

Annual Report: Budget Review

Board of Governors of the Federal Reserve System

2001

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Contents

Introduction

- 1 FEDERAL RESERVE BUDGET PROCESSES AND OPERATIONAL AREAS
- 1 Summary of 2000 income and expenditures
- 1 Budget processes
- 4 Operational areas

Part I The Budgets

Chapter 1

- 11 FEDERAL RESERVE SYSTEM
- 12 Net expenses
- 13 Trends in expenses and employment
- 14 2001 budget initiatives

Chapter 2

- 15 BOARD OF GOVERNORS
- 15 Overview of the budget process
- 17 Highlights of the budget
- 19 Operations budget by division and account classification
- 22 Operations budget by operational area
- 24 Capital budget
- 24 Positions
- 25 Trends in expenses and employment
- 26 Extraordinary items

Chapter 3

- 29 FEDERAL RESERVE BANKS
- 30 2000 budget performance
- 32 Factors affecting the 2001 budget
- 37 Risks in the 2001 budget
- 37 2001 capital plan

Part II Special Analysis

Chapter 4

- 43 CHECK MODERNIZATION
- 43 Background
- 44 Check modernization projects
- 46 Project management
- 47 Anticipated benefits

Appendixes

Appendix A

- 51 SPECIAL CATEGORIES OF SYSTEM EXPENSE
- 51 Priced services
- 54 Capital outlays
- 54 Currency printing and circulation

Appendix B

- 57 SOURCES AND USES OF FUNDS

Appendix C

- 59 FEDERAL RESERVE SYSTEM AUDITS
- 59 Independent audit
- 59 General Accounting Office
- 65 Office of Inspector General

Appendix D

- 67 EXPENSES AND EMPLOYMENT
AT THE FEDERAL RESERVE BANKS
- 74 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 2000 Income and Expenditures

In carrying out its responsibilities in 2000, the Federal Reserve System incurred an estimated \$1.3 billion in net operating expenses. Total spending of an estimated \$2.5 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 \$32.7 billion in 2000. Earnings in excess of expenses, dividends, and surplus are transferred to the U.S. Treasury—in 2000 an estimated \$25.3 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 2000.

Board of Governors

The Board's budget covers a two-year period. The first year of the budget cycle—the even-numbered year—is used to update the strategic plan for the next four years, and the second year is used to develop the budget for the next two years.

The two-year cycle begins in the fall (thus, for the 2000–01 budget, the fall of 1998). At that time, the Board's divisions examine their operating environments and look for any adjustments to their priorities, activities, and resources that might improve the efficiency and effectiveness of the Board's operations.

The management of each division discusses with the appropriate Board oversight committee the issues that result from its review. After any adjustment, the results are given to the Staff Planning Group, a small group of senior managers with a Boardwide perspective, for use in their analysis of the Board's budget options.

After consulting with the Board-level Committee on Board Affairs for final guidance, the Staff Planning Group updates the strategic plan, which is used to prepare a preliminary budget objective that identifies the level and allocation of resources needed to support the plan. 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 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 activities 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 depreciates 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 expenditures by month; the operating plan is also the vehicle for subsequent adjustments within the budget. Also at this point, the cash requirement for the first half of the calendar year is estimated, and the amount is raised by an assessment on each of the Reserve Banks in proportion to its capital stock and surplus. The cash requirement for the second half of each year is estimated in June, and another assessment is made in July.

The Board accounts for extraordinary items separately from the operations budget so that unique, one-time requirements do not compete with regular operations and so that expenses in those operations can be readily compared across years without distortion. As discussed more fully in chapter 2, the extraordinary items budget for 2000–01 consists of funds to support two periodic surveys, one on consumer finances and the other on small business finances, and the century date change work completed in early 2000.

The Board's Office of Inspector General (OIG), in keeping with its statutory independence, prepares its proposed budget apart from the Board's budget. The OIG presents its two-year budget directly to the Chairman for action by the Board, also at an open meeting in 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 functional and District comparability of 2001 budget data with budget and expense data from previous years.

Changes to Federal Reserve Bank accounting methodology are detailed in chapter 3 of this book.

Operational Areas

In 2000 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 companies. The Board of Governors adopts regulations to carry out statutory directives and establishes System supervisory and regulatory policies; the Reserve Banks conduct on-site examinations and inspections of state member banks and bank holding companies, review applications for mergers, acquisitions, and changes in control from banks and bank holding companies, and take formal supervisory actions. In 2000, the Federal Reserve conducted 589 examinations of state member banks (some of them jointly with state agencies) and 1,247 inspections and 2,351 risk assessments of bank holding companies; it acted on 3,232 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 2000, the System conducted 388 compliance examinations, including 284 covering state member banks and 104 covering foreign banking organizations. Procedures related to the Community Reinvestment Act were included in 114 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 2000, the Reserve Banks received \$564.3 billion in currency and \$3.9 billion in coin from depository institutions, distributed an estimated \$527.3 billion in currency and \$6.3 billion in coin, and destroyed \$112.2 billion in unfit currency.

The Reserve Banks (along with their Branches and regional centers) also process checks for collection. In 2000, the Reserve Banks processed approximately 17 billion commercial checks for collection with a total value of nearly \$13 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 reserve or clearing balances at the Reserve Banks and transfer funds anywhere in the country. In 2000, approximately 104.2 million transfers valued at about \$379 trillion were sent over the Fedwire funds transfer system, an average of \$3.6 million per transfer and \$1.5 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 check clearing-house associations, automated clearing-house (ACH) networks, credit card processors, automated teller machine networks, and a national funds transfer network. The Federal Reserve offers three types of settlement services: "settlement sheet," Fedwire-based, and enhanced.¹ The Reserve Banks provide settlement services to approximately ninety-one local and national private-sector clearing and settlement arrangements. In 2000, the Reserve Banks processed more than 390,000 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 2000, the Reserve Banks processed approximately 3.8 billion ACH transactions valued at about \$11.3 trillion; approximately 19 percent of the transactions were for the federal government, and the rest were for commercial establishments.

Reserve Banks provide securities services for the handling of book-entry (computer-based) securities and the collection of interest coupons and miscellaneous items. The book-entry service enables the holders of Treasury and government agency securities to transfer the securities electronically to other institutions throughout the country. In 2000, the Reserve Banks processed approximately 14.5 million securities transfers valued at \$190 trillion, an average of \$13 million per transfer and \$754 billion per day. The noncash collection service, through which maturing or called physical coupons and

1. The settlement sheet service will be phased out by year-end 2001, when all its participants must move to the enhanced service.

bonds are presented for collection, processed about 508,400 transactions in 2000.

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 and collects receipts. The Reserve Banks 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 2000, 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 1,300 depository institutions accept tax proceeds as investments and pay interest on the funds until Treasury calls the balances. These investments and other funds held at depository institutions must be collateralized at all times. During the fourth quarter of 2000, the Reserve Banks introduced new software, called the Treasury Investment Program (TIP), for collecting and investing tax proceeds. A principal enhancement of TIP is the real-time monitoring of collateral and removal of under-collateralized balances.

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. ■

Part I

The Budgets

Chapter 1

Federal Reserve System

For 2001, total operating expenses are budgeted at \$2,659.8 million, an increase from estimated 2000 expenses of 7.0 percent. Of this total, \$2,442.2 million is for the Reserve Banks, and \$217.6 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 \$977.8 million, or 36.8 percent of total budgeted operating expenses. This revenue, combined with claims for reimbursement and other income, results in projected net operating expenses of \$1,391.6 million.²

1. The Board of Governors now budgets on a two-year cycle (see chapter 2); in this chapter, 2001 values shown for the System and the Board reflect the approximate second-year effect of the Board's 2000–01 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

Not included in the budget for operations is the cost of currency, budgeted at \$427.0 million for 2001, a decrease of 1.9 percent from the estimated 2000 cost of \$435.2 million.³ The distribution of expenses is similar to that in previous years, with the Reserve Bank's expenses accounting for approximately three-fourths of the total (chart 1.1).

System employment is budgeted at 25,090 for 2001, an increase of 69 from the estimated 2000 level (details are given in chapters 2 and 3).

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

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

Table 1.1

Operating Expenses of the Federal Reserve System, Net of Receipts and Claims for Reimbursement, 1999–2001

Millions of dollars except as noted

Item	1999	2000 (estimated)	2001 (budgeted)	Percent change	
				1999 to 2000	2000 to 2001
Total System operating expenses	2,378.9	2,485.2	2,659.8	4.5	7.0
LESS					
Revenue from priced services	867.6	916.1	977.8	5.6	6.7
Other income	1.9	1.0	.3	-47.4	-70.0
Claims for reimbursement ¹	295.4	310.2	290.1	5.0	-6.5
EQUALS					
Net System operating expenses	1,214.0	1,257.9	1,391.6	3.6	10.6

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

Operating expenses reflect all redistributions for support and overhead 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, 1999–2001

Millions of dollars except as noted

Entity and type of expense	1999	2000 (estimated)	2001 (budgeted)	Percent change	
				1999 to 2000	2000 to 2001
Reserve Banks ¹	2,193.8	2,297.8	2,442.2	4.7	6.3
Personnel	1,459.5	1,523.5	1,611.6	4.4	5.8
Nonpersonnel	734.3	774.3	830.6	5.4	7.3
Board of Governors ²	185.1	187.4	217.6	1.2	16.1
Personnel	131.3	139.7	152.8	6.4	9.4
Nonpersonnel	53.9	47.8	64.8	-11.4	35.7
Total System operating expenses	2,378.9	2,485.2	2,659.8	4.5	7.0
Personnel	1,590.8	1,663.2	1,764.4	4.6	6.1
Nonpersonnel	788.2	822.1	895.4	4.3	8.9
Currency ³	485.7	435.2	427.0	-10.4	-1.9

NOTE. See general note to table 1.1.

1. For detailed information on Reserve Bank expenses, see chapter 3.

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

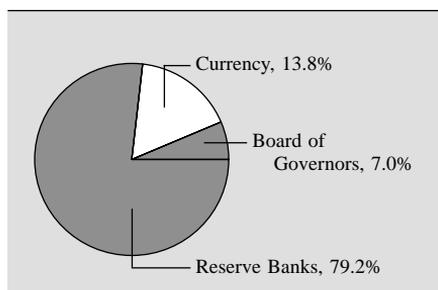
3. See text note 3 and appendix A.

Net Expenses

The System expects to recover 47.7 percent of its budgeted 2001 operating expenses through revenue from priced services, other income, and claims for reimbursement. When these items are deducted from budgeted 2001 operating expenses, the net expenses of the System

Chart 1.1

Distribution of Expenses of the Federal Reserve System, 2001



NOTE. See text notes 1 and 3.

show an increase of 10.6 percent from estimated 2000 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 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.

Table 1.3
Revenue from Priced Services, 1999–2001
Millions of dollars

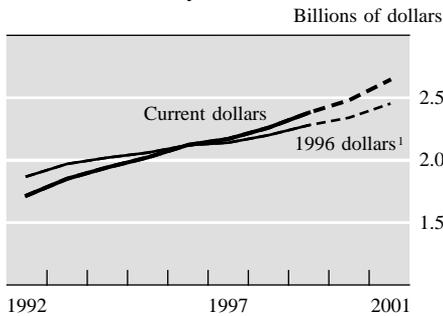
Service	1999	2000 (estimated)	2001 (budgeted)
Funds transfers and net settlement	69.2	65.0	63.2
Automated clearinghouse	67.8	70.6	75.5
Commercial checks	707.3	757.8	815.4
Book-entry securities transfers	17.3	18.0	19.9
Noncash collection	3.0	2.4	2.0
Special cash services	3.0	2.3	1.7
Total	867.6	916.1	977.8

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 1992 levels to budgeted 2001 amounts, the operating expenses of the Federal Reserve System have increased an average of 4.8 percent per year (2.9 percent per year when adjusted

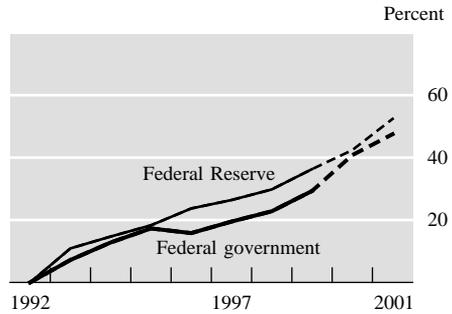
Chart 1.2
Operating Expenses of the Federal Reserve System, 1992–2001
Billions of dollars



NOTE. For 2000, estimated; for 2001, budgeted (for more detail see text note 1).

1. Calculated with the GDP price deflator.

Chart 1.3
Cumulative Change in Federal Reserve System Expenses and Federal Government Expenses, 1992–2001
Percent

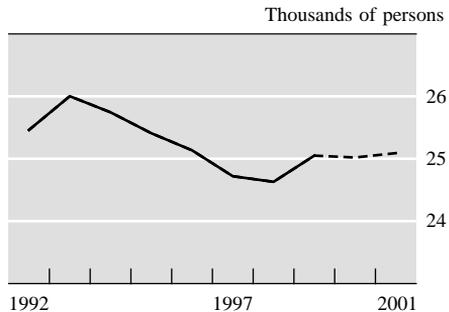


NOTE. Federal government expenses are discretionary spending less expenditures on defense. See also general note to chart 1.2.

for inflation) (chart 1.2). Over the same period, nondefense discretionary spending by the federal government has increased an annual average of 4.4 percent (chart 1.3). Over the 1992–2001 period, Federal Reserve System employment has decreased 372 (chart 1.4).

