net operating cost for office space in this budget. Capital investments are planned for the Board's facilities as discussed below, in the section on the capital budget. Noncapital improvements are also planned for the facilities.

Ramifications of the September Terrorist Attacks

After the terrorist attacks on September 11, the projects and initiatives listed below were added to the 2002–03 budget proposal. The list includes programmatic changes that will be required to handle the long-term changes to the working and economic environment. These items and their associated operating costs of \$13.8 million are included in the total budget.

- Enhanced capacity Boardwide for disaster recovery, including reducing the time to resume normal operations at remote sites and increasing the amount of information and the number of systems supported at those sites
- Initiatives to enhance physical security, including adding security staff; using bomb-sniffing dogs for greater perimeter security; using contractual support for mail processing; and other, less visible, measures
- Additional staff in the Division of Reserve Bank Operations and Payment Systems to focus on system security issues in response to new terrorism-related legislation, and a new section (including new staff) to

focus on private-sector clearance and settlement systems in order to increase the Board's understanding and competence in this area

- Two positions in Banking Supervision and Regulation, in response to new terrorism-related legislation, to focus on money laundering and financial transactions associated with terrorist activity
- Four positions in the Office of the Staff Director for Management to improve the planning and coordination of contingency operations and to act as a liaison with the new Office of Homeland Security.

Areas of Risk

The possibility remains, of course, that further developments could require significant resources beyond the current proposals. These developments could include the following:

- Significant changes in or shocks to the economy or financial system
- Additional terrorist activity or war
- Determination that Systemwide supervisory technology initiatives should be funded and managed by the Board
- Changes to the assumptions regarding the position vacancy rates used in developing the salary budget.

Operations Budget by Division and Account Classification

The Board's overall operations budget is detailed by division in table 2.1 and by account classification in table 2.3. Table 2.2 shows the number of authorized positions for Board operations by division. The largest increase in the 2002–03 budget is in personnel services. The budget for personnel services (salaries, retirement, and insurance) is \$338.1 million, or \$50.5 million greater

than the 2000–01 estimate (an average increase of 8.4 percent per year). The addition of eleven positions explains a portion of this increased budget. Merit pay, new compensation initiatives, promotions and reclassifications, higher benefit costs, and a lower vacancy rate in certain divisions is also increasing the budget requirements.

The 2002–03 budget for goods and services is \$116.8 million, which is \$11.1 million greater than the 2000–01 estimate (an increase of 5.1 percent per year). Much of this increase is attributable to additional disaster recovery work stemming from the September 11 attacks.

Partially offsetting these increases are programmatic reductions in areas throughout the Board. These include significant changes in various accounts due to the Board's transition from leasing office space at its new location to owning the building, with a net reduction in expenses of \$3.0 million annually. Additionally, the replacement cycle for desktop computers will be extended, and support for regular information technology projects has been considerably scaled back after various divisions changed priorities and eliminated lower-priority projects.

Operations Budget by Operational Area

The Board's operations budget supports four broadly defined operational areas: 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).

The largest increase in expenses is in the security portions (both information and physical) of overhead, which is spread, in proportion to direct expenses, among the four operational areas. This

Table 2.1

Operating Expenses of the Board of Governors, by Division, Office, or Special Account, 2000–01 and 2002–03

Thousands of dollars except as noted

Division, office, or special account	2000–01 (estimated)	2002–03 (budgeted)	Change	
			Amount	Average annual (percent)
Board Members	8,524	11,813	3,289	17.7
Secretary	8,959	11,256	2,296	12.1
Research and Statistics	62,741	67,382	4,640	3.6
International Finance	22,706	24,873	2,167	4.7
Monetary Affairs	18,835	19,666	831	2.2
Banking Supervision and Regulation	62,840	73,859	11,019	8.4
Consumer and Community Affairs	18,094	20,671	2,576	6.9
Legal	18,148	20,754	2,606	6.9
Reserve Bank Operations and Payment Systems	30,995	35,548	4,553	7.1
Staff Director for Management	3,935	7,097	3,162	34.3
Management	22,318	25,248	2,931	6.4
Support Services	59,289	63,684	4,395	3.6
Information Technology	76,041	81,855	5,814	3.8
Publications Committee	3,934	3,687	-247	-3.2
Special projects	15,000	29,073	14,073	39.2
IRM income account ¹	-38,968	-41,477	-2,509	3.2
Total, Board operations	393,393	454,988	61,595	7.5
Extraordinary items	8,598	1,500	-7,098	...
Office of Inspector General	6,617	7,757	1,139	8.3

NOTE: Operating expenses reflect all redistributions for support and allocations for overhead, and they exclude capital outlays. Components may not sum to totals and may not yield percentages shown because of rounding.

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

... Not applicable.

increase does not directly enhance the efficiency or effectiveness of current Board operations, but it is necessary given recent changes in the threat environment facing the nation and the Board.

Monetary and Economic Policy

The 2002–03 budget for monetary and economic policy is \$182.5 million, an increase of \$19.2 million, or an average of 5.7 percent per year, from the 2000–01 estimate. 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.

Besides the additional funding for compensation initiatives, programmatic increases in this area will cover the acquisition of additional data to assist staff in their responsibilities. These data relate to capital risk, retail banking fees and services, global financial markets, and consumer credit.

Supervision and Regulation

The 2002–03 budget for supervision and regulation is \$186.7 million, an increase of \$27.9 million, or an average of 8.4 percent per year, from the 2000–01

Table 2.2

Positions Authorized at the Board of Governors, by Division, Office, or Special Account, 2000–01 and 2002–03

Division, office, or special account	2000–01 (authorized)	2002–03 (budgeted)	Change
Board Members	43	42	–1
Secretary	56	56	0
Research and Statistics	279	278	–1
International Finance	119	119	0
Monetary Affairs	60	59	–1
Banking Supervision and Regulation	227	224	–3
Consumer and Community Affairs	78	82	4
Legal	82	82	0
Reserve Bank Operations and Payment Systems	127	138	11
Staff Director for Management	15	19	4
Management	93	94	1
Concern ¹	31	27	–4
Support Services	212	215	3
Information Technology (IT)	279	278	–1
Special projects	2	1	–1
Subtotal	1,703	1,714	11
Reimbursable IT support ²	25	27	2
Total, Board operations	1,728	1,741	13
Office of Inspector General	29	29	0

1. Summer intern and youth positions handled by the equal employment opportunity function in 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.

estimate. 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 2002–03 budgetary increases will enhance supervisory activities such as ongoing monitoring, inspecting, and examining of banking organizations to assess their condition and their compliance with relevant laws and regulations. Programmatic increases include funding for seven positions added in late 2000, greater focus on money laundering activities, international training and assistance to foreign governments, and a review of regula-

tions and policies related to consumer protection. As risks to the financial sector grow, the staff will need to spend more time on bank examinations and monitoring under the risk-based supervision model implemented over the past few years.

Services to Financial Institutions and the Public

The 2002–03 budget for oversight of Reserve Bank services to financial institutions and the public is \$9.0 million, a decrease of \$0.1 million, or an average of 0.4 percent per year, from the 2000–01 estimate. This operational area provides support to and oversight of the Federal Reserve Banks and

Table 2.3

Operating Expenses of the Board of Governors, by Account Classification, 1992–93 to 2002–03

Thousands of dollars except as noted

Account classification	1992–93	1994–95	1996–97	1998–99
<i>Personnel services</i>				
Salaries	169,265	190,210	211,005	222,203
Retirement	13,366	15,564	18,015	19,708
Insurance	14,407	16,862	19,196	14,463
Subtotal	197,039	222,637	248,215	256,374
<i>Goods and services</i>				
Travel	8,453	9,399	9,391	10,823
Postage and shipping	2,327	2,483	2,261	1,706
Telecommunications	3,665	4,168	4,367	6,120
Printing and binding	2,237	2,866	2,829	2,188
Publications	2,212	2,976	2,544	2,338
Stationery and supplies	1,635	1,755	1,756	1,831
Software	5,615	6,453	7,865	8,349
Furniture and equipment	2,442	2,497	2,568	7,607
Rentals	3,156	7,202	8,648	8,884
Books and subscriptions	1,451	1,913	1,904	1,765
Utilities	3,683	4,145	3,995	4,429
Building repairs and alterations	3,402	3,273	2,996	2,881
Furniture and equipment repairs and maintenance	4,072	4,198	3,285	3,517
Contingency Processing Center	465	206	0	181
Contractual professional services	9,666	13,797	19,438	24,421
Tuition, registration, and membership fees	1,823	2,394	2,311	2,672
Subsidies and contributions	1,504	1,433	1,299	1,524
Depreciation	12,574	14,347	17,683	20,204
Other	-8,309	-16,175	-18,502	-22,637
Subtotal	62,074	69,330	76,638	88,803
Total, Board operations	259,113	291,967	324,853	345,177
Extraordinary items	0	0	4,196	20,401
Office of Inspector General	4,640	5,880	5,975	5,640

Branches—specifically, evaluation of the operational and pricing performance of 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.

Costs associated with these programs will decline slightly during the next biennium because of the realization of savings from previous initiatives.

System Policy Direction and Oversight

The 2002–03 budget for System policy direction and oversight is \$76.8 mil-

lion, an increase of \$14.5 million, or an average of 11.0 percent per year, from the 2000–01 estimate. 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.