Two areas grew notably during this period. Spending on banking supervision rose to meet the increase in the number and complexity of examinations, to provide enhanced supervision

Chart 1.4
Employment in the Federal Reserve System, 1992–2001
Thousands of persons



NOTE. See general note to chart 1.2.

of foreign institutions, and to meet the requirements of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 and the Federal Deposit Insurance Corporation Improvement Act of 1991. Spending also increased as the Reserve Banks consolidated computer operations into three sites. Expenses for this centralization effort began to increase in 1992 and peaked during 1995 and 1996, as redundant equipment and staffing were needed prior to full transition. These expenditures have been balanced over the past several years by savings enabled by greater efficiencies and economies of scale. In addition, Reserve Banks have reduced expenses by consolidating several operations performed on behalf of the Treasury.

Reserve Banks have also realized productivity gains in the cash and check services areas. Based on several measures of productivity, each service has improved productivity by at least 25 percent since 1992.

2001 Budget Initiatives

In 2001, several major initiatives will continue to affect System budgets. As discussed in chapters 3 and 4, installation of equipment and software to support the standardization of check processing and check imaging and archiving is one of the primary drivers of the overall System budget. In addition, several Banks will realize the expense effect of facility upgrades, repairs, and maintenance.

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

Chapter 2

Board of Governors

As noted in the introduction to this book, the budget for the Board of Governors covers a two-year period. During 2000, the first year of the current budget period, a number of minor reallocations were made within the 2000–01 approved operations budget. The operations budget was also increased \$2.2 million to fund larger-than-budgeted staff merit pay increases and to enhance security procedures for the Chairman. An additional \$2.7 million was added to the capital budget for an emergency generator to enhance the Board's ability to operate in emergency situations.

The revised 2000–01 budget for the Board of Governors provides \$389.8 million for operations, \$7.8 million for extraordinary items (projects of a unique nature), and \$6.6 million for the Office of Inspector General. The Board has authorized a revised staff position count of 1,699 for operational areas and 29 positions for the Office of Inspector General; no positions are required for the extraordinary items function. The total of 1,728 positions is a decrease of 12 positions from the number authorized at the end of 1999.

As identified by division directors during the planning process, four items may require significant additional funding. Costs associated with the passage of the financial modernization bill (personnel services, travel, and the like) are being funded through a combination of work reallocation and staff overtime and, possibly, an increase in the Board's operations budget. Position vacancy rates are lower than past trends, adding costs. In addition, studies have determined that compensation packages in some

job families are insufficient to keep the Board competitive in the job market.

Overview of the Budget Process

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

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

Planning

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

- *Human resources and Board organization.* These critical areas affect operations through the following: compen-

sation that attracts, rewards, and retains staff; management succession; professional development; and coordination of employee skills to stay abreast of the growing complexity of operations and improvements in technology.

- *Financial industry restructuring.* The Board must focus its response to changing circumstances in the financial industry, the increasing concentration of financial institutions, and the growing importance of international financial activity to the Board's mission.¹
- *Assistance and support to foreign governments, central banks, and international organizations.* These activities continue to grow in importance, requiring a greater commitment of resources and making heavier demands on the time of key staff members.
- *Technology investments.* Up-to-date and fully functioning technology remains critical to maintaining efficient operations, implementing appropriate monetary policy decisions in an increasingly complex environment, and identifying supervisory risks in the financial sector and the actions needed to limit them.
- *Communications with the public.* The Board must take advantage of technology, particularly the web, to provide materials to the public that explain Board actions, policies, and objectives and to provide available data useful for research and public policy debates.
- *Facilities.* The Board must maintain safe facilities that foster efficient operations; continue necessary repairs to the Eccles Building, which is now

more than sixty years old; and devise a strategy to reduce the long-term cost of space for the staff.

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

Board Operations

The approved budget reflects difficult decisions affecting current operations, provides additional resources where operations need to respond to changes in the financial environment, and supports key efforts to continue to attract and retain the first-rate staff needed to accomplish the Board's mission.

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

These changes required additional resources; hence, the revised two-year budget increase averages 6.3 percent per

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

year. The increase is largely for personnel costs, which account for nearly three-fourths of the Board's operating budget, and investments in technology such as the Banking Organization National Desktop (BOND) project.

Extraordinary Items

Inclusion of certain periodic or one-time expenses in the Board's operations budget can result in undue volatility in the size of the budget. Therefore, funds for such extraordinary items are set apart from the operations budget. For 2000–01, \$7.8 million in operating funds has been budgeted for three extraordinary items: two major economic surveys and final reports and closeout efforts to modify or replace software to ensure continuity of operations after the century date change (CDC). Because the CDC efforts have been decreasing sharply over the 2000–01 period, this budget is approximately \$15.2 million less than in the 1998–99 budget.

Office of Inspector General

The 2000–01 budget of \$6.6 million for the Office of Inspector General (OIG) is separate from the Board's. The OIG's budget is prepared in a manner that is administratively consistent with the preparation of the Board's operating budget. In conformance with the statutory independence of the office, the OIG presents its budget directly to the Chairman of the Board of Governors for consideration by the Board.

Highlights of the Budget

The Board's 2000–01 operations budget represents an increase of \$44.6 million over 1998–99 actual expenses, an average increase of 6.3 percent per year

(table 2.1). The discussion below highlights the major components of this increase as well as the primary offsetting decreases.

The largest force driving the increase in the budget is personnel related. The total number of positions decreased by 12 from the 1998–99 (table 2.2); however, positions eliminated by technology improvements tend to be less costly than those added to meet the changes outlined in the overarching issues. The placeholder amounts included in the budget for merit increases were significantly higher than the placeholders for the 1998–99 biennium (4.4 percent and 4.0 percent in 2000 and 2001 respectively, compared with 3.8 percent and 3.5 percent in 1998 and 1999 respectively).² The larger amounts were in recognition of the need to keep the Board's salary structure aligned with appropriate labor markets.

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

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

In sum, increased spending on personnel services, including higher compensation packages designed to attract and

2. The actual merit increases in 1998 and 1999 were 3.8 percent and 4.2 percent respectively. The actual merit increases for 2000 and 2001 were 4.8 percent and 4.75 percent respectively. A portion of the unbudgeted increase was absorbed internally, and the balance was added to the budget.

retain highly skilled staff, account for \$29.7 million, or 66.7 percent, of the total budget increase.

The increase in the cost of goods and services, \$14.9 million, is largely due to increased operating expenses related to a number of projects. First, an additional \$3.0 million, or 6.7 percent of the total increase, funds further implementation of the BOND project. Second, rental expenses associated with the Eccles Building Infrastructure Enhancement Project account for \$1.3 million, or 2.9 percent, of the overall increase. Finally, contractual expenses largely related to the pent-up demand for information technology services, restrained by Year 2000 policy decisions

and the priority assigned to software remediation activities, are requiring an additional \$4.8 million. The remainder of the increase is associated with rate and volume adjustments as well as lower expenses in the 1998–99 time period.

Two major areas of budget decrease are in programs and depreciation. Program reductions worth \$2.2 million will allow added investment to support the overarching issues identified in planning. Depreciation expense declined \$2.3 million because of the change in the Board’s capitalization policy that took effect on January 1, 1998. Other, smaller decreases come from changes in operations. For example, mailing costs

Table 2.1

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

Thousands of dollars except as noted

Division, office, or special account	1998–99	2000–01 (revised budget)	Change	
			Amount	Percent
Board Members	8,282	8,480	197	2.4
Secretary	8,030	9,412	1,382	17.2
Research and Statistics	56,543	61,127	4,585	8.1
International Finance	20,297	22,741	2,444	12.0
Monetary Affairs	17,427	19,249	1,822	10.5
Banking Supervision and Regulation	53,713	58,867	5,154	9.6
Consumer and Community Affairs	15,148	17,813	2,665	17.6
Legal	15,296	17,643	2,347	15.3
Reserve Bank Operations and Payment Systems	30,547	32,435	1,888	6.2
Staff Director for Management	1,469	2,620	1,151	78.3
Management	19,851	22,079	2,229	11.2
Support Services	54,992	58,121	3,129	5.7
Information Technology	69,338	78,220	8,881	12.8
Publications Committee	2,574	3,059	485	18.8
Special projects	9,226	18,134	8,908	96.6
IRM income account ¹	-37,556	-40,242	-2,686	7.2
Total, Board operations	345,177	389,758	44,581	12.9²
Extraordinary items	20,401	7,847	-12,554	...
Office of Inspector General	5,640	6,617	977	17.3

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

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

2. Average annual change from 1999 through 2001 is 6.3 percent for Board operations and 8.3 percent for the Office of Inspector General.

... Not applicable.

Table 2.2

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

Division, office, or special account	1998–99 (authorized)	2000–01 (revised budget)	Change
Board Members	34	35	1
Secretary	56	56	0
Research and Statistics	276	279	3
International Finance	115	119	4
Monetary Affairs	65	65	0
Banking Supervision and Regulation	224	220	-4
Consumer and Community Affairs	76	78	2
Legal	82	82	0
Reserve Bank Operations and Payment Systems	135	128	-7
Staff Director for Management	3	11	8
Management	89	89	0
Concern ¹	31	31	0
Support Services	216	198	-18
Information Technology (IT)	281	280	-1
Special projects	3	3	0
Subtotal	1,686	1,674	-12
Reimbursable IT support ²	25	25	0
Total, Board operations	1,711	1,699	-12
Office of Inspector General	29	29	0

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

2. Positions in the Division of Information Technology that provide support to the Federal Financial Institutions

Examination Council for processing data collected under the Home Mortgage Disclosure Act and the Community Reinvestment Act.

are declining because of an improved ability to disseminate information to constituent groups through electronic distribution of documents and expansion of the Board's web site.

Risk Areas

When budgets were prepared in mid-1999, division directors identified items that could require significant additional resources during the 2000–01 period. These potential items were as follows:

- Passage of a financial modernization bill (enacted in late 1999)
- Some job families in which current compensation packages did not seem to be competitive in the job market

- Possible changes to the position vacancy rates used in developing the proposed salary budget and the resulting facility requirements should staffing patterns change
- A sharp increase in the rate of financial innovation.

Operations Budget by Division and Account Classification

The largest increase in the 2000–01 revised budget is in the area of personnel services (table 2.3). The proposed budget for personnel services (salaries, retirement, and insurance) is \$29.7 million greater than the 1998–99 budget (an average increase of 5.6 percent per year). As the number of authorized posi-

Table 2.3

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

Thousands of dollars except as noted

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

tions is actually declining by 12 over this period, this dollar increase is due to higher compensation levels necessary to attract and retain highly skilled staff members and a projected reduction in the number of vacant positions, particularly in the supervision and regulation function (table 2.2).

The 2000–01 budget for goods and services is \$14.9 million greater than 1998–99 actual expenses (an average increase of 6.3 percent per year). Much of the increase in the area of goods and services is attributable to a \$3.8 million (7.5 percent per year) increase in contractual professional services associ-

ated with outsourcing the cafeteria services, purchasing additional economic data, providing technical assistance with the Daylight Overdraft Reporting and Pricing System, and obtaining contractual support for various information technology initiatives. Increases in programming efforts on the BOND project account for \$3.0 million.

Partially offsetting these increases are program reductions in various areas throughout the Board. These include specialized activities in the Division of Banking Supervision and Regulation, cafeteria services, streamlined operations in the Management Division,

Table 2.3
Continued

Thousands of dollars except as noted

Account classification	1998–99	2000–01 (revised budget)	Average annual change (percent)	
			1998–2001	1990–2001
<i>Personnel services</i>				
Salaries	222,203	248,394	5.7	5.7 ¹
Retirement	19,708	21,214	3.8	8.2
Insurance	14,463	16,475	6.7	3.7
Subtotal	256,374	286,083	5.6	5.7
<i>Goods and services</i>				
Travel	10,823	11,314	2.2	5.1
Postal and shipping	1,706	1,716	.3	-3.1
Telecommunications	6,120	6,164	.4	6.2
Printing and binding	2,188	2,608	9.2	1.5 ¹
Publications	2,338	2,297	-9	18.9 ¹
Stationery and supplies	1,831	2,062	6.1	2.1 ¹
Software	8,349	10,509	12.2	8.8
Furniture and equipment	7,607	8,576	6.2	18.9 ²
Rentals	8,884	10,422	8.3	. . . ¹
Books and subscriptions	1,765	2,109	9.3	5.9
Utilities	4,429	4,619	2.1	3.1
Building repairs and alterations	2,881	3,635	12.3	6.5
Furniture and equipment repairs and maintenance	3,517	4,273	10.2	1.4
Contingency Processing Center	181	0	. . .	-99.9
Contractual professional services	24,421	28,226	7.5	18.1
Tuition, registration, and membership fees . . .	2,672	3,427	13.2	10.4
Subsidies and contributions	1,524	1,482	-1.4	2.4
Depreciation	20,204	17,939	-5.8	4.6
Other	-22,637	-17,702	-11.6	14.3
Subtotal	88,803	103,675	8.0	8.0
Total, Board operations	345,177	389,758	6.3	6.3
Extraordinary items	20,401	7,847
Office of Inspector General	5,640	6,617	8.3	40.1

1. The method of accounting for income in performance reports changed during the period. Until 1991, income was netted against expenses in the appropriate cost center and program; since then, income has been captured in the "all other" account. The change has had only a minor effect on the 1990–2001 percentage change in the accounts for salaries, printing and binding, and stationery and supplies, but in the accounts for publications and

rentals, it has made a measurement of the 1990–2001 change much less meaningful.

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

. . . Not applicable.

attrition in the Office of the Secretary, and administrative reductions in the Division of Information Technology (table 2.1).

Savings in support-related areas include a reduction in postage and shipping expenses due to increased use

of the Internet and intranet for information sharing, lower depreciation costs following the 1998 raising of the capitalization threshold, and increased income from other government agencies and Reserve Banks for information technology services.

Operations Budget by Operational Area

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

(tables 2.4 and 2.5). Overhead is allocated to each of these functions, and the financial data include the allocation.

Monetary and Economic Policy

The 2000–01 revised budget for monetary and economic policy is \$164.8 mil-

Table 2.4

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

Thousands of dollars except as noted

Activity	1998–99	2000–01 (revised budget)	Change	
			Amount	Percent
Monetary and economic policy	145,612	164,806	19,194	13.2
Supervision and regulation	129,949	149,757	19,808	15.2
Services to financial institutions and the public	6,026	7,942	1,916	31.8
System policy direction and oversight	63,590	67,253	3,663	5.8
Total, Board operations	345,177	389,758	44,581	12.9¹
Extraordinary items	20,401	7,847	-12,554	...
Office of Inspector General	5,640	6,617	977	17.3

NOTE. See general note to table 2.1.
... Not applicable.

1. Average annual change from 1999 through 2001 is 6.3 percent for Board operations and 8.3 percent for the Office of Inspector General.

Table 2.5

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

Activity	1998–99	2000–01 (revised budget)	Change
Monetary and economic policy	426	433	7
Supervision and regulation	383	381	-2
Services to financial institutions and the public ..	22	22	0
System policy direction and oversight	174	173	-1
Support and overhead ¹	681	665	-16
Subtotal	1,686	1,674	-12
Reimbursable IT support ²	25	25	0
Total, Board operations	1,711	1,699	-12
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.

lion, an increase of \$19.2 million, or an average of 6.4 percent per year more than 1998–99 actual expenses. Activities in this operational area include the Board’s monitoring and analysis of developments in the money and credit markets, the setting of reserve requirements, the approval of changes in the discount rate, and other activities related to managing the nation’s monetary policy. The entire increase is associated with higher costs of personnel, including the addition of four positions in the Division of International Finance to meet the expanding need for risk assessment and analysis.

In addition to the changes in personnel services are internally funded initiatives in the Division of Research and Statistics to collect more data related to developments in financial markets; gain a better understanding of embodied technological change; expand the sectoral productivity database; and further assess credit bureau data. These initiatives are all funded by reductions, primarily in automation support.

Supervision and Regulation

The 2000–01 revised budget for supervision and regulation is \$149.8 million, an increase of \$19.8 million, or an average of 7.4 percent per year more than 1998–99 actual expenses. Activities in this area include working with other federal and state financial authorities to ensure safety and soundness in the operation of financial institutions, stability in the financial markets, and fair and equitable treatment of consumers in their financial transactions. The budget, as described below, enables enhanced supervisory activities such as continuous monitoring, inspection, and examination of banking organizations to assess their condition and their compliance with relevant laws and regulations.

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

Many positions in this operational area were vacant for long periods following the voluntary retirement incentive program in 1998 but have now been filled. Success in filling these positions results in part from substantial salary increases within key job families to improve retention and assist with recruiting. Thus, in the Division of Banking Supervision and Regulation, the vacancy rate has decreased. The number of positions in the Consumer Affairs area has increased, and the investment in software to better analyze data gathered under the Community Reinvestment Act and the Home Mortgage Disclosure Act continues to be substantial.

Services to Financial Institutions and the Public

The 2000–01 revised budget for oversight of Reserve Bank services to financial institutions and the public is \$7.9 million, an increase of \$1.9 million, or an average of 14.8 percent a year more than 1998–99 actual expenses. This operational area provides support to, and oversight of, the Federal Reserve Banks and Branches—specifically, evaluation of the operational and pricing performance for the check-payment activities of the Reserve Banks; oversight of the electronic payments mechanism; and annual evaluation of the Federal

Reserve System's currency, coin, and food coupon operations. The increase reflects new software development for managing the currency operations and a lower projected rate of vacancies in key programs analyzing payment system risk.

System Policy Direction and Oversight

The 2000–01 revised budget for System policy direction and oversight is \$67.3 million, an increase of \$3.7 million, or an average of 2.8 percent per year more than 1998–99 actual expenses. This operational area covers oversight and direction of Board and Reserve Bank programs. It includes programs that directly support Board members in carrying out their oversight function for Reserve Bank operations, budgeting and accounting, financial examinations, audit and operations reviews, and automation and communications. Salary increases are the largest single factor in the higher costs of this area, which are tempered by lower costs associated with changes in oversight policy.

Capital Budget

The Board's 2000–01 capital budget is \$26.5 million, an increase of \$5.5 million from 1998–99 actual expenses. Of this total, \$14.7 million is for regular operations, an increase of \$1.9 million above the 1998–99 level. This portion of the budget supports continued improvements in office automation and major upgrades to the information infrastructure, including a major cable upgrade to enhance bandwidth and communication speeds. Funds are also provided for the restoration of aging facilities such as restrooms; mail distribution and central file storage systems; heating, ventila-

tion, and air conditioning systems; and other, smaller facilities projects.

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

Positions

The overall position authorization for the Board decreased by 12, primarily in overhead and support areas, from 1998–99 actual levels, to a total of 1,699 positions (table 2.2).

Reductions in support-related areas include a significant number in Support Services due to faster-than-anticipated consolidation of the duplicating, publications, and cafeteria functions, reflecting reorganizations and changes in business practices to increase efficiency. Reductions are projected for the Division of Information Technology and the Management Division as part of their planning initiatives to increase efficiency and effectiveness. Finally, reductions in the Division of Banking Supervision and Regulation have been made to accommodate shifting priorities.

These decreases are partially offset by an increase of nine positions in the core mission areas. Three positions have been added in the Division of Research and Statistics to expand its analysis of financial markets data and to continue development of a sectoral productivity database. Four economist positions have been added in the Division of International Finance to meet the expanding need for risk assessment and analysis in

the monetary policy and research areas to enable the Board to keep current on the rapid changes in the financial industry both domestically and abroad. Two analyst positions have been added in the Division of Consumer and Community Affairs to handle a growing volume of consumer complaints and a shift to a more risk-focused approach to consumer compliance examinations.

Trends in Expenses and Employment

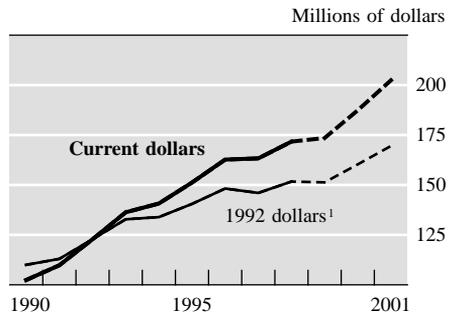
The rate of increase in the 2000–01 revised budget, 6.3 percent on an annual basis, is slightly higher than the 4.1 percent rate in the 1998–99 biennium. The projected annual rate of increase over the 1999–2001 period averages 6.3 percent (table 2.3; see also charts 2.1–2.5). The main cause of the larger increase over the entire period is the net increase in positions, higher salary and benefit costs, and an increasingly sophisticated automation system required to manage a sharp increase in the volume and complexity of the Board’s workload. The higher increase from the last budget results from a larger merit component (4.4 percent for 2000 versus 3.5 percent for 1999), major software development costs for the supervision and regulation function, and a smaller volume of savings from administrative actions and programmatic reductions.

Approximately three-fourths of the Board’s operating expenses are for personnel; consequently, analysis of trends is heavily tied to staffing levels. From 1990 to 2001, the number of authorized positions for Board operations rose from 1,529 to 1,668, a net increase of 139, or 9.1 percent.

Automation changes to provide sophisticated analytical tools to staff members, manage larger data sets, and

Chart 2.1

Operating Expenses of the Board of Governors, 1990–2001



Year	Millions of dollars	
	Current dollars	1992 dollars ¹
1990	102.4	110.0
1991	109.8	113.0
1992	122.8	122.8
1993	136.3	132.8
1994	140.7	133.9
1995	151.2	140.5
1996	162.7	148.2
1997	163.3	146.0
1998	171.7	151.7
1999	173.5	151.3
2000	187.4	160.3
2001	202.4	169.5

NOTE. For 2000, estimated; for 2001, budgeted. Excludes the Office of Inspector General and extraordinary items. The annual values for 1998, 1999, 2000, and 2001 are the approximate calendar-year figures contained within the respective two-year budgets.

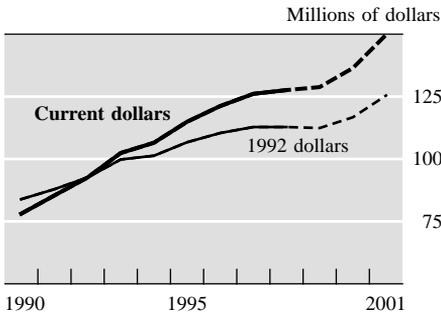
1. Calculated with the GDP price deflator.

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

Changes in banking, frequently associated with automation enhancements, increased the complexity of safety and soundness activities and caused an increase of 51 positions over the period. Increased attention to consumer issues,

Chart 2.2

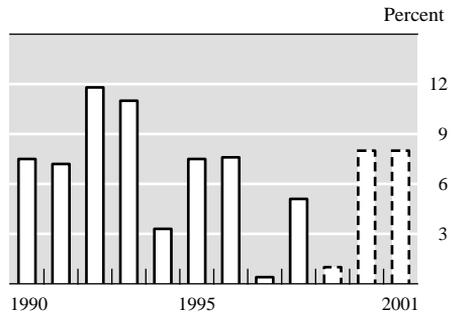
Expenses for Personnel Services at the Board of Governors, 1990–2001



NOTE. See notes to chart 2.1.

Chart 2.4

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



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

including collection and analysis of data collected under the Home Mortgage Disclosure Act and the Community Reinvestment Act, added 35 positions. Increasing complexity of monetary policy issues resulted in an increase of 34 positions. Oversight of Reserve Bank operations became more complex, resulting in an increase of 12 positions. These increases were partially offset by a decline of 25 administrative and support positions resulting from capital investments, improved efficiency, and outsourcing.

Although the number of positions at the Board has fluctuated during the

1990–2001 period, the salary budget (not including retirement and insurance benefits) has remained relatively stable at roughly 65 percent of operating expenses. The portion of operating expenses devoted to retirement and insurance has decreased approximately 1 percentage point over the period as a result of administrative actions to limit costs for health insurance and other benefits.

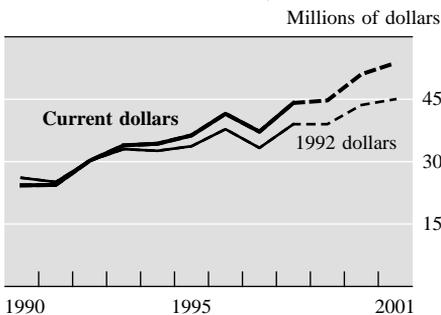
Extraordinary Items

The Board’s extraordinary items budget provides \$7.8 million for three projects. The first, a survey of consumer finances (\$5.5 million), will provide financial data for various policy analysis and monetary policy purposes. This effort reflects the Board’s interest in improving the quality of economic data by obtaining information on the income, assets, debts, pensions, employment, use of financial services, savings behavior, and other characteristics of U.S. households. Cross-categorization of the data will allow important statistical observations useful in a wide variety of economic studies.

The second project is the completion of the National Survey of Small Busi-

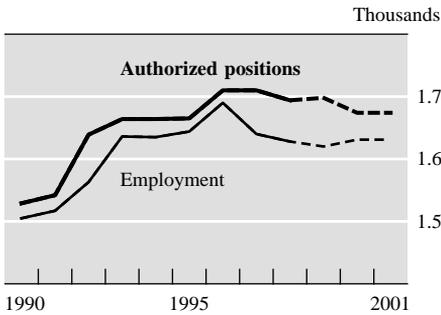
Chart 2.3

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



NOTE. See notes to chart 2.1.