Major programmatic changes in this area include greater emphasis on security and contingency planning System-wide and a new section to provide staff expertise on private-sector clearance and settlement systems. Fewer vacan-

Table 2.3
Continued

Thousands of dollars except as noted

Account classification	2000-01 (estimated)	2002-03 (budgeted)	Average annual change (percent)	
			2000-03	1992-2003
<i>Personnel services</i>				
Salaries	245,031	287,097	8.2	5.4
Retirement	22,897	27,421	9.4	7.5
Insurance	19,725	23,631	9.5	5.1
Subtotal	287,653	338,149	8.4	5.5
<i>Goods and services</i>				
Travel	12,235	13,606	5.5	4.9
Postal and shipping	1,576	1,607	1.0	-3.6
Telecommunications	7,046	7,798	5.2	7.8
Printing and binding	2,549	2,543	-1	1.3
Publications	2,296	2,066	-5.1	-7
Stationery and supplies	2,005	2,404	9.5	3.9
Software	9,915	11,223	6.4	7.2
Furniture and equipment	8,100	7,000	-7.0	11.1
Rentals	10,274	857	-71.1	-12.2
Books and subscriptions	2,087	2,120	.8	3.9
Utilities	4,517	5,555	10.9	4.2
Building repairs and alterations	3,479	3,688	3.0	.8
Furniture and equipment repairs and maintenance	4,278	7,124	29.1	5.8
Contingency Processing Center	400	400	. . .	-1.5
Contractual professional services	28,538	32,384	6.5	12.9
Tuition, registration, and membership fees ...	3,214	3,173	-6	5.7
Subsidies and contributions	1,866	1,897	.8	2.3
Depreciation	17,420	25,482	20.9	7.3
Other	-16,054	-14,089	-6.3	5.4
Subtotal	105,740	116,839	5.1	6.5
Total, Board operations	393,393	454,988	7.5	5.8
Extraordinary items	7,847	1,500	-56.3	. . .
Office of Inspector General	6,617	7,757	8.3	5.3

NOTE. 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. Components may not sum to totals and may not yield percentages shown because of rounding.

. . . Not applicable.

cies and an enhanced communication program are also responsible for the substantial increase.

Capital Budget

The Board's proposed 2002-03 capital budget is \$29.9 million. Of this total, \$19.8 million supports continued improvements in office automation and major upgrades to the information technology infrastructure, including completion of the Martin building

recabling project, centralization and improvement of distributed systems disk storage, and scheduled server replacements in the data center. Funds are also provided for the maintenance and upkeep of the Eccles and Martin buildings, including security system upgrades planned before the events of September 11; elevator refurbishment; equipment replacement; interior restoration on the concourse and terrace levels of the Martin building; and restoration of the Eccles building courtyard follow-

ing completion of the Eccles Building Infrastructure Enhancement Project. Major facility projects include the purchase of an emergency generator, replacement of the Eccles building roof, upgrades to security at building entrances, and a design and feasibility

study for a major renovation of the Martin building.

An additional \$3.3 million has been budgeted for projects resulting from the September terrorist attacks, including substantial improvements to information disaster recovery systems and

Table 2.4

Expenses of the Board of Governors for Operational Areas,
Extraordinary Items, and Office of Inspector General, 2000–01 and 2002–03

Thousands of dollars except as noted

Activity	2000–01 (estimated)	2002–03 (budgeted)	Change	
			Amount	Average annual (percent)
Monetary and economic policy	163,242	182,475	19,233	5.7
Supervision and regulation	158,799	186,711	27,912	8.4
Services to financial institutions and the public	9,083	9,015	–68	–.4
System policy direction and oversight	62,269	76,787	14,518	11.0
Total, Board operations	393,393	454,988	61,595	7.5
Extraordinary items	8,598	1,500	–7,098	. . .
Office of Inspector General	6,617	7,757	1,140	8.3

NOTE. See general note 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, 2000–01 and 2002–03

Activity	2000–01 (estimated)	2002–03 (budgeted)	Change
Monetary and economic policy	431	429	–2
Supervision and regulation	374	373	–1
Services to financial institutions and the public ..	24	24	0
System policy direction and oversight	155	166	11
Support and overhead ¹	719	722	3
Subtotal	1,703	1,714	11
Reimbursable IT support ²	25	27	2
Total, Board operations	1,728	1,741	13
Office of Inspector General	29	29	0

1. Includes positions for 17 youths, 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.

expansion of the scope of the building entrance security upgrade project already scheduled.

The Eccles Building Infrastructure Enhancement Project will be completed during the 2002–03 budget period. The amount budgeted, \$3.5 million, is \$8.3 million less than the amount provided during the 2000–01 budget period because of the phased nature of the project, which began in July 1999. The project consists of replacing the voice and data cabling plant, replacing piping, and making other, related repairs and will extend the building's useful life and improve the fire safety systems.

The remaining \$3.3 million of the capital budget is for projects associated with acquisition of the new building. These improvements, which were identified during the due-diligence period of the purchase negotiations, include enhancements to building security; code compliance issues; garage repairs; installation of an emergency generator; electrical, HVAC, and control system upgrades; and carpet replacement.

Positions

In response to the September terrorist attacks, a net of eleven positions have been added to the Board's number of authorized positions; the proposed total is 1,741 positions (table 2.2).

Before September 11, the staff conducted a thorough planning review, yielding an original budget request that included a net reduction of eight positions. A net increase of four positions was authorized for the Division of Consumer and Community Affairs to eliminate four long-term dual occupancies. One position was added to the Division of Reserve Bank Operations and Payment Systems and one position to the Management Division in response to an increased workload. Small, off-

setting position reductions were made in many divisions where efficiencies and workload factors made such decreases possible.

After September 11, nineteen positions were added. These positions are necessary to increase the Board's physical security (seven), ensure compliance with new police powers provided to System security staff under new legislation (two), provide additional resources for antiterrorism and anti-money-laundering activities (two), and increase the Board's expertise in private-sector clearing and settlement systems (eight).

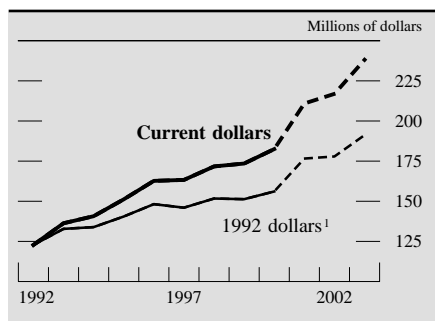
Trends in Expenses and Employment

The rate of increase within the 2002–03 budget biennium is 7.5 percent per year, which is slightly higher than the 6.3 percent annual rate in the 2000–01 biennium (table 2.3). The projected average annual rate of increase from 1992–93 to 2002–03 is 5.8 percent (charts 2.1–2.5). This increase is mainly attributable to the increasing complexity of Board work over this period, which has resulted in a net increase in positions and higher average grades, higher salary and benefit costs, and increasingly sophisticated automation systems required to manage sharply increasing volumes of data. Merit pay, new compensation initiatives, promotions and reclassifications, higher benefit costs, a lower projected number of vacancies in certain divisions, and increased usage of contractual support for continuity of operations increased the budget requirement.

Approximately three-fourths of the Board's operating expenses are for personnel; consequently, analysis of trends is heavily tied to staffing levels. From 1992 to 2003, the number of

Chart 2.1

Operating Expenses of the
Board of Governors, 1992–2003



Year	Millions of dollars	
	Current dollars	1992 dollars ¹
1992	122.8	122.8
1993	136.3	132.8
1994	140.7	133.9
1995	151.2	140.4
1996	162.7	148.2
1997	163.3	146.1
1998	171.7	151.7
1999	173.5	151.4
2000	182.5	156.1
2001	210.9	176.6
2002	216.9	177.9
2003	238.1	191.2

NOTE. For 2001, estimated; for 2002–03, budgeted. Excludes the Office of Inspector General and extraordinary items. The annual values for 1998–2003 are the approximate calendar-year figures contained within the respective two-year budgets.

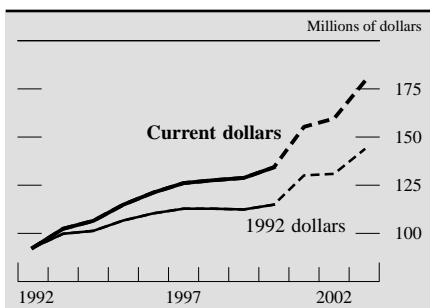
1. Calculated with the GDP price deflator.

authorized positions for Board operations rose from 1,668 to 1,741, a net increase of 73, or 4.4 percent. Reflecting the growing complexity of the Board's work, the average grade for professional staff rose from 25 to 26.

Changes in banking, frequently associated with automation enhancements, increased the complexity of safety and soundness supervisory activities. To adequately perform these activities, and to increase attention to consumer issues, including collection and analysis of data collected under the Home Mortgage Disclosure Act and Community

Chart 2.2

Expenses for Personnel Services
at the Board of Governors, 1992–2003

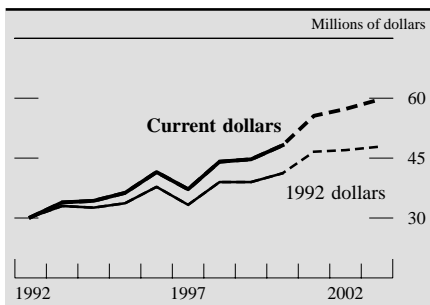


NOTE. See notes to chart 2.1.

Reinvestment Act, a net of thirty-four positions were added. (Many positions associated with lower-priority work were eliminated to offset the cost of the new work.) The increasing complexity of monetary policy issues resulted in an increase of twenty-five positions. Oversight of Reserve Bank operations became more complex resulting in an increase of nineteen positions. Finally, a net decrease of five administrative and support positions resulted from the Board's efforts to outsource where feasible; without these efforts, the number of administrative and support positions would have increased

Chart 2.3

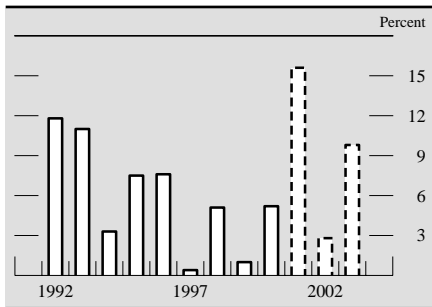
Expenses for Goods and Services
at the Board of Governors, 1992–2003



NOTE. See notes to chart 2.1.

Chart 2.4

Annual Change in Operating Expenses
of the Board of Governors, 1992–2003



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

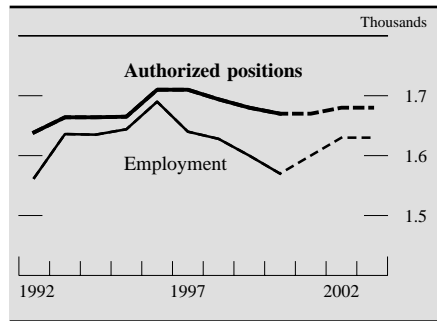
because of enhanced security and the acquisition of new office space.

While the number of positions at the Board has fluctuated during the 1992–2003 period, the salary budget (not including retirement and insurance benefits) has remained relatively stable at roughly 64 percent of operating expenses. The portion of operating expenses devoted to retirement and insurance has increased approximately 1 percentage point over the period as a result of administrative actions to enhance health insurance and other benefits.

The Board experienced an average annual percentage increase in expenses for goods and services of 6.5 percent over the 1992–2003 period. The largest contributor to this increase was a 12.9 percent annual rate of increase in the contractual professional services account because of outsourcing tasks such as security, IT services, and facilities support. Increases in the complexity of the Board's work resulted in additional data purchases and training requests. Partially offsetting the overall increase is a significant decrease in rental costs because of the year-end 2001 acquisition of a building previously rented by the Board.

Chart 2.5

Employment and Authorized Positions
at the Board of Governors, 1992–2003



Year	Employment	Authorized positions
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	1,629	1,694
1999	1,600	1,680
2000	1,568	1,668
2001	1,599	1,668
2002	1,631	1,681
2003	1,631	1,681

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 2002 and 2003. 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 for 2002–03 provides funds of \$1.5 million for the Survey of Consumer Finances (\$0.7 million) and the Survey of Small Business Finances (\$0.8 million). These surveys will improve the quality of economic data produced by the Board by gathering information on the economic behavior of U.S. households and the financial health of U.S. firms. Data collection for the 2001 Survey of Consumer Finances was completed at the beginning of December

2001, and data processing will accelerate in 2002. Final data will not be completed until 2002, though preliminary data are expected to be available earlier. A summary article on the survey is scheduled to be published in the January 2003 *Federal Reserve Bulletin*, and a version of the survey data will be released to the public shortly thereafter. Preparations for the 2004 Survey of Consumer Finances are expected to be under way no later than the first quarter of 2003. The survey instrument will be reprogrammed, requiring the generation of highly detailed specifications and the development of a new data management protocol. The last half of 2003 will see increasingly intensive testing of the instrument, development of materials to support data collection, preliminary sample design work, and a full pretest of operations. The staff expects to start interviewing for the 2004 survey in spring 2003.

Work on the Survey of Small Business Finances during the second half of 2002 will involve canvassing Board staff, academics, and other researchers to help determine the content of the

2003 survey. By the first quarter of 2003, survey staff will write a memorandum for the Board with recommendations regarding the 2003 survey. Survey staff will also develop a statement of work with a request for proposal expected to be issued around May or June 2003. Following the evaluation of proposals, a contract will be awarded during the fourth quarter of 2003. Work should begin in the fourth quarter of 2003, and fieldwork (which is the portion of the contract with the largest expenditures) will not begin until about April 2004.

Office of Inspector General

The 2002–03 budget of \$7.8 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. ■

Chapter 3

Federal Reserve Banks

The 2002 operating budgets of the twelve Reserve Banks total \$2,580.2 million.¹ The 2002 total is \$118.4 million, or 4.8 percent, above estimated 2001 expenses (table 3.1).² Approximately 37 percent of Reserve Bank expenses in the 2002 budget are offset by priced service revenues, and an additional 12 percent are reimbursable claims for services provided to the

U.S. Treasury and other government agencies.

Revenues from priced services are budgeted to increase 0.3 percent in 2002 as a result of projected price increases and modest volume growth in the check service. The increase in revenues is moderated, however, by declining revenue in other services, namely automated clearinghouse (ACH), Fedwire, and book-entry securities. ACH revenue reductions reflect some erosion of commercial origination volume, due to increased competition, as well as price reductions. Declining revenue in the Fedwire funds transfer and book-entry securities services is also attributed to price reductions. Reimbursable claims for Treasury-related services are expected to increase 5.4 percent.

1. These expenses include those budgeted by Federal Reserve Information Technology (FRIT) and the Office of Employee Benefits (OEB). Expenses from these entities have been charged to the Reserve Banks, as appropriate, and included in their budgets.

2. Unless otherwise noted, expenses also include costs associated with the check standardization special project. Special projects are major efforts having Systemwide significance that are outside the budgets of the individual Reserve Banks.

Table 3.1

Expenses of the Federal Reserve Banks, Net of Receipts and Claims for Reimbursement, 2001 and 2002

Millions of dollars except as noted

Item	2001 (estimated)	2002 (budgeted)	Change	
			Amount	Percent
Operations	2,461.8	2,580.2	118.4	4.8
LESS				
Revenue from priced services	951.8	954.4	2.6	.3
Other income	1.1	1.0	-.1	-10.0
Claims for reimbursement ¹	292.2	307.9	15.7	5.4
EQUALS				
Net expenses	1,216.7	1,316.9	100.2	8.2

NOTE. 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. 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.

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

At each Reserve Bank, budgeted 2002 expenses are increasing from estimated 2001 expenses by amounts ranging from 0.3 percent to 8.7 percent (see table D.1, appendix D). The Reserve Bank budget increase of \$118.4 million provides funding for each District's salary administration and benefits program, local initiatives, nationally provided support service (NPSS) initiatives, and consolidated operations.

The average number of personnel (ANP) projected to be employed at the Reserve Banks, Federal Reserve Information Technology (FRIT), and the Office of Employee Benefits (OEB) during 2002 is 23,550, an increase of 282 ANP, or 1.2 percent, from estimated 2001 staff levels (table 3.2).³ Reserve Bank employment is expected to increase 228 ANP or 1.0 percent in 2002; this increase is largely a result of plans to increase the number of security staff (for more detail on expenses and ANP

by District and operational area, see tables D.1 through D.4, appendix D).

2001 Budget Performance

The Reserve Banks estimate 2001 expenses to have been \$2,461.8 million, an increase of \$19.6 million, or 0.8 percent, from the approved 2001 budget of \$2,442.2 million (table 3.3). The Reserve Banks estimate employment, including FRIT and OEB, to have been 23,268 ANP, a decrease of 218 ANP from approved 2001 levels.

Eight Reserve Banks had cost overruns in 2001 ranging from 0.1 percent (Dallas) to 6.8 percent (Kansas City). The remaining four Banks estimated their 2001 expenses to have been below their approved 2001 budgets by amounts ranging from 0.7 percent (Philadelphia) to 4.5 percent (Atlanta). In appendix D, tables D.5 through D.8 detail 2001 expense and ANP estimates by District and operational area.

About \$9.5 million of the Reserve Banks' 2001 overrun is attributable to higher-than-budgeted contract staff expenses. The largest share of these expenses (\$3.8 million) reflect fees for consultants involved in national project management and development support

3. 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 3.2

Employment at the Federal Reserve Banks, FRIT, and OEB, 2001 and 2002

Average number of personnel except as noted

Item	2001 (estimated)	2002 (budgeted)	Change	
			Number	Percent
Reserve Banks	22,525	22,753	228	1.0
Federal Reserve Information Technology	712	763	51	7.2
Office of Employee Benefits	31	34	3	9.7
Total	23,268	23,550	282	1.2

NOTE. Components may not sum to totals and may not yield percentages shown because of rounding. See text note 3 for definition of average number of personnel.

Table 3.3

Budget Performance of the Federal Reserve Banks,
Operating Expenses and Employment, 2001

Item	2001 (budgeted)	2001 (estimated)	Change	
			Amount	Percent
Operating expenses (millions of dollars)	2,442.2	2,461.8	19.6	.8
Employment (average number of personnel)	23,486	23,268	-218	-.9

NOTE. See note to table 3.1. See text note 3 for definition of average number of personnel.

for the check standardization project. The remainder of these expenses (\$5.7 million) reflect the hiring of technical personnel to support local information technology (IT) initiatives, the hiring of temporary staff in New York's check-processing operation, and several major Systemwide initiatives to convert to standardized software applications.