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



Year	Employment	Authorized positions
1990	1,505	1,529
1991	1,517	1,542
1992	1,563	1,639
1993	1,636	1,664
1994	1,635	1,664
1995	1,644	1,665
1996	1,686	1,712
1997	1,638	1,713
1998	1,629	1,694
1999	1,620	1,680
2000	1,631	1,668
2001	1,631	1,668

NOTE. Year-end data. Excludes summer intern and youth positions as well as positions for the Office of Inspector General. These positions number 60 for 2000 and 2001. Includes positions that provide support to the Federal Financial Institutions Examination Council for processing data collected under the Home Mortgage Disclosure Act and the Community Reinvestment Act.

ness Finances (NSSBF), begun in 1999 for data as of year-end 1998 (\$1.2 mil-

lion). The purpose of the survey was to gather data from small businesses on their financial relationships, credit experiences, lending terms and conditions, income and balance sheet information, location and types of financial institutions used, and other firm characteristics. The NSSBF is used in analyzing the competitive effect of bank mergers, in benchmarking other data series (such as the noncorporate sector of the flow-of-funds statistics), and in writing the quinquennial small business report mandated by section 227 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996. It is also used for research and policy analysis of a wide variety of issues in small business finances.

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

Chapter 3

Federal Reserve Banks

The operating budgets of the twelve Reserve Banks for 2001 total \$2,442.2 million.¹ The 2001 total is an increase of \$116.3 million, or 5.0 percent, above the 2000 approved budget and an increase of \$144.4 million, or 6.3 percent, over estimated 2000 expenses (table 3.1).² The Reserve

Banks' estimated 2000 expenses were \$28.1 million under budget. This under-run is explained in the 2000 Budget Performance section of this chapter.

Approximately 40 percent of Reserve Bank expenses in the 2001 budget are offset by priced service revenues, and an additional 12 percent are offset by reimbursable claims for services provided to the U.S. Treasury and other government agencies. Revenues from priced services are budgeted to increase 6.7 percent in 2001, primarily as a result of projected increases in automated clearinghouse (ACH) volume, check

1. This total includes the cost of a special project. Special projects are major efforts that have Systemwide significance and are outside the budgets of the individual Reserve Banks. The only special project currently in effect reflects \$16.4 million in costs associated with the check standardization initiative. (See tables D.1–D.4, appendix D.)

2. Includes expenses budgeted by Federal Reserve Information Technology (FRIT) and the Office of Employee Benefits (OEB); expenses of these entities have been charged to the Reserve Banks, as appropriate, and included in their budgets. Because of their unique roles within the System, FRIT and the OEB have prepared their own budgets. Data for FRIT are included in this

document; the OEB's staffing level of 29 ANP is not discussed further. Unless otherwise noted, expenses also include costs associated with the check standardization special project. Special project costs are estimated to be \$6.7 million in 2000 and are projected to be \$16.4 million in 2001.

Table 3.1

Expenses of the Federal Reserve Banks, Net of Receipts and Claims for Reimbursement, 2000 and 2001

Millions of dollars except as noted

Item	2000 (estimated)	2001 (budgeted)	Change	
			Amount	Percent
Operations	2,297.8	2,442.2	144.4	6.3
LESS				
Revenue from priced services	916.1	977.8	61.7	6.7
Other income	1.0	.3	-.7	-70.0
Claims for reimbursement ¹	310.2	290.1	-20.1	-6.5
EQUALS				
Net expenses	1,070.5	1,174.0	103.5	9.6

NOTE. Excludes capital outlays. Includes expenses budgeted by Federal Reserve Information Technology (FRIT) and the System's Office of Employee Benefits (OEB). For more detail on FRIT and OEB, see text note 2. 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.

volume, and check fees as well as the introduction of new priced check products. Reimbursable claims will decrease 6.5 percent, primarily because of the consolidation of the Treasury Tax and Loan and Treasury Direct servicing functions.

At individual Reserve Banks, 2001 budget expenses vary from a decrease of 4.2 percent from estimated 2000 expenses to a 19.3 percent increase (see table D.1, appendix D). The wide range is directly related to recent Reserve Bank accounting changes that shifted costs among the Reserve Banks and between cost centers.³ The total Reserve Bank increase of \$144.4 million provides funding for each District's salary administration and benefit programs, local operations, nationally provided support services, and consolidated operations.

3. These cost shifts were recommended in three studies concerning the accounting practices of Federal Reserve Banks (the Accountability, Integrity, Decision-making, and Efficiency (AIDE) Report; the Treatment of National Costs and Revenues Study; and a capitalization threshold change proposal). Because of the cost shifts, budget data from previous years are not completely comparable with current-year data. An overview of the accounting changes and the corresponding effects on the 2001 budget is included later in this chapter.

The average number of personnel (ANP) projected to be employed during 2001 at the Reserve Banks and FRIT is 23,458, an increase of 68 ANP, or 0.3 percent, from estimated 2000 staff levels (table 3.2).⁴ Reserve Bank employment is expected to increase 38 ANP, or 0.2 percent, largely because of the effect of 2000 staff additions and, to a lesser extent, initiatives planned for 2001. FRIT employment is expected to increase 30 ANP, or 4.5 percent, to carry out several initiatives, including Fednet modernization, the image services system (ISS) and check standardization projects, and new distributed processing services. (For more detail on expense and ANP changes by District, see tables D.1 and D.2, appendix D. For trends over the last ten years, see charts 3.3 and 3.4 at the end of this chapter.)

2000 Budget Performance

The Reserve Banks estimate 2000 expenses to have been \$2,297.8 million,

4. 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

Table 3.2

Employment at the Federal Reserve Banks, 2000 and 2001

Average number of personnel except as noted

Item	2000 (estimated)	2001 (budgeted)	Change	
			Number	Percent
Reserve Banks	22,721	22,760	38	.2
Federal Reserve Information Technology	668	698	30	4.5
Total	23,389	23,458	68	.3

NOTE. See note to table 3.1. See text note 4 for definition of average number of personnel.

Table 3.3
Budget Performance of the Federal Reserve Banks,
Operating Expenses and Employment, 2000

Item	2000 (budgeted)	2000 (estimated)	Change	
			Amount	Percent
Operating expenses (millions of dollars)	2,325.9	2,297.8	-28.1	-1.2
Employment (average number of personnel)	23,751	23,389	-362	-1.5

NOTE. See note to table 3.1. See text note 4 for definition of average number of personnel.

a decrease of \$28.1 million, or 1.2 percent, from the approved 2000 budget of \$2,325.9 million (table 3.3) and an increase of \$104.0 million, or 4.5 percent, above 1999 actual expenses. Eight of the twelve Reserve Banks have estimated their 2000 expenses to have been below the approved 2000 budget, ranging from a 0.1 percent underrun in Kansas City to a 3.0 percent underrun in New York. The remaining four Reserve Banks were over their approved budgets, ranging from 0.1 percent in Atlanta to 2.5 percent in Richmond. Tables D.3 and D.4 in appendix D detail 2000 performance for each District.

Reserve Bank underruns are partly explained by staffing levels that were substantially lower than budgeted. ANP for 2000 is estimated at 23,389, which is 362 ANP below the 2000 approved level and 22 ANP below the 1999 actual level. Reserve Banks with lower-than-budgeted staffing levels projected a correlated underrun in officer and employee salaries of \$16.4 million. New York's budget underrun of \$13.7 million, for example, was largely due to the Bank's staffing underrun of 84 ANP, which resulted in a personnel cost

underrun of \$7.4 million. Reserve Banks report that staffing level variances were due primarily to turnover and delays in new hiring because of tight labor markets and productivity improvements.

In addition to the effect of lower-than-budgeted ANP, more than half the Reserve Banks have identified lower-than-anticipated costs with respect to retirement and other benefits because of changes to the postretirement benefits plan (Financial Accounting Standard 106). These changes have resulted in savings of \$3.3 million.

Despite common themes across the Reserve Banks, a variety of District-specific factors were also at work, and initiatives in several of the outlier Banks either added to or partially offset the underrun in 2000 estimated expenses. The staffing level decreases at the New York Bank, discussed above, continue a trend of dramatic ANP declines in that Bank that began in 1998. These declines were due primarily to productivity-improvement and operating-efficiency initiatives both at the Bank and resulting from System consolidation efforts. Other Banks were under budget because of the deferral or cancellation of capital projects, decisions to forgo system and equipment upgrade plans because of the move to the common platforms required

calendar year; two half-time employees who start on January 1 count as 1 ANP.

in the check modernization initiative, and declining check volume combined with improved productivity in check-processing initiatives.

Richmond's overrun of \$4.5 million has been partly attributed to unanticipated work on two projects for the Department of the Treasury and increased costs for an upgrade to the Bank's purchasing, accounts payable, and asset management system. Expenditures by the Retail Payments Office (RPO), which is accounted for in Atlanta's budget, were also substantially more than planned. The RPO projected increases associated with higher-than-anticipated fuel costs for Check Relay and for the creation of a check modernization implementation team. Other unbudgeted expenses included the establishment of a payment card research center at the Philadelphia Bank and the accelerated purchase of check-processing equipment in Kansas City to meet the check standardization conversion schedule.

Factors Affecting the 2001 Budget

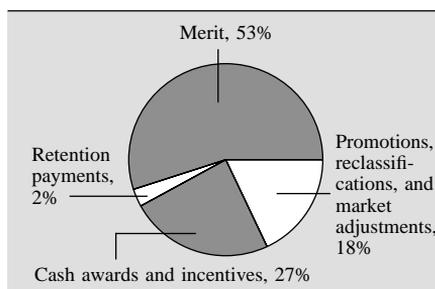
Personnel expenses are the major driver of the year-over-year budget increase. These expenses include both salaries and benefits and represent 63.3 percent of projected Reserve Bank expenses. Reserve Bank budgets include a total of \$88.7 million to fund salary administration programs for officers and employees.⁵ FRIT has budgeted \$4.2 million.

Merit increases are budgeted at \$46.9 million, or 52.9 percent, of the total 2001 Reserve Bank salary admin-

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.

Chart 3.1

Components of Salary Administration at the Federal Reserve Banks, 2001



NOTE. See text note 5.

istration budget (chart 3.1). The budget includes average merit increases of 4.5 percent for officers and 4.3 percent for employees. Promotions, reclassifications, and market adjustments account for \$16.1 million; retention payments for \$2.1 million; and officer and employee incentive payments and cash awards for \$23.6 million. Merit increases and other salary-related expenses are in line with trends in both the public and private sectors.

In 2001, officer incentive payments and cash awards are expected to total \$7.9 million, or 5.8 percent of officer salary liability. The officer variable pay threshold will increase to 6.0 percent of salary liability.

Employee incentive payments and cash award funds are budgeted at \$16.6 million, or 1.7 percent of employee salary liability in 2001. The employee variable pay threshold will increase to 1.7 percent in 2001.

Officer turnover (including retirements) is projected to remain stable at 4.0 percent in 2001, ranging from 0.0 percent (Dallas) to 16.0 percent (San Francisco). Similarly, employee turnover in 2001 is projected to remain stable at 13.1 percent, ranging from

8.1 percent (Richmond) to 16.2 percent (San Francisco). Banks are reporting higher turnover in check processing and some professional and technical areas. If market pressures continue in 2001, the risk of losing employees with critical skills will increase. As a result, the 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 14.0 percent of Reserve Bank budgets, are anticipated to increase \$23.5 million, or 7.4 percent, in 2001. The higher costs are projected to result primarily from increases in salary-related benefits, such as social security and thrift plan contributions, which are expected to increase along with the number of ANP in 2001. Other contribut-

ing factors include higher postretirement and postemployment valuations (Financial Accounting Standards 106 and 112, respectively); these valuations are directly related to changes in actuarial assumptions. The budgeted increases in employer contributions for health benefits average 5.6 percent for non-HMO plans, 8.5 percent for HMO plans, and 6.4 percent for dental plans.

Other major factors affecting the 2001 budget are shown in table 3.4 and discussed below.

Fee-based Services to Financial Institutions

The factors affecting the budget for services provided to depository institutions are primarily related to the check modernization projects.

Table 3.4

Changes in Expense and Employment for Major Initiatives at the Federal Reserve Banks, 2000 to 2001

Millions of dollars except as noted

Initiative	2000 (estimated)	2001 (budgeted)	Change	
			Amount	Average number of personnel
<i>Fee-based services provided to depository institutions</i>				
Check modernization	27.3	84.1	56.8	223
Other check initiatives	48.6	52.3	3.7	-33
<i>Reimbursable services</i>				
Treasury Direct consolidation	19.5	15.9	-3.6	-53
Treasury Tax and Loan consolidation	4.1	1.4	-2.7	-30
<i>Central bank services</i>				
Cash initiatives	22.5	30.0	7.5	53
Supervision and regulation staffing	27.3	29.7	2.4	26
<i>Cross-functional areas</i>				
Infrastructure initiatives	39.0	58.8	19.9	25
FRIT initiatives	11.7	24.2	12.5	73
Capitalization threshold changes0	12.9	12.9	...
Total	199.9	309.4	109.5	285

NOTE. See notes to table 3.1. See text note 4 for definition of average number of personnel.

... Not applicable.

Check Modernization

The Federal Reserve Banks, under the leadership of the Retail Payments Office, have undertaken 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 function’s operating platform across all forty-five check-processing sites. (For more detail on the check modernization projects, see chapter 4.) The 2001 budget for the Reserve Banks includes \$84.1 million for the four projects, which is an increase over estimated 2000 expenses of \$56.8 million and 223 ANP. The budgetary effect of each of the check modernization projects is described below.