Estimated expenses for 2001 also include \$6.8 million in unbudgeted costs related to the September 11 terrorist acts.⁴ These costs are primarily for an increase in overtime for protection staff, alternative check shipping arrangements, and the shipping of currency to alternative storage locations. Offsetting a portion of these expenses are lower-than-planned travel expenses (\$1.0 million).

Estimated 2001 expenses include a net increase of \$4.7 million and 14 ANP associated with the System's revamped financial services product office structure. The Reserve Banks created the product office structure in the early 1990s to centralize leadership of the System's major financial services business lines. The structure is designed to

draw on leadership from Reserve Bank offices that possess specialized expertise in a particular business area. As business requirements change and Reserve Banks develop new projects and initiatives, leadership of a product office may shift from one Reserve Bank to another, and responsibilities may be redefined. In 2001, the Reserve Banks redefined several areas of responsibility and shifted leadership among several Banks. Because final plans for these changes had not been approved when the Banks developed their 2001 budgets, the associated costs were unbudgeted. Most of the increase is the result of expanded product office responsibilities.

Higher costs associated with fully reimbursable Treasury projects account for \$2.9 million of the 2001 overrun. This increase reflects higher communications costs for Treasury Direct consolidation, additional enhancements requested by the Treasury for continued development of the ASAP.gov application, and the new Pay.gov and Government Point-of-Sale Check Conversion (GPCC) projects.

In addition to the broader trends discussed above, specific factors at a few Reserve Banks contributed to the overrun in 2001. The Retail Payments Office in the Atlanta District reported

4. These costs are not included in the 2001 overrun discussed in subsequent paragraphs.

higher-than-budgeted costs for the Check Relay air transportation function (\$2.1 million) because of higher fuel costs. Several Banks incurred higher-than-planned medical costs (\$5.9 million) and one-time transition costs associated with the Systemwide consolidation of ACH operations (\$1.5 million); in addition, Chicago increased its supervision staff by seventeen ANP to enhance the quality of that function (\$1.2 million). In Richmond and Dallas, severance payments associated with restructuring, centralization, and efficiency initiatives also added to the over-run (\$4.2 million).

Partially offsetting these increases were lower costs related to the check imaging project as a result of delays in its implementation schedule (\$3.6 million); lower-than-expected spending in San Francisco (\$3.0 million); and cost reductions in Atlanta (\$8.1 million and 157 ANP) and Richmond (\$1.1 million and 72 ANP).

The 2002 Budget

The discussion of the 2002 budget covers salary administration and System and Reserve Bank initiatives.

2002 Salary Administration

The budgets for the Reserve Banks, FRIT, and OEB include \$108.9 million to fund salary administration programs for officers and employees (table D.9).⁵ Average merit increases of 4.5 percent for officers and 4.3 percent for employ-

ees account for \$52.0 million, or 48 percent, of the total salary administration budget. Variable pay programs, which include cash awards and incentive payments for officers and employees, represent \$33.2 million of the total budget.⁶ Promotions, reclassifications, and market adjustments represent \$16.4 million; retention payments represent \$4.1 million; and severance payments represent \$3.2 million. Merit and other salary-related expenses are in line with public and private sector trends.

Officer incentive payments and cash awards total \$10.2 million, or 7.0 percent of officer salary liability. Officer variable pay continues to show increased funding for incentive-type awards, with one District using the entire variable pay pool for incentive awards.

Employee incentive payments and cash award funds total \$22.8 million, or 2.2 percent of employee salary liability. Three Banks opted to apportion a higher percentage of the award funds to the top three grades, with a commensurate reduction in other grade pools; these actions are consistent with the variable pay guidelines. The mix between incentive and cash awards in the employee category continues to be heavily weighted toward cash awards.

Officer turnover in 2002, including retirements, is projected to decrease from an estimated 5.9 percent in 2001 to 4.0 percent in 2002; Boston and Kansas City expect no turnover in 2002, while San Francisco expects 12.3 percent, the high end of the projections. Employee turnover is projected to increase slightly

5. 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 lags in hiring, and overtime.

6. Cash awards are payments for exceptional achievements during the year. Incentive payments represent awards for the accomplishment of pre-defined objectives related to specific projects and initiatives.

from 10.9 percent in 2001 to 11.1 percent in 2002, ranging from 8.1 percent (Richmond) to 15.0 percent (Kansas City). Reserve Banks are reporting relatively higher turnover in check operations and some professional and technical areas compared with other areas. To assist in retaining employees with critical skills, Reserve Banks plan to maximize variable pay, retention incentives, and other monetary and non-monetary rewards for key officers and employees.

Retirement and other benefit expenses, which account for 15 percent of Reserve Bank budgets, are anticipated to increase \$31.0 million, or 8.9 percent, in 2002. Salary-related benefits, such as social security and Thrift Plan contributions, will increase 9.7 percent. The increase is primarily related to the combined effect of higher salaries and a change in 2002 in the employer-matching component of the System's Thrift Plan (increasing the employer match from 80 percent to 100 percent for employees with at least five years of service). Other factors include projections of higher post-retirement and postemployment benefit expenses, which are directly related to changes in actuarial assumptions. Non-salary-related benefits will increase 10.7 percent, primarily because of increases in employer contributions for health benefits (10.2 percent for non-HMO plans, 14.0 percent for HMO plans, and 6.2 percent for dental plans). These increases are partially offset by projected savings from the new System prescription drug program.

Initiatives Affecting the 2002 Budget

The 2002 budget provides funding for several System and Reserve Bank initiatives. The budgetary requirements for these initiatives are described below.

Fee-Based Services to Financial Institutions

Initiatives for fee-based services in 2002 include check modernization and the wholesale payments and automated clearinghouse consolidations.

Check Modernization

In 1999, the Federal Reserve Banks, under the leadership of the Retail Payments Office, initiated four major projects, collectively referred to as check modernization. The four projects—check standardization, enterprisewide adjustments, image services system, and electronic access and delivery—will standardize the check-processing infrastructure, enable new products to be introduced into the market more quickly, reduce operational costs, and facilitate the move to electronic payments. The 2002 budget for the check modernization projects consists of \$82.4 million in System costs and \$23.8 million in local Reserve Bank costs. The budgetary effect of each of the check modernization projects is described below. (For a discussion of the operational details of the check modernization projects, see chapter 4 of *Budget Review 2001*.)

Check Standardization. For the check standardization project, the Reserve Banks and FRIT have identified nationally provided support service (NPSS) costs of \$39.7 million, local Reserve Bank implementation costs of \$22.5 million, and special project costs of \$12.4 million.⁷ Reserve Bank implementation costs vary significantly by District

7. The check standardization special project includes only the portion of the check standardization project that relates to redundant operational costs and severance and retention payments for staff affected by each Bank's transition to the new check operating environment.

and are determined by the timing of each office's conversion in the forty-five-month implementation schedule.

Enterprisewide Adjustments. The 2002 budget for the enterprisewide adjustments (EWA) project consists of \$7.7 million for NPSS costs and \$0.5 million for costs at individual Reserve Banks. The San Francisco District is responsible for the development and Systemwide implementation of EWA. Twenty-five offices had converted to EWA by the end of 2000, and by late 2001, thirty-seven adjustment offices were relying on EWA for check adjustments processing. The remaining offices are scheduled to convert during 2002. In late 2002 and early 2003, the servers that support EWA are scheduled to migrate to FRIT.

Image Services System. The 2002 budget for the image services system (ISS) consists of \$15.5 million in NPSS costs and \$0.4 million in individual Reserve Bank costs. The Boston District is managing the ISS project, which will convert the Federal Reserve's diverse and decentralized commercial image archive systems to a standardized, centrally managed national image archive. As the project management site, the Boston Reserve Bank began staffing an ISS centralized business administration function in 2001 that will support ongoing operations after ISS implementation. Three Reserve Banks will serve as regional archive sites for the System. The first archive was not ready for production until early 2002, almost a year later than originally planned, because of software vendor delays.

Electronic Access and Delivery. The 2002 budget for electronic access and delivery (EAD) consists of \$7.0 million in NPSS costs and \$0.4 million

in individual Reserve Bank costs. The Dallas Reserve Bank is responsible for developing this application. The System began converting customers to EAD under a controlled rollout in July 2001.

Wholesale Payment Consolidations

The 2002 budget includes net cost reductions as a result of the continued consolidation efforts of the Wholesale Payment Product Office (WPPO). In 2002, consolidation is expected to yield savings of \$4.9 million in the funds transfer service and nearly \$1.4 million in the book-entry securities service and a reduction in staff of sixteen ANP.

Off-line transfer services were consolidated into two Reserve Banks. In the fourth quarter of 2001, the WPPO began consolidating the on-line support and related administrative functions for the funds transfer and book-entry securities transfer services to these two sites. Customer testing is being consolidated into one Reserve Bank. These consolidations, scheduled for completion in the third quarter of 2002, will reduce costs across the System by standardizing the provision of the service while improving service quality.

Automated Clearinghouse Consolidation

Early in 2001, the RPO announced the consolidation of ACH operations into two processing sites, resulting in 2002 budget savings of \$8.8 million and thirty-seven ANP.