Check Standardization. Six Districts have identified costs for check standardization activities performed within their Districts on behalf of the other Reserve Banks, totaling \$38.1 million. FRIT has budgeted \$7.3 million for data processing support, and an additional \$9.2 million has been included by the Banks for local incremental costs to implement the project. Costs vary significantly by District and are determined by the timing of each office’s conversion in the four-year implementation schedule.

Enterprisewide Adjustments (EWA). San Francisco is the host Bank for the development and implementation of the EWA system. The 2001 budget includes \$7.4 million for this project, which represents a \$2.4 million increase over 2000 estimated expenses. Project plans call for the conversion of twenty-six check-processing sites to the system by the end of 2000, thirteen sites in 2001, and the remaining six sites in 2002.

Image Services System (ISS). The Boston District will manage the implementation and deployment of ISS to the four regional archive sites (Cleveland, Philadelphia, Helena, and Minneapolis). The 2001 budget includes \$17.0 million for this project. Thirty-two sites currently are scheduled to transition to the regional archives in 2001, with the remaining sites converting in 2002.

Electronic Access and Delivery (EA&D). The Dallas Bank is responsible for development of this application. Initially, the project will develop web-based interfaces for check services currently offered through FedLine. The 2001 budget includes \$5.1 million for the project. Web-based check services are scheduled to be available to depository institutions in 2001.

Other Check-Processing Initiatives

Five Districts have included a total of \$52.3 million in their budgets to support other local check-processing initiatives. These initiatives include the Utica regional check-processing center check image effort, increased staff to process volume increases, and additional equipment (personal computers, high-speed and medium-speed reader-sorters, and image capture systems) needed in 2001 to accommodate check modernization project schedules.

Reimbursable Services

Factors affecting the budgets for reimbursable services include Treasury Direct consolidation and Treasury Tax and Loan consolidation.

Treasury Direct Consolidation

Customer support for the Treasury Department’s Treasury Direct application will be consolidated into three sites

(Boston, Minneapolis, and Dallas). This initiative is projected to reduce Reserve Bank expenses by \$3.6 million and 53 ANP in 2001. The three consolidation sites have budgeted an increase of \$3.5 million above estimated 2000 costs; staff levels at the three sites are budgeted to increase by 52 ANP above the estimate for 2000, reflecting Treasury requirements. This cost increase is more than offset by cost reductions of \$7.1 million and staff decreases of 105 ANP at the other Reserve Banks. This initiative is fully reimbursable.

Treasury Tax and Loan (TT&L) Consolidation

The implementations of the Treasury Investment Program (TIP) and the Paper Tax System (PATAX) operations at the St. Louis Reserve Bank have replaced the existing TT&L software and staff at all Reserve Banks. All Reserve Banks moved to this new system in October 2000. The 2001 budget includes a net decrease in Reserve Bank costs of \$2.7 million and 30 ANP. Minimal staff will be retained in the other Reserve Banks for definitive collateral safekeeping.

Central Bank Services

Factors affecting the budgets for central bank services include cash initiatives and supervision and regulation.

Cash Initiatives

Cash initiatives, primarily the new Phoenix currency operations center and the addition of processing capacity at the Philadelphia and Atlanta Banks, are projected to increase costs \$7.5 million and add 53 ANP in 2001.

Supervision and Regulation

Three factors are contributing to staffing increases in supervision and regulation: an increase in the number of state member banks, the Large Complex Banking Organization initiative, and development of the Risk Management Information System. These initiatives are expected to add \$2.4 million and 26 ANP in 2001.

Cross-functional Areas

Factors affecting the budgets across functional areas include infrastructure initiatives, FRIT initiatives, and capitalization threshold changes.

Infrastructure Initiatives

The 2001 budget includes an expense increase of \$12.0 million for new buildings, leased space, and enhanced security in five Districts. Reserve Bank automation initiatives add another \$7.9 million, of which about \$2.5 million is for efforts directly tied to System initiatives (electronic access projects, the Internet firewall, and the Groupware Leadership Center). The remaining expenses address a variety of needs, including support for Treasury-related projects, human resource information systems, and information security.

FRIT Initiatives

FRIT has undertaken several customer-driven projects to support web access and centralized distributed processing applications. These projects are projected to increase costs \$8.2 million above estimates for 2000. Infrastructure improvements, primarily for distributed computing and Fednet modernization, add \$4.3 million to costs.

Capitalization Threshold Changes

Beginning in 2001, the Reserve Banks will increase the thresholds above which they are required to capitalize certain acquisitions and then depreciate costs over time. As a result, some items formerly capitalized, most notably personal computers, will be expensed. Although the changes result in higher expenses in 2001, real spending is not increased, as depreciation expenses will be offset in future years. The one-time implementation effect of changing this accounting practice raises stated expenses by \$12.9 million.

Additional Reserve Bank Accounting Changes

In addition to the capitalization threshold changes discussed above, the Reserve Banks approved recommendations made in two studies concerning the accounting practices of the Banks (the AIDE Report and the Treatment of National Costs and Revenues Study). Although the implementation of these recommendations in 2001 does not have a material effect on Reserve Bank total spending, some expenses have been shifted to different cost centers, thus limiting the comparability of budget and expense data across Districts and functions. Several of the tables and charts that previously were included in this book have been excluded this year for that reason. A summary of the accounting changes is provided below.

AIDE. In 1997, the Reserve Banks began an extensive review of the Federal Reserve's Planning and Control System (PACS) and private industry practices. The goal of the review was to incorporate industry "best practices" into the Reserve Bank cost accounting framework wherever possible, while ensuring that the cost accounting system

maintained accountability, integrity, decisionmaking, and efficiency (AIDE).

The AIDE concepts result in new methods for assigning costs to the appropriate activity, a shift of some activities among operational areas, and a change in management responsibility related to statistical data. These changes have been implemented in PACS while maintaining the system's full costing foundation. The new processes and structural changes should improve efficiency by reducing some of the burden currently inherent in the PACS system.

Treatment of National Costs and Revenues. In 1999, the Reserve Banks also approved recommendations to eliminate geographic sharing of costs for all services and operations that are provided centrally to all Reserve Banks.⁶ Under this new approach, the Reserve Banks report the associated expenses where the costs are incurred. To ensure consistent implementation, these recommendations are being addressed in conjunction with the structural changes previously discussed.

Over the past several years, the Reserve Banks have consolidated the development, processing, and management responsibilities of many operations. Cost accounting rules have not kept pace with this shift. Costs associated with these consolidation efforts have been shared among the Reserve Banks as defined in PACS. For example, before 2001 the costs of operating the Support Function Office (SFO) were incurred by the San Francisco Reserve Bank and shared with all other Reserve Banks so that each Bank's bottom line reflected one-twelfth of the costs of operating the SFO. The sharing of these

6. As a service provider, Federal Reserve Information Technology will continue to charge its costs to Reserve Banks and the Board.

costs reduced accountability, confused responsibility, and complicated monthly accounting processes. These costs are now reported in the Districts where the activities are provided.

Based on the accounting change described above, Banks that distributed more costs than they received in 2000 generally have the largest year-over-year increases in 2001. With the elimination of cost sharing in 2001, Banks have retained in their budgets the national service costs previously shared. Conversely, Banks that were net receivers have not included these national expenses in their budgets.

Risks in the 2001 Budget

Reserve Banks have noted several common risks associated with the 2001 budgets. First, issues and problems relating to the check modernization projects could divert significant amounts of resources, including management attention, as complex implementation schedules have the potential for costly delays. As these plans are refined and the projects progress, actual expenses may vary considerably from the 2001 budget. Second, most Banks have projected no increase in check volumes and only moderate increases in cash volumes for 2001. Volatility in production volumes could create capacity problems and affect the System's ability to meet cost performance expectations.

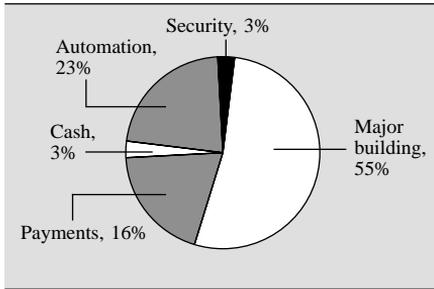
In addition, the passage of the Gramm–Leach–Bliley Act is expected to have significant implications for the bank supervision and regulation function. As the umbrella supervisor, the Federal Reserve has broad financial holding company oversight responsibilities. Resource implications on the supervisory function were unclear at the time the budgets were developed.

Finally, some Reserve Banks are finding it difficult to attract and retain key staff because of tight labor markets. Turnover poses a significant risk when compounded by the resource demands necessary to implement check modernization and expanded bank supervision and regulation responsibilities. Initiatives that are contingent upon successful staffing efforts present additional uncertainties in the 2001 budget.

2001 Capital Plan

The 2001 capital budgets submitted by the Reserve Banks and FRIT total \$361.3 million, a decrease of \$106.0 million from the estimated 2000 level. The budget includes \$323.0 million for the Banks and \$38.3 million for FRIT. The substantial decrease in budgeted 2001 outlays from estimated 2000 outlays results in part from the conclusion or near completion of several major building projects, including the new Birmingham Branch building project (\$22.7 million decrease in 2001 outlays), Atlanta's new building project (\$21.1 million decrease), and the Phoenix currency operations center (\$12.8 million decrease). After the land purchase in 2000, outlays for the new Houston Branch building project will decrease significantly in 2001 (\$24.2 million decrease). Capital for software and equipment acquisitions at FRIT for the check standardization and ISS projects is \$13.1 million lower in the 2001 budget than has been estimated for 2000. Other factors contributing to the reduction in capital outlays include the nonrenewal of software licenses and maintenance contracts associated with check standardization, a shift of outlays for check-processing equipment from future years into 2000 because of the check standardization project schedule, the completion of various building reno-

Chart 3.2
Major Capital Projects
at the Federal Reserve Banks, 2001



NOTE. Includes Federal Reserve Information Technology.

vation and software development projects, and the shift of funds from capital to expense resulting from the capitalization threshold changes. Tables D.6 and D.7 in appendix D provide detail of capital expenditures by District and asset classification.

As in previous years, the 2001 capital budgets developed by the Reserve Banks and FRIT include funding for projects that support the goals outlined in the Banks' strategic plans. These strategic goals include improving operational efficiency and effectiveness, improving services to Bank customers, and providing a safe, high-quality work environment. In support of these goals, the 2001 budget includes five major categories of capital outlays: building and facility improvements, automation-related initiatives, payment system improvements, Reserve Bank security initiatives, and cash services initiatives (chart 3.2).

Buildings and Facilities

The 2001 capital budget includes \$197.9 million for the renovation, modernization, or replacement of physical facilities and the replacement or upgrading of critical systems. Of the total building-related capital, \$101.1 million

(51.1 percent) is attributable to seven initiatives with budgets greater than \$4.0 million: the New York District's floor-by-floor head office modernization program, the Atlanta District's new head office building project, relocation of the Chicago District's Detroit Branch and the Chicago check-processing function, major floor renovations at the Chicago Bank, the Houston Branch building project, and the check department renovation at the St. Louis head office. In addition to these larger projects, funding is also provided for the routine replacement of building-related equipment, as well as furniture and fixtures.

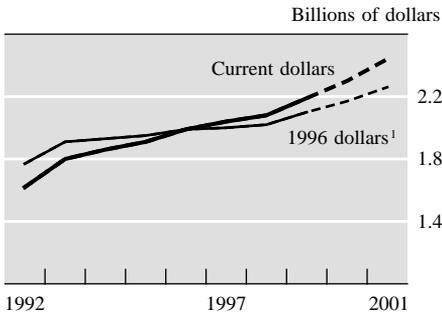
Automation

The capital budget includes \$82.0 million for major automation initiatives. These initiatives do not include the automation components of building, payment systems (including check modernization), or cash services initiatives that are discussed separately. The strategic directions outlined in the individual Reserve Bank budgets include enhanced technological capabilities, the continued implementation of LAN technology, the development of common office environments and web-based applications, and several Treasury-related initiatives.

Of the total automation-related outlays, FRIT projects and acquisitions account for \$26.7 million. FRIT's 2001 capital plan includes outlays for Fednet modernization (\$8.7 million), virtual tape server implementation (\$1.8 million), and various software and hardware upgrades and enhancements. Aside from FRIT, major automation-related projects include \$2.3 million for continued development of New York's Transaction Processing System; \$1.9 million for enhancements to the Statistics and Reserves (STAR) system; \$1.3 million

Chart 3.3

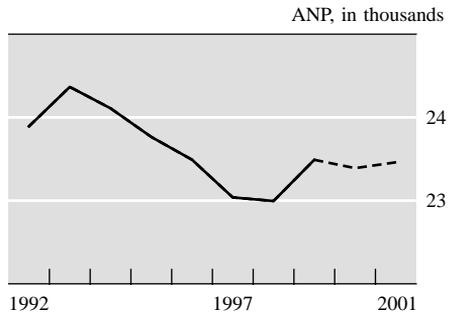
Operating Expenses of the
Federal Reserve Banks, 1992–2001



NOTE. For 2000, estimated; for 2001, budgeted.
1. Calculated with the GDP price deflator.

Chart 3.4

Employment at the
Federal Reserve Banks, 1992–2001



NOTE. Includes Federal Reserve Automation Services.
For 2000, estimated; for 2001, budgeted. See text note 4
for definition of ANP.

for development of the Account Management Information (AMI) gateway; \$1.3 million for upgrades to the System's Internet and directory services (IDS) competency center; and \$1.1 million for the Atlanta District's ethernet conversion project.

The automation total also includes \$4.2 million in capital for software development for, and equipment enhancements to, several reimbursable Treasury-related initiatives, including the Treasury Automated Auction Processing System (TAAPS), the Intra-governmental Payment and Collection (IPAC) system, the Savings Bond Architecture Project (SnAP), the Automated Standard Application for Payments (ASAP) system, and the Treasury Check Operations Re-engineering Effort (TCORE). The largest share of the remaining funds supports the Districts' distributed technology strategies.

Payment System

The 2001 capital budget includes \$57.4 million for initiatives related to payment system improvements. These initiatives include \$11.6 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.

Reserve Bank Security

The 2001 capital budget includes \$11.6 million in spending for enhanced Bank security. Over half of this funding (\$5.8 million) is for the Richmond Bank's security enhancement project.

Cash Services

Outlays of \$12.4 million have been included in the capital budget for cash services initiatives. The Atlanta District's initiatives account for \$5.9 million of the total, including the Atlanta Bank's cash vault automation and currency disposal systems (\$4.2 million) and new currency processing machines for the Atlanta and Jacksonville offices (\$1.7 million). ■

Part II

Special Analysis

Chapter 4

Check Modernization

In recent years, the Federal Reserve Banks have explored ways of modernizing their check-processing systems to expand the services they offer and improve operational efficiency. In late 1999, they began the multiyear check modernization initiative, which will result in the standardization of check processing at all Reserve Banks, the adoption of common software for processing and researching check-adjustment cases, the creation of a national system for archiving and retrieving check images, and the delivery of check services to depository institutions via the Internet.

Check modernization will directly affect approximately 5,500 Federal Reserve employees and 8,000 depository institutions and will substantially alter the infrastructure of the Reserve Banks' check service line. The four projects that make up the initiative are expected to result in capital expenditures of approximately \$90 million and total expenses of approximately \$250 million over five years, from 2000 through 2004. These costs are expected to be offset, over the long run, by more cost-effective operations and by additional revenue from new product offerings.

Background

The Federal Reserve Banks currently process checks, resolve adjustment requests, and provide image-based check services using multiple hardware and software platforms. They also provide remote access and delivery of certain check services using a technologically

outdated platform. Adjustments, imaging, and electronic delivery are key check-related services, but the core function on which they rely is check processing. Accordingly, the effort to implement a standard check-processing platform is the most significant component of the check modernization initiative.

Currently, seven Reserve Banks use a Unisys check-processing platform at twenty-six sites, and five Reserve Banks use an IBM check-processing platform at nineteen sites. The Reserve Banks also use a combination of internally developed and vendor-provided software applications. The Unisys-based Reserve Banks use local Unisys mainframe computers to process checks. Four IBM-based Reserve Banks use data-processing services provided by Federal Reserve Automation Services, and the fifth uses a local mainframe computer to run its check-processing system.

As check-processing technology has advanced, vendors have begun to discontinue support for older equipment and software. The high cost of replacing some of the older systems prompted the Reserve Banks in 1997 to begin reviewing their check automation options. At the same time, the Reserve Banks faced changes in the market as depository institutions began to demand greater uniformity in the products and services provided by the Reserve Banks. Consolidation within the banking industry has had a major effect on customer demand. For example, many depository institutions have come to expect the Reserve Banks to provide uniform services, using the latest check-processing technologies and without significant fee

increases, so that the depository institutions, in turn, can provide their customers with similar services nationwide. To keep up with changing market demands and remain a viable provider of payment services, the Reserve Banks must improve their ability to bring innovative products to the market quickly.

The Reserve Banks' current check-processing infrastructure, however, hampers their ability to implement new technologies rapidly and roll out new national products to meet customer demand. This inability may be attributed, at least in part, to the independence that each Reserve Bank has historically exercised in building its check-processing infrastructure and in shaping its product offerings to accommodate customer demand. This independence has resulted in a large number of software applications, each with District-specific variations. In the current environment, to offer a new national product to meet a particular market need, the Reserve Banks might have to modify hardware and software configurations in up to forty-five check-processing sites across the nation.

Check Modernization Projects

The check modernization initiative comprises four projects—check standardization, enterprisewide adjustments, image services system, and electronic access and delivery. Collectively, these projects will reduce the time needed to develop and deploy new products; facilitate the move to electronic payments; improve the overall consistency, quality, and flexibility of the services delivered to depository institutions; and improve the cost-effectiveness of Federal Reserve check services over the long run.

Check Standardization

The primary strategy of the check modernization initiative is to replace the current network of twelve relatively independent check-processing systems with a standard platform in all twelve Banks. The key to accomplishing this goal lies in the check-processing software. The core components of a check-processing system are check sorters, which electronically capture data from checks as the checks are physically sorted, and software, which drives the sorters and manages the captured data. The software is the primary driver of a platform's functionality and its ability to interface with other applications. Although the Reserve Banks currently use only two basic types of check-processing systems, each Reserve Bank uses a variety of software packages to enhance the functionality of these systems.

In the check standardization project, standard check-processing software will be installed at all forty-five processing sites. The check-processing system used at these sites will be centrally managed and will support a uniform set of products nationwide. Once they have converted to the standard platform, the Reserve Banks will be able to operate multiple types of check-sorting hardware using the same software.

The check standardization project is the most complex of the four check modernization projects and is expected to take nearly four years to complete, with the last site converting to the standard platform in 2003. Capital outlays for the project are expected to total approximately \$60 million, and expenses are expected to total slightly more than \$200 million through the end of the project in 2004. Concurrent with the project, the Reserve Banks will be required to upgrade many of their

high-speed check sorters as vendors discontinue support for older models. Although these upgrades will be coordinated with the check standardization project, they are not included in the project budget because the upgrades would have been necessary even without the check modernization initiative. For several Reserve Banks, these upgrades will constitute a significant portion of their 2001 capital expenditures.

Enterprisewide Adjustments

The enterprisewide adjustments (EWA) project will streamline the process for researching and resolving check adjustments by creating a centrally managed, enterprisewide adjustment system. The adjustments process deals with the exceptions that inevitably occur during the normal course of processing checks—checks processed for the wrong dollar amount, lost checks, and the like. Because these errors are generally detected after a depository institution has settled with a Reserve Bank, the depository institution submits an adjustment request for an offsetting debit or credit to resolve the difference.

The adjustment process has historically been manual and labor-intensive. Over the past decade, automated systems have been developed that manage and aid in researching adjustment requests and create accounting entries. In addition, depository institutions can now submit adjustment requests electronically. Although all Reserve Banks can receive the electronic requests, some Banks must print out the requests and manually enter them into an adjustment tracking system, delaying the research and resolution of the cases. When fully installed, the EWA system will not only fully automate the adjustment request process, but will also allow adjustment requests received by any Reserve Bank

site to be processed by any other Reserve Bank site, thus relieving backlogs.

By the end of 2000, the EWA system had been installed in twenty-six of the forty-three Reserve Bank sites that process adjustment requests. The remaining sites will be converted to the new system by June 2002. Capital outlays for the EWA project are expected to total slightly more than \$4 million, and expenses are expected to total approximately \$14 million through the end of the project in 2002.

Image Services System

The image services system (ISS) project will redesign the current image-processing infrastructure to produce a nationwide, centrally managed system for the storage and retrieval of check images. This project leverages one of the newest technologies to gain widespread use in check processing—digital imaging. As checks are processed, cameras on the sorter capture digital images of each check. These digital images can be stored in an archive at a Reserve Bank or delivered to a depository institution by CD-ROM or magnetic tape. Depository institutions use these images in lieu of the original checks in various ways, including creating image statements, enabling account holders to access images of their checks either on CD-ROM or over the Internet, and archiving the images for future research.

The Reserve Banks have been using different hardware and software to capture and store check images and, as a result, often deliver images in different formats. The ISS project will allow Reserve Banks to offer a standard format for image files across all sites. It will also establish regional archive sites that will allow each Reserve Bank site to

continue capturing images locally but will consolidate the storage of images to achieve greater economies of scale. The new infrastructure will enable Reserve Bank staff and depository institutions throughout the nation to retrieve images captured at any Reserve Bank site.

The ISS project began in 2000, with the first installation scheduled for early 2001. All sites are scheduled to convert to the new system by the end of 2002. Capital outlays for the project are expected to total approximately \$27 million, and expenses are expected to total approximately \$22 million through the end of the project in 2002.¹

Electronic Access and Delivery

The electronic access and delivery (EA&D) project will convert check services from the current PC-based FedLine platform to a “FedLine for the Web” platform. The new platform will reduce the Reserve Banks’ reliance on an outdated DOS platform, in use since the early 1980s, and provide opportunities for offering new services over the web. FedLine provides depository institutions with a secure connection to Reserve Bank computer networks so they can use certain transactional and informational services, including wire transfers, automated clearinghouse (ACH) transactions, electronic check presentment files, and access to account balance information. The current FedLine platform limits access to computers equipped with certain encryption devices. The EA&D project will give depository institutions the option of using FedLine for the Web for electronic access to and

delivery of check services from almost any location.

The Reserve Banks are currently converting all applications on the current DOS-based FedLine system to either Windows- or web-based applications, depending on the requirements of each application. The EA&D project is scheduled to have web-based services available by the second quarter of 2001, at which time the Reserve Banks will begin assisting customers with the transition to the new platform. Capital outlays for the project are expected to total slightly more than \$2 million, and expenses are expected to total slightly more than \$6 million through 2001.

Project Management

Management of the check modernization initiative is structured to ensure that the schedules of these four interrelated and virtually concurrent projects are coordinated, that interproject issues are resolved, and that the financial and operational risks to the check service line are managed. Central project teams, made up of staff from multiple Reserve Banks, are responsible for individual projects. A central management team, made up of the four project leaders and representatives from key groups, including the Reserve Banks’ Retail Payments Office, Board staff, Reserve Bank internal audit, and Federal Reserve Automation Services, is responsible for overseeing the four projects and ensuring that the projects’ goals are achieved.

In addition, each of the Reserve Banks has a District transition manager, who is responsible for coordinating the four projects in that District. Each District transition manager is supported by up to four coordinators, who are responsible for coordinating one of the four projects with the central project teams. This structure is designed

1. Capital outlays exceed expenses over the life of the ISS project because capitalized expenditures will not be fully depreciated by the end of the project.

to provide consistent communication on key issues and to mitigate some of the risks in managing such a large initiative.

Anticipated Benefits

The check modernization initiative is intended to position the Reserve Banks to meet the challenges of the changing payment services environment in a number of ways. First, the standardization of the check-processing infrastructure will result in the uniform adoption of new technologies across the Federal Reserve System. Second, maintaining and managing a single processing infrastructure should improve the operational efficiency and cost-effectiveness of the check services over the long run. Third, the standard infrastructure will improve the consistency, quality, and uniformity of the check services that Reserve Banks deliver to their customers and allow the system to be modified more efficiently

and new services to be developed and deployed more quickly. Finally, the standardization of the check-processing infrastructure will facilitate Reserve Banks' efforts to support national initiatives to promote electronic check presentment.

The check modernization initiative will also allow Reserve Banks to adjust their processing infrastructure in response to external market conditions. Consolidation within the banking industry and in the operating structures within depository institutions will likely continue to result in significant shifts in check volumes among Reserve Bank processing sites. Further, technological and regulatory changes may result in increased reliance on electronic payment alternatives. The standard processing environment is designed to allow Reserve Banks to adapt more rapidly and efficiently to these types of changes in the check-processing environment. ■

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 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 from a model of the fifty largest U.S. bank holding companies; these rates are applied to the assets the Federal Reserve expects to use in providing priced services in the coming year. The other components of the PSAF are derived from the budgets of the Reserve Banks and the Board: the imputed sales tax (based on budgeted outlays for materials, supplies, and capital assets); the imputed assessment for insurance by the Federal Deposit Insurance Corporation (FDIC) (based on expected clearing balances and amounts deferred to depository institutions for items deposited for collection with the Reserve Banks); and the portion of the expenses of the Board of Governors directly related to providing priced services.

Calculation of the PSAF for 2001

In 2000, the Board approved a 2001 private sector adjustment factor for Reserve Bank priced services of \$206.9 million, an increase of \$14.3 mil-

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.

lion, or 7.4 percent, from the PSAF of \$192.6 million targeted for 2000.