Services Provided to the Treasury and Other Government Agencies

Five Districts identified projects for the Treasury that in the aggregate are projected to add \$9.1 million and five ANP to 2002 expenses. The Treasury

will reimburse the Reserve Banks for project development costs. These projects include the Treasury Check Information System, Pay.gov, Government Point-of-Sale Check Conversion, the Intragovernment Payment and Collection System, the Automated Standard Application for Payment, and the Treasury Web Application Infrastructure.

Central Bank Services

Initiatives for 2002 in the central bank services area consist of projects in the cash and the supervision and regulation areas.⁸

Cash Initiatives

Three Districts have identified cash initiatives that will result in an aggregate increase of \$5.7 million and ten ANP. The increased costs are primarily the result of the full-year effect of opening the new Phoenix operations center in September 2001. To a lesser degree, costs related to additional currency processing shifts at the Atlanta and Dallas Banks and currency volume increases in the Atlanta and San Francisco Districts are contributing to growth in this area.

Supervision and Regulation

Initiatives affecting bank supervision and regulation are projected to add \$5.1 million and thirty-seven ANP in 2002. Additional resources are needed to address the growth in the number of state member banks, increased supervisory responsibilities related to large complex banking organizations, and the

full-year effect of 2001 staff increases. These initiatives are concentrated in the Richmond, Chicago, Kansas City, and San Francisco Districts.

Cross-Functional Areas

Cross-functional initiatives for 2002 involve staff reductions and security enhancements.

Targeted Staff Reductions

Ten Districts identified savings totaling \$66.0 million and staff reductions of 392 ANP resulting from initiatives to improve productivity, streamline operations, and reduce discretionary expenditures. The majority of the staff reductions are in Reserve Bank support and overhead areas, including information technology, financial management, administrative services, personnel services, and business development. Targeted reductions in discretionary expenditures include areas such as equipment, travel, training and education, and food service operations.

Security Enhancements

The budgets include \$50.3 million to enhance security at the Reserve Banks, an increase of \$11.4 million from estimated 2001 expenses. About half of the increase is associated with salary-related expenses for additional staff. Also included in this increase are expenses for security screening equipment and depreciation of various security-related building projects.

Risks in the 2002 Budget

The Reserve Banks have noted several common risks associated with the 2002 budgets. A number of Banks believe that some cost-reduction initiatives,

8. Central Bank Services is composed of monetary and economic policy, services to financial institutions and the public, and supervision and regulation.

necessary to meet System budget guidance, may be difficult to achieve. Many of the efficiency initiatives include staff reductions through attrition. If attrition is not sufficient to achieve needed staff reductions, a limited amount of unbudgeted severance may be required.

The check modernization projects continue to present budget risks. Delays with the ISS project have shifted some resources and costs from 2001 to 2002. Similar pressures exist with the check standardization project. In addition to potential resource diversions, delays in project schedules could result in higher-than-projected costs for staffing, equipment, and software. The amount of expense associated with this risk varies by Bank and is dependent upon each Bank's position in the transition schedule. Following conversion, unforeseen problems, such as the inability to stabilize operations, could present additional risk.

Some risk also exists in bank supervision and regulation. Most prevalent are concerns that additional staff could be needed if examination requirements exceed those already factored into the budgets. In the past, filling additional positions has presented challenges for Reserve Banks because of tight labor markets. However, with the exception of highly specialized positions, Banks recently have reported greater success in hiring examiners, a fact attributable primarily to softening labor markets. In addition, the supervision function is sharing more resources and specialized skills across Districts.

The Reserve Banks are conducting a post-September 11 assessment, with a focus on further improving the robustness and resiliency of critical Federal Reserve functions. Funding needed to implement recommendations that may arise from this assessment has not been included in the budgets. In addition, the

Reserve Banks' 2002 budgets include early estimates of the expense and capital funding that will be required to enhance the overall physical security of the Banks. As Reserve Banks finalize these plans, additional resources may be required.

2002 Capital Plan

The 2002 capital budget submitted by the Reserve Banks, FRIT, and OEB totals \$375.1 million—\$338.3 million for the Reserve Banks, \$33.5 million for FRIT, and \$3.3 million for OEB. Tables D.10 and D.11, in appendix D, detail capital expenditures by District and asset classification.

As in previous years, the 2002 capital budgets include funding for projects that support the strategic direction outlined in the plans of the Reserve Banks, FRIT, and OEB. 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 goals, the 2002 budget contains four major categories of capital outlays: building and facility improvements, including security enhancements; automation and communications-related initiatives; payment service improvements; and cash services initiatives.

Buildings and Facilities

The proposed capital budget includes an estimated \$220.7 million for building-related projects and facility improvements. These projects are geared toward renovation, modernization, or replacement of physical facilities, and replacement or upgrading of critical systems. Building initiatives include several projects in New York, including the continuation of the multiyear modernization of the head office building, and

various other building and leasehold improvements. Budgets also include funding for the new building project at the Eleventh District's Houston Branch, the Detroit building project, renovations at the Chicago Bank, and remodeling of the San Francisco Bank's lobby. In addition to these larger projects, funding is provided for security enhancements and for routine replacement of furniture, fixtures, and building-related equipment.

Automation

The proposed capital budget includes \$75.9 million in funding for major automation and communications initiatives. These initiatives do not include the automation components of building, payment systems, or cash services initiatives that are discussed separately. The strategic directions outlined in the individual Bank budgets include enhanced technological capabilities, the continued implementation of LAN technology, and the development of common office environments and web-based applications.

FRIT projects and acquisitions account for \$27.8 million of total automation-related outlays. FRIT's 2002 capital plan includes outlays for FEDNET modernization, a mainframe processor replacement project, and various software and hardware upgrades and enhancements. Aside from FRIT, major automation-related projects include \$10.3 million for server equipment (primarily in the New York and Atlanta Districts), \$5.1 million for additional phases of the Transaction Processing System and the Foreign Processing System projects in New York, \$2.1 million for telecommunication equipment upgrades and Internet gateway-directory

services in Boston, and \$1.5 million for local area network upgrades in Philadelphia.

The automation total also includes \$11.9 million in capital expenditures for reimbursable Treasury initiatives, including the Treasury Web Application Infrastructure project, the Treasury Check Information System, and the Savings Bond Architecture Project. The largest share of the remaining funds supports the Districts' distributed technology strategies.

Payment System

The 2002 capital budget includes \$43.8 million for initiatives to improve the payment system. These initiatives include \$5.7 million in FRIT's budget for hardware, software, and network components for the ISS and check standardization projects. The remaining funds support other national and local initiatives associated with the check modernization projects, the acquisition and installation of high-speed check imaging equipment and software, and check reader-sorter and endorser replacements. Many aspects of these initiatives are under way in a majority of the Districts.

Cash Services

Outlays of \$34.7 million have been included in the capital budget for cash services initiatives. For 2002, Bank budgets include \$27.1 million for the Board-approved cash project to install new sensors and scanners on all currency-processing machines. In addition, San Francisco has included \$4.1 million for an inventory-management system. ■

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 charge depository institutions for 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 intent of the PSAF calculation is to impute the costs that would have been incurred and the profits that would have been earned had the Federal Reserve Banks' priced services been provided by a private firm.

Annual Pricing Process

To meet the requirement for the full recovery of costs, the Federal Reserve has developed an annual pricing process involving projections of Reserve Bank expenses, volumes, and revenues, as well as the PSAF and net income on clearing balances, for each major service category.

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

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 using 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.² 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 Banks); and the portion of the expenses

1. The product directors are the first vice presidents at selected Reserve Banks with responsibility for day-to-day policy guidance over specific services. The Financial Services Policy Committee (FSPC) is responsible for the overall direction of financial services and related support functions for the Federal Reserve Banks.

2. Beginning in 2002, a portion of depository institution clearing balances held with the Federal Reserve for processing transactions will be used as a funding source for priced service assets. Equity will be imputed at 5 percent of total assets to meet the FDIC definition of a well-capitalized institution in its classification for assessing insurance premiums. The equity financing rate, or pretax return on equity, will be based on the average of the return-on-equity results of three economic models using data from the bank holding company model.

of the Board of Governors directly related to providing priced services.

Calculation of the PSAF for 2002

In 2001, the Board approved a 2002 private sector adjustment factor for Reserve Bank priced services of \$150.1 million, a decrease of \$56.8 million, or 27.5 percent, from the PSAF of \$206.9 million for 2001.

Asset Base

The value of Federal Reserve assets to be used in providing priced services in 2002 is estimated at \$11,846.9 million (table A.1). These assets are to be financed with short-term payables, clearing balances, long-term liabilities, and equity. The value of non-imputed assets in 2002 is \$1,592.6 million, an increase of \$92.9 million over the value of non-imputed assets in 2001 (table A.2). Growth of \$81.6 million in the pension asset explains the majority of the increase, while increases in short-term assets explain an increase of \$9.0 million, and increases in Board and Reserve Bank building assets explain an additional \$13.6 million. These increases are offset by a decrease of \$11.3 million in other Reserve Bank fixed assets.