Asset Base

The value of Federal Reserve assets to be used in providing priced services in 2001 is estimated at \$12,530.7 million (table A.1). The value of assets assumed

to be financed through debt and equity in 2001 is \$1,162.4 million, an increase of \$45.9 million, or 4.1 percent, from 2000 (table A.2). Most of the increase results from the growth of net pension assets, while higher Reserve Bank building and equipment assets account for the remainder. Partially offsetting the

Table A.1

Pro Forma Balance Sheet for Federal Reserve Priced Services, 2000 and 2001

Millions of dollars

Item	2000	2001
ASSETS		
<i>Short-term assets</i>		
Imputed reserve requirement on clearing balances	762.2	742.4
Investment in marketable securities	6,859.5	6,681.9
Receivables ¹	74.2	77.3
Materials and supplies ¹	3.4	3.6
Prepaid expenses ¹	21.4	23.4
Items in process of collection	<u>3,804.2</u>	<u>3,606.7</u>
Total short-term assets	11,524.9	11,135.3
<i>Long-term assets</i>		
Premises ^{1,2}	411.7	417.5
Furniture and equipment ¹	180.1	185.5
Leasehold improvements and long-term prepayments ¹	64.2	73.9
Prepaid pension costs ¹	<u>599.8</u>	<u>718.5</u>
Total long-term assets	<u>1,255.8</u>	<u>1,395.4</u>
Total assets	12,780.7	12,530.7
LIABILITIES		
<i>Short-term liabilities</i>		
Clearing balances and balances arising from early credit of uncollected items	7,621.7	7,424.3
Deferred-credit items	3,804.2	3,606.7
Short-term debt ³	99.0	18.9
Short-term payables ⁴	<u>.0</u>	<u>85.4</u>
Total short-term liabilities	11,524.9	11,135.3
<i>Long-term liabilities</i>		
Postemployment/postretirement benefits ¹	238.3	251.9
Long-term debt ³	<u>400.9</u>	<u>479.1</u>
Total long-term liabilities	<u>639.2</u>	<u>731.0</u>
Total liabilities	12,164.1	11,866.3
Equity ³	<u>616.6</u>	<u>664.4</u>
Total liabilities and equity	12,780.7	12,530.7

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

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

2. Includes allocations of Board of Governors' assets to priced services of \$0.7 million for 2001 and \$0.5 million for 2000.

3. Imputed figures represent the source of financing for certain priced-services assets.

4. For the 2001 PSAF, short-term payables attributable to priced services are included as a financing source for short-term assets such as receivables, materials and supplies, and prepaid expenses.

increase in asset levels is a reduction of \$80.1 million, resulting from the inclusion of short-term accounts payable as a financing source. Short-term assets that cannot be financed with actual (rather than imputed) short-term liabilities are financed with short-term debt.

Table A.2

Derivation of the Private Sector Adjustment Factor (PSAF), 2000 and 2001

Millions of dollars except as noted

Item	2000	2001
PSAF COMPONENTS		
<i>Assets to be financed</i> ¹		
Short-term ²	99.0	18.9
Long-term ³	1,017.5	1,143.5
Total	1,116.5	1,162.4
<i>Weighted average costs (percent)</i>		
<i>Capital structure</i> ⁴		
Short-term debt	8.9	1.6
Long-term debt	35.9	41.2
Equity	55.2	57.2
<i>Financing rates and costs</i> ⁴		
Short-term debt	5.1	4.7
Long-term debt	6.6	6.5
Pretax return on equity ⁵	23.3	24.0
Weighted average long-term cost of capital	16.7	16.7
Tax rate (percent)	31.5	31.5
REQUIRED PSAF RECOVERIES		
<i>Capital costs</i>		
Short-term debt	5.0	.9
Long-term debt	26.5	31.1
Equity ⁵	143.7	159.5
Total	175.2	191.5
<i>Other costs</i>		
Sales taxes	10.4	10.5
Assessment for federal deposit insurance	2.9	.0
Expenses of Board of Governors	4.2	4.9
Total	17.5	15.4
Total PSAF recoveries		
Millions of dollars	192.6	206.9
As a percentage of capital	17.3	17.8
As a percentage of expenses ⁶	28.0	28.5

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

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

2. For 2001, short-term assets consist only of those short-term assets that are financed with short-term debt.

3. Consists of total priced long-term assets, less postemployment/postretirement benefit liabilities.

4. For 2001, net short-term assets are assumed to be financed with short-term debt; for 2000, all short-term assets are assumed to be financed with short-term debt. Of the total 2001 long-term assets, 41.9 percent are assumed to be financed with long-term debt and 58.1 percent with

equity; for 2000, 39.4 percent of long-term assets were financed with long-term debt and 60.6 percent were financed with equity.

5. 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.

6. System priced-services expenses, less shipping, were budgeted at \$725.7 million for 2001 and \$687.0 million for 2000.

Cost of Capital and Taxes and Other Imputed Costs

For 2001, a pretax rate of return on equity of 24.0 percent, or \$159.5 million, is planned. Other required PSAF recoveries for 2001—imputed sales taxes, the imputed FDIC insurance assessment, and Board expenses—total \$15.4 million (table A.2).

Capital Outlays

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

The Banks and the Board capitalize and depreciate all assets that cost \$5,000 or more; they may either capitalize or expense assets costing less.

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

Board for further review and approval. The Board of Governors also reviews capital expenditures for the Board.

Currency Printing and Circulation

The Department of Treasury's Bureau of Engraving and Printing (BEP) prints U.S. currency; the Federal Reserve Banks put it into circulation through depository institutions and destroy it as it wears out. Under authority delegated by the Board, the director of the Division of Reserve Bank Operations and Payment Systems submits an order for new currency to the BEP each July. Upon reviewing the order, the BEP establishes 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 2000 totaled \$435.2 million, which is \$21.2 million, or 4.6 percent, less than budgeted (table A.3). In 2000, estimated fourth-quarter note production, 201.4 million notes, was less than the original budget forecast because Reserve Banks

Table A.3

Federal Reserve Costs of Supplying Currency, 2000 and 2001

Thousands of dollars except as noted

Item	2000 (estimated)	2001 (budgeted)	Percent change
Printing of new Federal Reserve notes	423,302	410,763	-3.0
Currency transportation	6,166	9,630	56.2
Counterfeit deterrence research	3,043	3,700	21.6
Reimbursement to the U.S. Treasury's Office of Currency Standards	2,700	2,900	7.4
Total cost of currency	435,211	426,993	-1.9

generally maintained high inventory levels after the Y2K buildup. The printing cost for the 2001 budget is \$410.8 million, or 3.0 percent less than the estimated 2000 expenditures.

Printing of Federal Reserve Notes

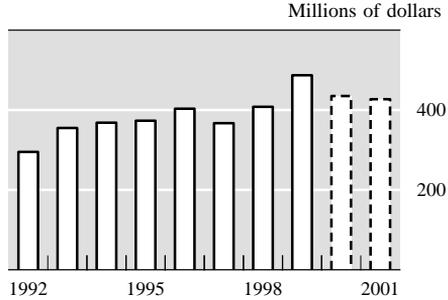
Because of high currency inventory levels at the Reserve Banks, the Board limited the print order for the 2001 budget to 8.2 billion notes. The budget for printing the 8.2 billion notes is \$410.8 million, or 96.2 percent of the total 2001 new currency budget. For January through September 2001 (the portion of the federal government’s fiscal 2001 that falls within calendar 2001), production is set at 6.2 billion notes. The Board’s staff estimates that for October through December 2001, production could be 2.0 billion notes (chart A.1).

The BEP charges the Board for each of the three types of currency produced: unthreaded (\$1s), New Currency Design (NCD) without optical-varying ink (\$5s), and NCD with optical-varying ink (\$10s, \$20s, \$50s, and \$100s) (table A.4).² The

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

Chart A.1

Federal Reserve Budget for Supplying U.S. Currency, 1992–2001



NOTE. For 2000, estimated; for 2001, budgeted.

average price charged to the Board by the BEP for producing all three types of notes will increase 2.6 percent in 2001, from \$47.35 per thousand notes printed to \$48.58. During 2001, 42.5 percent of the notes produced will be NCD notes, and the remaining 57.5 percent will be unthreaded (\$1s). The billing rate for each type blends the costs of producing the notes at the Washington, D.C., and Fort Worth, Texas, facilities of the BEP. The 2001 billing rate for the \$5 note is expected to decline by about 5.92 percent because the production volume will increase 70.8 percent over 2000.

Table A.4

Projected Cost of Printing New Notes, by Type of Note, 2001

Type of currency	Number of notes (millions)	Percentage of total notes	Cost per thousand notes (dollars)	Total cost (thousands of dollars)
Unthreaded (\$1s)	4,724.8	58	39.98	188,898
New Currency Design ¹				
\$5s	1,158.5	14	56.65	65,629
\$10s, \$20s, \$50s, \$100s	2,297.6	28	68.00	156,237
Total	8,180.9	100	48.58²	410,763

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

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

Currency Transportation

The 2001 budget for currency transportation is \$9.6 million, which includes shipments from the BEP to the Reserve Banks and shipments among the Reserve Banks. Although note production in 2001 is lower than in 2000, the transportation budget is 56.2 percent higher than estimated 2000 expenses because of a Government Services Administration decision not to permit contractors to receive government rates for airfare. The 2001 budget for new BEP shipments is \$7.6 million, or 60.7 percent greater than estimated 2000 expenses.

The 2001 budget for currency shipments between Reserve Banks is \$2.0 million, or 140.5 percent greater than estimated 2000 expenses. Intra-System shipments are used to move currency from Banks with excess fit currency to Banks that would otherwise require new currency from the BEP. Because the BEP is printing a limited number of \$100 notes and not printing

any \$2 and \$50 notes in fiscal 2001, Reserve Banks that need these notes will need to obtain them from other Banks.

Counterfeit Deterrence Research

The 2001 budget includes \$3.7 million to fund the final phase of the three-year counterfeit deterrence system effort. This effort, operating under the auspices of the G-10 governors, combats digital counterfeiting.

Treasury's Office of Currency Standards (OCS)

The OCS develops standards for the cancellation, destruction, and accountability of unfit currency. As a public service, the BEP processes claims for the redemption of damaged or mutilated currency that is turned over to the Reserve Banks. The 2001 budget includes \$2.9 million to reimburse the Treasury for OCS expenses. ■

Appendix B

Sources and Uses of Funds

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

The System derives its income primarily from earnings on U.S. government securities that the Federal Reserve has acquired through open market operations, one of the tools of monetary policy. These earnings account for approximately 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 \$25.4 billion and \$25.3 billion for 1999 and 2000 respectively. In addition to these payments, a special transfer of surplus of \$3.752 billion on May 10, 2000, was statutorily required.

Table B.1
Income of the Federal Reserve System,
1999 and 2000

Millions of dollars

Source	1999	2000 (estimated)
Loans	11.1	22.8
U.S. government securities ...	28,216.1	32,736.9
Foreign currencies	224.8	269.5
Priced services	835.9	881.5
Other	58.9	53.2
Total	29,346.8	33,964.0

Table B.2

Distribution of the Income of the Federal Reserve Banks, 1999 and 2000

Millions of dollars

Item	1999	2000 (estimated)
Current income ¹	29,347	33,964
LESS		
<i>Current expenses of Reserve Banks</i> ²		
Operating expenses	1,531	1,586
Costs of earnings credits	321	385
EQUALS		
Current net income	27,495	31,992
PLUS		
Net additions to, or deductions from (-), current net income ³	-526	-1,492
LESS		
Cost of unreimbursed Treasury services ⁴	8	8
<i>Assessments by the Board</i>		
Board expenses	214	188
Cost of currency	485	436
<i>Other distributions</i>		
Dividends paid to member banks ⁵	374	410
Transfers to, or from (-), surplus ^{6,7}	479	4,115
EQUALS		
Payment to U.S. Treasury ⁷	25,410	25,344

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 \$366.8 million in 1999 and \$392.6 million in 2000.

3. This account is the same as that reported under the same name in the table "Income and Expenses of Federal Reserve Banks" in the Statistical Tables section of the Board's *Annual Report* and includes realized and unrealized gains on assets denominated in foreign currencies, gains on sales of U.S. government securities, and miscellaneous gains and losses.

4. The cost of services provided to the U.S. Treasury that are reimbursable under agreements with the Treasury and for which reimbursement is not anticipated.

5. The Federal Reserve Act requires the Federal Reserve to pay dividends to member banks at the rate of 6 percent of paid-in capital.

6. Each year, to provide a reserve against losses, the Federal Reserve transfers to its surplus account an amount sufficient to equate surplus to paid-in capital.

7. Does not reflect the special transfer of surplus from the Federal Reserve System to the Treasury of \$3.752 billion on May 10, 2000.

*Appendix C**Federal Reserve System Audits*

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

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

Independent Audit

The Board of Governors contracts with an external audit firm, currently PricewaterhouseCoopers L.L.P., for an annual 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, which currently has 8 projects in various stages of completion, since 1979 has completed 191 reports on selected aspects of Federal Reserve operations (tables C.1 and C.2). The GAO has also involved the Federal Reserve in about 104 other reviews not directly related to the System and has terminated 56 others before completion. The reports are available directly from the GAO.