Debt and Equity Costs, Taxes, and Other Imputed Costs

For 2002, a pretax rate of return on equity of 22.1 percent, or \$130.9 million, is planned. This represents a decrease from the pretax return on equity of 24.0 percent for 2001. As a result of this rate decrease and reduced imputed equity, the imputed return on equity declined \$28.6 million. The elimination of short- and long-term

debt results in a decline of expenses associated with debt financing of \$32.0 million. Other required PSAF recoveries for 2002—imputed sales taxes, the imputed FDIC insurance assessment, and Board expenses—total \$19.2 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 operating assets over their estimated useful lives.

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

Federal Reserve Banks circulate new and fit currency through depository institutions and destroy currency already in circulation as it becomes unfit or when a new design is issued. Each year, under authority delegated by the Board, the director of the Division of Reserve Bank Operations and Payment Systems orders new currency from the U.S. Department of Treasury's Bureau of

Table A.1

Pro Forma Balance Sheet for Federal Reserve Priced Services, 2001 and 2002

Millions of dollars

Item	2001	2002
ASSETS		
<i>Short-term assets</i>		
Imputed reserve requirement on clearing balances ¹	742.4	678.5
Investment in marketable securities ¹	6,681.9	5,473.0
Receivables	77.3	81.7
Materials and supplies	3.6	3.8
Prepaid expenses	23.4	27.8
Items in process of collection ²	<u>3,606.7</u>	<u>4,102.8</u>
Total short-term assets	11,135.3	10,367.6
<i>Long-term assets</i>		
Premises ³	417.5	431.1
Furniture and equipment	185.5	177.7
Leasehold improvements and long-term prepayments	73.9	70.4
Prepaid pension costs	<u>718.5</u>	<u>800.1</u>
Total long-term assets	<u>1,395.4</u>	<u>1,479.3</u>
Total assets	12,530.7	11,846.9
LIABILITIES		
<i>Short-term liabilities</i>		
Clearing balances and balances arising		
from early credit of uncollected items	7,424.3	7,377.5
Deferred-credit items ²	3,606.7	3,509.8
Short-term debt ⁴	18.9	.0
Short-term payables	<u>85.4</u>	<u>103.9</u>
Total short-term liabilities	11,135.3	10,991.2
<i>Long-term liabilities</i>		
Postemployment/postretirement benefits	251.9	263.4
Long-term debt ⁴	<u>479.1</u>	<u>.0</u>
Total long-term liabilities	<u>731.0</u>	<u>263.4</u>
Total liabilities	11,866.3	11,254.6
Equity	<u>664.4</u>	<u>592.3</u>
Total liabilities and equity	12,530.7	11,846.9

NOTE. Data are averages for the year. Components may not sum to totals because of rounding.

1. Funded with clearing balances.

2. Represents float costs that are directly estimated at the service level.

3. Includes allocations of Board of Governors' assets to priced services of \$0.7 million for 2001 and \$1.1 million for 2002.

4. No debt is imputed in 2002 because clearing balances are used as available funding source.

Engraving and Printing (BEP). Upon reviewing the order, the BEP sets billing rates for new currency, which the Board's staff uses to prepare the annual budget for new currency. Once the Board approves the new currency budget, it assesses each Federal Reserve Bank through an accounting procedure similar

to that used in assessing the Banks for the Board's operating expenses.

Estimated currency expenditures for 2001 totaled \$343.5 million, which is \$83.5 million, or 19.5 percent, less than budgeted (table A.3). This underrun resulted from reducing the original print order by close to one billion notes

Table A.2

Derivation of the Private Sector Adjustment Factor (PSAF), 2001 and 2002

Millions of dollars except as noted

Item	2001	2002
PSAF COMPONENTS		
<i>Non-imputed assets</i> ¹		
Short-term	104.3	113.3
Long-term	1,395.4	1,479.3
Total	1,499.7	1,592.6
<i>Imputed elements</i>		
Short-term debt ²	18.9	.0
Long-term debt ³	479.1	.0
Equity	664.4	592.3
<i>Financing rates and costs (percent)</i>		
Short-term debt	4.7	.0
Long-term debt	6.5	.0
Pretax return on equity ⁴	24.0	22.1
Tax rate (percent)	31.5	29.3
REQUIRED PSAF RECOVERIES		
<i>Capital costs</i> ⁵		
Short-term debt .....	.9	.0
Long-term debt	31.1	.0
Equity	159.5	130.9
Total	191.5	130.9
<i>Other costs</i>		
Sales taxes	10.5	14.1
Assessment for federal deposit insurance .....	.0	.0
Expenses of Board of Governors	4.9	5.1
Total	15.4	19.2
Total PSAF recoveries		
Millions of dollars	206.9	150.1
As a percentage of assets	1.7	1.3
As a percentage of expenses ⁶	28.5	19.0

1. Priced services assets are based on "direct determination of assets" method.

2. For 2001, short-term debt is imputed to finance only those assets that are not financed with short-term payables. No short-term debt is imputed in 2002 because clearing balances are used as a funding source.

3. For 2001, long-term debt consists of total priced long-term assets less postretirement/postemployment benefit liabilities. No long-term debt is imputed in 2002 because clearing balances are used as a funding source.

4. For 2001, 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. For 2002, the pretax rate of return on equity is determined averaging the result from the method used for 2001 (23.5 percent), along with results from a capital asset pricing model (21.4 percent), and a discounted cash flow model (21.4 percent).

5. The division of financing between debt and equity for 2001 was determined using the debt-to-equity ratio from the bank holding company model.

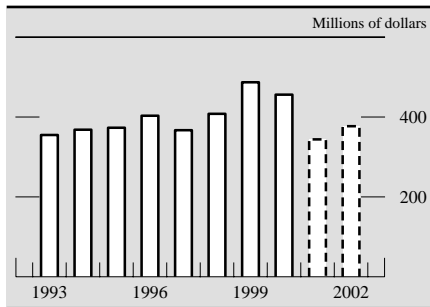
6. System budgeted priced services expenses less shipping are \$725.7 million for 2001 and \$791.9 million for 2002.

because of high currency inventories at Reserve Banks. Budgeted currency expenditures for 2002 total \$376.8 million, or 9.7 percent more than estimated

2001 expenses (chart A.1). The increase is due primarily to 2002 printing costs, which are 9.5 percent greater than estimated 2001 expenses.

Chart A.1

Federal Reserve Budget for
Supplying U.S. Currency, 1993–2002



NOTE. For 2001, estimated; for 2002, budgeted.

Printing of Federal Reserve Notes

The Board ordered 7.2 billion new notes for the calendar year 2002 budget. The budget for printing the Board's order is \$360.1 million, or 95.6 percent of the total 2002 new currency budget. For January through September 2002 (the portion of the federal government's 2002 fiscal year that falls within the 2002 calendar), production is set at 5.5 billion notes. The Board's staff estimates that for October through December 2002, production will be 1.7 billion notes.

The Federal Reserve System circulates three types of notes: unthreaded (\$1s and \$2s), New Currency Design (NCD)

without optical-varying ink (\$5s), and NCD with optical-varying ink (\$10s, \$20s, \$50s, and \$100s) (table A.4).³ During 2002, 46 percent of the notes produced will be NCD notes, and the remaining 54 percent will be unthreaded (\$1s). The average price the Board pays the BEP for producing all types of notes in 2002 will be \$50.73 per thousand notes printed.

Currency Transportation

The currency transportation budget consists of funds for shipping new currency from the BEP and between the Reserve Banks. The 2002 currency transportation budget is \$9.2 million, which is \$0.4 million, or 4.5 percent, less than the Board budgeted for 2001. The 2002 budget for new currency shipments from the BEP is \$7.0 million, or 7.0 percent, greater than estimated 2001 expenses because of a projected increase in the number of currency shipments. The 2002 budget for currency shipments between Reserve Banks is \$2.2 million, or 6.3 percent, greater than estimated 2001 expenses. These

3. The color of the optical-varying ink shifts from green to black as the viewing angle of the note changes.

Table A.3

Federal Reserve Costs of Supplying Currency, 2001 and 2002

Thousands of dollars except as noted

Item	2001 (estimated)	2002 (budgeted)	Percent change
Printing of new Federal Reserve notes	328,820	360,060	9.5
Currency transportation	8,606	9,199	6.9
Counterfeit deterrence research	3,027	4,103	35.5
Reimbursement to the U.S. Treasury's Office of Currency Standards	3,089	3,414	10.5
Total cost of currency	343,542	376,776	9.7

Table A.4

Projected Cost of Printing New Notes, by Type of Note, 2002

Type of currency	Number of notes (millions)	Percentage of total notes	Cost per thousand notes (dollars)	Total cost (thousands of dollars)
Unthreaded (\$1s)	3,854.0	53.8	39.98	154,082
New Currency Design ¹				
\$5s	1,687.8	23.6	56.65	95,614
\$10s, \$20s, \$50s, \$100s	1,623.0	22.6	68.00	110,364
Total	7,164.8	100	50.73²	360,060

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

2. Average cost for printing all three types of currency.

shipments move currency from Reserve Banks with excess fit currency to Banks that would otherwise require new currency from the BEP.

Counterfeit Deterrence Research

The 2002 budget for the counterfeit-deterrence program is \$4.1 million. The funds will support the Federal Reserve System's participation in the Central Bank Counterfeit Deterrence Group (formerly known as the SSG-2), which operates under the auspices of the G-10 governors to combat digital counterfeiting.

Treasury's Office of Currency Standards

The 2002 budget includes \$3.4 million to reimburse the Treasury for expenses for the Office of Currency Standards (OCS). The OCS develops standards for the cancellation, destruction, and accountability of unfit currency, and processes claims for the redemption of damaged or mutilated currency. ■

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 96 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 \$25.3 billion and \$27.1 billion for 2000 and 2001 respectively.

Table B.1

Income of the Federal Reserve System,
2000 and 2001

Millions of dollars

Source	2000	2001 (estimated)
Loans	22.8	11.7
U.S. government securities ...	32,736.9	30,541.7
Foreign currencies	269.5	239.1
Priced services	881.5	926.3
Other	53.2	151.6
Total	33,964.0	31,870.4

NOTE: Components may not sum to totals because of rounding.

Table B.2

Distribution of the Income of the Federal Reserve Banks, 2000 and 2001

Millions of dollars

Item	2000	2001 (estimated)
Current income ¹	33,964	31,870
LESS		
<i>Current expenses of Reserve Banks</i> ²		
Operating expenses	1,587	1,781
Costs of earnings credits	385	253
EQUALS		
Current net income	31,992	29,837
PLUS		
Net additions to, or deductions from (-), current net income ³	-1,492	-1,117
LESS		
Cost of unreimbursed Treasury services ⁴	8	0
<i>Assessments by the Board</i>		
Board expenses	188	295
Cost of currency	436	339
<i>Other distributions</i>		
Dividends paid to member banks ⁵	410	428
Transfers to, or from (-), surplus ⁶	4,115	517
EQUALS		
Payment to U.S. Treasury	25,344	27,140

NOTE: Components may not sum to totals because of rounding.

1. For sources of income, 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 \$392.6 million in 2000 and \$392.4 million in 2001.

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 for an annual 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 Division of Reserve Bank Operations and Payment Systems.

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 completed 7 reports in 2001 on selected aspects of Federal Reserve operations (table C.1), bringing the total number of reports since 1979 to 198. It has 10 projects in various stages of completion (table C.2). The GAO has also involved the Federal Reserve in about 111 other reviews not

Table C.1

Completed GAO Reports Relating to the Federal Reserve System, 2001

Report	Number	Date issued
Money Laundering: Oversight of Suspicious Activity Reporting at Bank-Affiliated Broker-Dealers Ceased	GAO-01-474	3-22-01
Financial Privacy: Too Soon to Assess the Privacy Provisions in the Gramm-Leach-Bliley Act of 1999	GAO-01-617	5-3-01
Consumer Finance: College Students and Credit Cards	GAO-01-773	6-20-01
Equity Hedging: OCC Needs to Establish Policy on Publishing Interpretive Decisions	GAO-01-945	8-16-01
Federal Reserve Banks: Areas for Improvement in Computer Controls	GAO-01-1049R	8-30-01
Anti-Money Laundering: Efforts in the Securities Industry	GAO-02-111	10-10-01
Check Relay: Controls in Place Comply with Federal Reserve Guidelines	GAO-02-19	12-12-01

directly related to the System and has terminated 56 others before completion. The reports are available directly from the GAO.

Office of Inspector General

The Board’s Office of Inspector General (OIG) functions in accordance with the Inspector General Act of 1978, as amended. The OIG plans and conducts audits and investigations of the programs and operations of the Board and its delegated functions at the Federal Reserve Banks. The OIG also reviews existing and proposed legislation and regulations for economy and efficiency.

It recommends policies, and it supervises and conducts activities that promote economy and efficiency and that prevent and detect waste, fraud, and abuse in Board and Board-delegated programs and operations.

In addition, it coordinates its efforts with other governmental and nongovernmental agencies to promote economy and efficiency and to detect and prevent fraud and abuse in activities administered or financed by the Board. The OIG keeps the Congress and the Chairman of the Board fully informed about serious abuses and deficiencies and about the status of any corrective actions.

During 2001, the OIG completed eleven audits, reviews, and assessments

Table C.2
Active GAO Projects Relating to the Federal Reserve, Year-End 2001

Subject	Date initiated
Various aspects of identify fraud/theft	4-4-01
Federal Reserve’s role in payment systems	4-19-01
Bureau of Public Debt financial statements	5-29-01
Foreign entities in U.S. capital markets	6-15-01
Money laundering in the credit card industry	7-30-01
Supervisory issues related to the failure of Superior Bank, FSB	8-10-01
Securities and Exchange Commission’s resources	8-28-01
Electronic funds transfer program	9-18-01
Marketing of the new dollar coin	10-2-01
Effects of terrorist attacks on U.S. financial markets	11-7-01

Table C.3
Completed OIG Audit Reports Relating to the Federal Reserve System, 2001

Report	Number	Month issued
Audit of the Board’s Financial Statements (years ended 1999 and 2000)	A0008BD	February
Audit of the FFIEC’s Financial Statements (years ended 1999 and 2000)	A0008	February
Review of the Board’s Internet Site Data Collection	A0102	February
Implementation of Critical Infrastructure Protection	A0007	March
Implementation of the Endeavor Change Control Project	P0020	May
Efforts to Implement Performance Management Principles Consistent with the Results Act	A0004	July
Observations on the Organization of the Board’s Publications Program	R0101	August
Oversight Approach for the Federal Reserve’s Check Modernization Project ..	A0013	September
Audit of the Board’s Information Security Program	A0106	September
Review of the Board’s Efforts to Implement Umbrella Supervision	A0108	September
Audit of the Federal Reserve’s Background Investigation Process	A0107	October

(table C.3) and conducted a number of follow-up reviews to evaluate action taken on earlier recommendations. In

addition, the OIG closed nine 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, 2001 and 2002

Thousands of dollars except as noted

District	2001 (estimated)	2002 (budgeted)	Change	
			Amount	Percent
Boston	145,356	155,701	10,345	7.1
New York	490,179	508,994	18,816	3.8
Philadelphia	120,743	125,751	5,008	4.1
Cleveland	129,413	138,766	9,353	7.2
Richmond	194,906	198,829	3,924	2.0
Atlanta	284,111	298,857	14,746	5.2
Chicago	236,690	244,842	8,152	3.4
St. Louis	128,164	139,348	11,184	8.7
Minneapolis	144,707	145,083	375	.3
Kansas City	160,993	170,040	9,047	5.6
Dallas	144,777	151,614	6,837	4.7
San Francisco	267,970	290,009	22,039	8.2
Total, all Districts	2,448,008	2,567,835	119,827	4.9
<i>Special project</i>				
Check standardization	13,803	12,387	-1,416	-10.3
Total	2,461,811	2,580,221	118,411	4.8

NOTE. Excludes capital outlays. Includes expenses budgeted by Federal Reserve Information Technology (FRIT) and the System's Office of Employee Benefits (OEB).

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.

Table D.2

Employment at the Federal Reserve Banks, by District, and at FRIT and OEB, 2001 and 2002

Average number of personnel except as noted

District	2001 (estimated)	2002 (budgeted)	Change	
			Amount	Percent
Boston	1,316	1,341	26	2.0
New York	3,428	3,383	-45	-1.3
Philadelphia	1,290	1,298	8	.6
Cleveland	1,344	1,402	58	4.3
Richmond	2,139	2,173	34	1.6
Atlanta	2,504	2,463	-42	-1.7
Chicago	2,145	2,160	14	.7
St. Louis	1,305	1,355	50	3.8
Minneapolis	1,296	1,306	9	.7
Kansas City	1,717	1,769	52	3.0
Dallas	1,561	1,531	-30	-1.9
San Francisco	2,479	2,572	93	3.7
Total, all Districts	22,525	22,753	228	1.0
Federal Reserve Information Technology	712	763	51	7.2
Office of Employee Benefits	31	34	3	9.7
Total	23,268	23,550	282	1.2

NOTE. See note to table D.1. See text note 3, chapter 3, for definition of average number of personnel.

Table D.3

Operating Expenses of the Federal Reserve Banks, by Operational Area, 2001 and 2002

Thousands of dollars except as noted

Operational area	2001 (estimated)	2002 (budgeted)	Change	
			Amount	Percent
Monetary and economic policy	234,043	242,938	8,895	3.8
Services to U.S. Treasury and other government agencies	265,617	284,116	18,500	7.0
Services to financial institutions and the public	578,826	626,782	47,957	8.3
Supervision and regulation	444,752	474,993	30,241	6.8
Fee-based services to financial institutions	924,769	939,004	14,235	1.5
Total	2,448,008	2,567,835	119,827	4.9

NOTE. Operational expenses include FRIT and OEB and exclude special project costs.

Table D.4

Employment at the Federal Reserve Banks, by Operational Area, 2001 and 2002

Average number of personnel except as noted

Operational area	2001 (estimated)	2002 (budgeted)	Change	
			Amount	Percent
Monetary and economic policy	886	850	-36	-4.1
Services to U.S. Treasury and other government agencies	1,387	1,334	-53	-3.8
Services to financial institutions and the public	2,818	2,916	98	3.5
Supervision and regulation	2,572	2,607	35	1.4
Fee-based services to financial institutions	5,436	5,402	-34	-.6
Support and overhead	9,426	9,644	218	2.3
Total	22,525	22,753	228	1.0

NOTE. Operational area employment excludes FRIT, OEB,
and special project average number of personnel.

Table D.5

Budget Performance of the Federal Reserve Banks:
Operating Expenses, by District, 2001

Thousands of dollars except as noted

District	2001 (budgeted)	2001 (estimated)	Change	
			Amount	Percent
Boston	144,041	145,356	1,315	.9
New York	484,358	490,179	5,821	1.2
Philadelphia	121,597	120,743	-855	-.7
Cleveland	131,778	129,413	-2,364	-1.8
Richmond	188,288	194,906	6,617	3.5
Atlanta	297,629	284,111	-13,518	-4.5
Chicago	226,869	236,690	9,821	4.3
St. Louis	123,780	128,164	4,384	3.5
Minneapolis	138,828	144,707	5,879	4.2
Kansas City	150,806	160,993	10,187	6.8
Dallas	144,597	144,777	180	.1
San Francisco	273,246	267,970	-5,277	-1.9
Total, all Districts	2,425,817	2,448,008	22,191	.9
Special project	16,392	13,803	-2,589	-15.8
Total	2,442,209	2,461,811	19,602	.8

NOTE. See note to table D.1.

Table D.6

Budget Performance of the Federal Reserve Banks, by District, and of FRIT and OEB:
Employment, 2001

Average number of personnel except as noted

District	2001 (budgeted)	2001 (estimated)	Change	
			Amount	Percent
Boston	1,285	1,316	31	2.4
New York	3,431	3,428	-2	-.1
Philadelphia	1,287	1,290	3	.3
Cleveland	1,392	1,344	-47	-3.4
Richmond	2,205	2,139	-66	-3.0
Atlanta	2,666	2,504	-162	-6.1
Chicago	2,111	2,145	34	1.6
St. Louis	1,318	1,305	-13	-1.0
Minneapolis	1,289	1,296	7	.6
Kansas City	1,678	1,717	39	2.3
Dallas	1,600	1,561	-39	-2.5
San Francisco	2,499	2,479	-20	-.8
Total, all Districts	22,760	22,525	-234	-1.0
Federal Reserve Information Technology	698	712	15	2.1
Office of Employee Benefits	29	31	2	7.8
Total	23,486	23,268	-218	-.9

NOTE. See note to table D.1. See text note 3, chapter 3, for definition of average number of personnel.

Table D.7

Budget Performance of the Federal Reserve Banks:
Operating Expenses, by Operational Area, 2001

Thousands of dollars except as noted

Operational area	2001 (budgeted)	2001 (estimated)	Change	
			Amount	Percent
Monetary and economic policy	229,340	234,043	4,703	2.1
Services to U.S. Treasury and other government agencies	264,406	265,617	1,211	.5
Services to financial institutions and the public	574,360	578,826	4,466	.8
Supervision and regulation	445,165	444,752	-412	-.1
Fee-based services to financial institutions	912,547	924,769	12,223	1.3
Total	2,425,817	2,448,008	22,191	.9

NOTE. Operational expenses include FRIT and OEB and exclude special project costs.

Table D.8

Budget Performance of the Federal Reserve Banks: Employment, by Operational Area, 2001

Average number of personnel except as noted

Operational area	2001 (budgeted)	2001 (estimated)	Change	
			Amount	Percent
Monetary and economic policy	890	886	-4	-.4
Services to U.S. Treasury and other government agencies	1,422	1,387	-35	-2.5
Services to financial institutions and the public	2,834	2,818	-16	-.6
Supervision and regulation	2,575	2,572	-3	-.1
Fee-based services to financial institutions	5,396	5,436	39	.7
Support and overhead	9,643	9,426	-216	-2.2
Total	22,760	22,525	-234	-1.0

NOTE. Operational area employment excludes FRIT, OEB,
and special project average number of personnel.

Table D.9

Salary Administration Expenses of the Federal Reserve Banks, by District, and of FRIT and OEB, for Officers and Employees, 2002

Thousands of dollars except as noted

District	Merit	Promotions and reclassifications	Market adjustments	Cash awards	Incentive payments	Retention payments	Severance	Total	
								Amount	As a share of total personnel expense (percent)
Boston	3,086	525	63	460	1,365	...	...	5,499	7.0
New York	10,244	1,687	950	4,688	2,303	398	1,499	21,769	8.5
Philadelphia	2,349	407	281	1,057	650	66	125	4,935	7.2
Cleveland	2,180	370	381	1,096	514	145	...	4,686	6.8
Richmond	4,116	1,334	734	1,812	849	...	...	8,844	8.2
Atlanta	5,302	1,914	267	2,132	940	229	203	10,987	8.9
Chicago	4,822	1,650	600	1,586	1,669	200	403	10,930	8.7
St. Louis	2,552	325	15	704	1,006	190	...	4,792	7.3
Minneapolis	2,531	328	125	775	727	1,361	...	5,846	9.0
Kansas City	3,612	1,394	797	1,080	970	277	74	8,205	8.9
Dallas	2,815	355	70	1,102	352	81	60	4,834	6.4
San Francisco	6,013	1,016	431	2,092	1,424	540	824	12,340	7.9
Total, all Districts ..	49,621	11,304	4,713	18,583	12,769	3,488	3,188	103,666	8.1
Federal Reserve Information Technology	2,239	420	...	526	1,154	625	...	4,963	8.2
Office of Employee Benefits	129	...	11	48	101	...	...	290	8.3
Total	51,989	11,724	4,724	19,158	14,024	4,112	3,188	108,920	8.1

NOTE. See text note 5, 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.

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 expense that represents payments for awards in recognition of exceptional achievements.

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

Retention payments: The amount of expense that represents payments to employees based on contractual agreement with the Bank. Generally used to retain staff in positions critical to the success of the Bank.

Severance: The amount of expense that represents payments to employees upon separation from the Bank.

Table D.10

Capital Outlays of the Federal Reserve Banks, by District, and of FRIT and OEB, 2001 and 2002

Thousands of dollars except as noted

District	2001 (estimated)	2002 (budgeted)	Change	
			Amount	Percent
Boston	13,262	19,282	6,021	45.4
New York	46,476	66,718	20,242	43.6
Philadelphia	9,953	19,513	9,560	96.1
Cleveland	22,746	22,781	35	.2
Richmond	23,935	27,284	3,349	14.0
Atlanta	88,202	26,877	-61,325	-69.5
Chicago	32,957	54,634	21,677	65.8
St. Louis	20,635	19,312	-1,322	-6.4
Minneapolis	7,237	7,374	137	1.9
Kansas City	16,031	19,264	3,232	20.2
Dallas	9,339	18,579	9,239	98.9
San Francisco	19,810	36,673	16,863	85.1
Total, all Districts	310,583	338,291	27,708	8.9
Federal Reserve Information Technology	42,035	33,511	-8,524	-20.3
Office of Employee Benefits	1,475	3,300	1,825	123.7
Total	354,093	375,102	21,009	5.9

Table D.11

Capital Outlays of the Federal Reserve Banks, by Asset Classification, 2001 and 2002

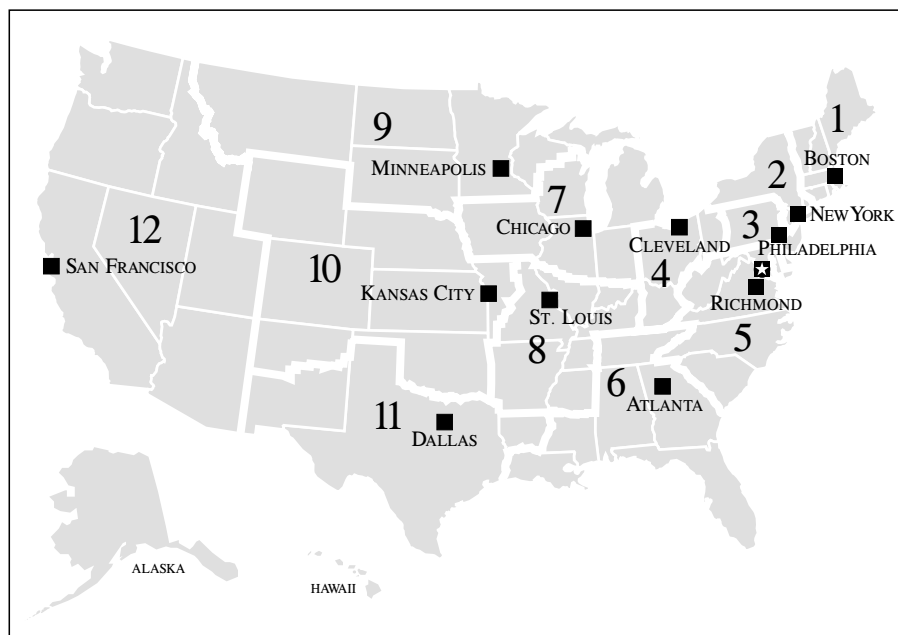
Thousands of dollars except as noted

Asset classification	2001 (estimated)	2002 (budgeted)	Change	
			Amount	Percent
Equipment	127,316	137,083	9,767	7.7
Furniture, furnishings, and fixtures	27,914	17,496	-10,418	-37.3
Land and other real estate	1,772	15,403	13,631	769.4
Building	127,062	122,899	-4,163	-3.3
Building machinery and equipment	19,564	35,984	16,420	83.9
Leasehold improvements	6,761	5,402	-1,359	-20.1
Software	43,704	40,835	-2,870	-6.6
Total	354,093	375,102	21,009	5.9

NOTE. Includes outlays for FRIT and OEB.

*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 2001.