Table C.1

Active GAO Projects Relating to the Federal Reserve, Year-End 2000

Subject	Date initiated
Issues related to money laundering and the securities industry	5-1-00
Federal telecommunications profile project	5-4-00
Student credit card debt	6-19-00
U.S. government's financial statements in FY 2000	6-20-00
Fraudulent access to financial information	6-29-00
Assessment of human capital management policies and practices	10-27-00
Siting of federal facilities	11-9-00
Mandatory flood insurance purchase requirements	12-8-00

Table C.2

Completed GAO Reports Relating to the Federal Reserve System, 1979–2000

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

Table C.2
Continued

Report	Number	Date issued
Issues to Be Considered while Debating Interstate Bank Branching	GGD-82-36	4-9-82
The Federal Reserve Should Move Faster to Eliminate Subsidy of Check-Clearing Operations	GGD-82-22	5-7-82
Information about Depository Institutions' Ancillary Activities Is Not Adequate for Policy Purposes	GGD-82-57	6-1-82
Bank Merger Process Should Be Modernized and Simplified	GGD-82-53	8-16-82
An Analysis of Fiscal and Monetary Policies	PAD-82-45	8-31-82
Bank Examination for Country Risk and International Lending	ID-82-52	9-2-82
Credit Insurance Disclosure Provisions of the Truth-in-Lending Act Consistently Enforced Except When Decisions Appealed	GGD-83-3	10-25-82
Survey of Investor Protection and the Regulation of Financial Intermediaries	GGD-83-30	7-13-83
Financial Institutions Regulatory Agencies Can Make Better Use of Consumer Complaint Information	GGD-83-13	8-25-83
Expediting Tax Deposits Can Increase the Government's Interest Earnings	GGD-84-14	11-21-83
Unauthorized Disclosure of the Federal Reserve's Monetary Policy Decision	GGD-84-40	2-3-84
Federal Financial Institutions Examination Council Has Made Limited Progress toward Accomplishing Its Mission	GGD-84-4	2-3-84
Control Improvements Needed in Accounting for Treasury Securities at the Federal Reserve Bank of New York	AFMD-84-10	5-2-84
Statutory Requirements for Examining International Banking Institutions Need Attention	GGD-84-39	7-11-84
Supervisory Examinations of International Banking Facilities Need to Be Improved	GGD-84-65	9-30-84
An Examination of Concerns Expressed about the Federal Reserve's Pricing of Check-Clearing Activities	GGD-85-9A	1-14-85
Difficulties in Evaluating the Effectiveness of the Community Reinvestment Act	OCE-86-1	11-4-85
International Coordination of Bank Supervision: The Record to Date ...	NSIAD-86-40	2-6-86
Implementation of the Export Trading Company Act of 1982	NSIAD-86-42	2-27-86
Information on Independent Public Accountant Audits of Financial Institutions	GGD-84-44FS	4-21-86
An Analysis of Two Types of Pooled Investment Funds	GGD-86-63	5-12-86
How the Markets Are Developed and How They Are Regulated	GGD-86-26	5-15-86
U.S. Banking Supervision and International Supervisory Principles	NSIAD-86-93	7-25-86
Financial Institution Regulators' Compliance Examination	GGD-86-94	8-1-86
The Market's Structure, Risks, and Regulation	GGD-86-80BR	8-20-86
Dealer Views on Market Operations and Federal Reserve Securities Transfer System	GGD-86-147FS	9-29-86
Questions about the Federal Reserve's Securities Transfer System	GGD-87-15BR	10-20-86
Federal Reserve Board Opposition to Credit Card Interest Rate Limits .	GGD-87-38BR	4-7-87
Insulating Banks from the Potential Risk of Expanded Activities	GGD-87-35	4-14-87
The Federal Reserve Response Regarding Its Market-Making Standard .	GGD-87-55FS	4-21-87
Change in Fees and Deposit Account Interest Rates since Deregulation .	GGD-87-70	7-13-87
An Examination of Views Expressed about Access to Brokers' Services .	GGD-88-8	12-18-87
Issues Related to Repeal of the Glass-Steagall Act	GGD-88-37	1-22-88
Preliminary Observations on the October 1987 Crash	GGD-88-38	1-26-88
Supervision of Overseas Lending Is Inadequate	NSIAD-88-87	5-5-88
Competitive Concerns of Foreign Financial Firms in Japan, the United Kingdom and the United States	NSIAD-88-171	6-2-88
Administrative Expenses at FHLBB and FRB for 1985 and 1986	AFMD-88-33	6-15-88

Table C.2

Completed GAO Reports Relating to the Federal Reserve System—Continued

Report	Number	Date issued
Government in the Sunshine Act Compliance at Selected Agencies	GGD-88-97	7-20-88
Trends in Commercial Bank Performance, December 1976–June 1987 . .	GGD-88-106BR	7-28-88
U.S. Commercial Banks' Securities Activities in London	NSIAD-88-238	9-8-88
Lending to Troubled Sectors	GGD-88-126BR	9-26-88
Government Check-Cashing Issues	GGD-89-12	10-7-88
Conflict of Interest: Abuses in Commercial Banking Institutions	GGD-89-35	1-27-89
Competitive Fairness Is an Elusive Goal	GGD-89-61	5-12-89
Independent Audits Needed to Strengthen Internal Control and Bank Management	AFMD-89-25	5-31-89
Information on the System's Check Collection Service	GGD-90-17	12-15-89
Oversight of Critical Banking Systems Should Be Strengthened	IMTEC-90-14	1-14-90
Activities of Securities of Bank Holding Companies	GGD-90-48	3-14-90
The Stock, Options, and Futures Markets Are Still at Risk	GGD-90-33	4-11-90
Update on U.S. Commercial Banks' Securities in London	NSIAD-90-98	5-7-90
U.S. Financial Services' Competitiveness under the Single Market Program	NSIAD-90-99	5-21-90
Limited Public Demand for New Dollar Coin or Elimination of Pennies .	GGD-90-88	5-23-90
Oversight of Automation Used to Clear and Settle Trades Is Uneven . .	IMTEC-90-47	7-12-90
The Government's Exposure to Risks	GGD-90-97	8-15-90
Office of Inspector General Operations at Financial Regulatory Agencies .	AFMD-90-55FS	8-24-90
Additional Reserves and Reform Needed to Strengthen the Fund	AFMD-90-100	9-11-90
More Transaction Information and Investor Protection Measures Are Needed	GGD-90-114	9-14-90
Issues Relating to Banks Selling Insurance	GGD-90-113	9-25-90
Implementation of Risk-Based Capital Adequacy Standards	NSIAD-91-80	1-25-91
Overview of Six Foreign Systems	NSIAD-91-104	2-22-91
Deposit Insurance: A Strategy for Reform	GGD-92-26	3-4-91
Bank Supervision: Prompt and Forceful Regulatory Actions Needed	GGD-91-69	4-15-91
Many Federal Agencies Collect and Disseminate Information	NSIAD-91-173	5-1-91
Money Laundering: The U.S. Government Is Responding to the Problem .	NSIAD-91-130	5-16-91
A Framework for Limiting the Government's Exposure to Risks	GGD-91-90	5-22-91
Treasury Tax and Loan Activity at Two Troubled Banks	AFMD-91-87	9-12-91
OCC's Supervision of the Bank of New England Was Not Timely or Forceful	GGD-91-128	9-16-91
Bank Holding Company Securities Subsidiaries' Market Activities Update	GGD-91-131	9-20-91
Time Limits on Holding Deposits Generally Met but More Oversight Needed	GGD-91-132	9-30-91
Legislation Needed to Strengthen Bank Oversight	AFMD-92-19	10-21-91
Contracting Practices with Data Processing Servicers	GGD-92-19	2-5-92
Challenges to Harmonizing International Capital Standards Remain	GGD-92-41	3-10-92
Assessing the Need to Regulate Additional Financial Activities	GGD-92-70	4-21-92
Call Report Automation	IMTEC-92-60R	5-28-92
Flexible Accounting Rules Lead to Inflated Financial Reports	AFMD-92-52	6-1-92
Cross-Border Information Sharing Is Improving, but Obstacles Remain . .	GGD-92-110	7-28-92
Changes in Collateral Practices Could Reduce the Federal Government's Risk of Loss	AFMD-92-54	9-14-92
Initial Assessment of Certain BCCI Activities in the U.S.	GGD-92-96	9-30-92
Appraisal Reform: Implementation Status and Unresolved Issues	GGD-93-19	10-30-92
Bank and Thrift Criminal Fraud: The Federal Commitment Could Be Broadened	GGD-93-48	1-8-93
FRB Examinations and Inspections Do Not Fully Assess Bank Safety and Soundness	AFMD-93-13	2-16-93
Improvements Needed in Examination Quality and Regulatory Structure . .	AFMD-93-15	2-16-93

Table C.2
Continued

Report	Number	Date issued
Personnel Engaged in Public and Congressional Affairs in Federal Agencies	GGD-93-71FS	3-8-93
Credit Availability Guidance	GGD-93-15R	3-30-93
Treasury Automation: Automated Auction May Not Achieve Benefits or Operate Properly	IMTEC-93-28	4-27-93
IRS Can Improve the Federal Tax Deposit System	AFMD-93-40	4-28-93
Funding Foreign Bank Examinations	GGD-93-35R	5-4-93
Preliminary Information Related to a Futures Transaction Fee	GGD-93-108	5-17-93
The Business Environment in the United States, Japan, and Germany	GGD-93-124	8-9-93
Regulatory Impediments to Small Business Lending Should Be Removed	GGD-93-121	9-7-93
Recent Developments in Foreign Exchange Markets	GGD-93-154	9-24-93
Benefits and Risks of Removing Regulatory Restrictions	GGD-94-26	11-2-93
Regulatory Burden: Recent Studies, Industry Issues, and Agency Initiatives	GGD-94-28	12-13-93
Strengthening the Framework for Supervising International Banks	GGD-94-68	3-21-94
Insider Problems and Violations Indicate Broader Management Deficiencies	GGD-94-88	3-30-94
U.S. Credit Card Industry: Competitive Developments Need to be Closely Monitored	GGD-94-23	4-28-94
Better Guidance Is Needed for Real Estate Evaluations	GGD-94-144	5-24-94
Treasury Securities Auction	AIMD-94-165R	8-25-94
Divergent Loan Loss Methods Undermine Usefulness of Financial Reports	AIMD-95-8	10-31-94
Interstate Banking: Experiences in Three Western States	GGD-95-35	12-30-94
Lessons Learned from Resolving First City Bancorporation of Texas ...	GGD-95-37	3-15-95
Investment of Trust Assets in Bank Proprietary Mutual Funds	GGD-95-21	3-16-95
Status Report on the Initiative to Improve Economic Statistics	GGD-95-98	7-7-95
Mandated Studies to Review Costly Bank and Thrift Failures	GGD-95-126	7-31-95
Differences in Screening Bank Executives	GGD-95-181R	8-17-95
Banks' Securities Activities: Oversight Differs Depending on Activity and Regulator	GGD-95-214	9-21-95
Mutual Funds: Impact on Bank Deposits and Credit Availability	GGD-95-230	9-22-95
Bank Mutual Funds: Sales Practices and Regulatory Issues	GGD-95-210	9-27-95
Challenges Remain to Successfully Implement CRA	GGD-96-23	11-28-95
Foreign Banks: Assessing Their Role in the U.S. Banking System	GGD-96-26	2-7-96
Federal Reserve Banks: Internal Control, Accounting, and Auditing Issues	AIMD-96-5	2-9-96
Mexico's Financial Crisis: Origins, Awareness, Assistance, and Initial Efforts to Recover	GGD-96-56	2-23-96
Counterfeit U.S. Currency Abroad: Issues and U.S. Deterrence Efforts ...	GGD-96-11	2-26-96
Money Laundering: A Framework for Understanding U.S. Efforts Overseas	GGD-96-105	5-24-96
Federal Reserve System: Current and Future Challenges Require Systemwide Attention	GGD-96-128	6-17-96
Fair Lending: Federal Oversight and Enforcement Improved but Some Challenges Remain	GGD-96-145	8-13-96
Federal Reserve Banks: Inaccurate Reporting of Currency at the Los Angeles Branch	AIMD-96-146	9-30-96
Implementation of the Foreign Bank Supervision Enhancement Act of 1991	GGD-96-187	9-30-96
Financial Derivatives: Actions Taken or Proposed since May 1994	GGD-AIMD-97-8	11-1-96
Inspectors General: Mandated Studies to Review Costly Bank and Thrift Failures	GGD-97-4	11-7-96
Regulatory Burden: Measurement Challenges and Concerns Raised by Selected Companies	GGD-97-2	11-18-96
Bank Oversight Structure: U.S. and Foreign Experience May Offer Lessons for Modernizing U.S. Structure	GGD-97-23	11-20-96

Table C.2

Completed GAO Reports Relating to the Federal Reserve System—Continued

Report	Number	Date issued
Bank Oversight Structure: U.S. and Foreign Experience May Offer Lessons for Modernizing U.S. Structure	GGD-07-23	11-20-96
Implementation of FDICIA's Prompt Regulatory Action Provisions	GGD-97-18	11-21-96
Bank Regulatory Structure: Japan	GGD-97-5	12-27-96
Bank Data: Material Loss of Oversight Information from Interstate Banking Is Unlikely	GGD-97-49	3-26-97
The Commodity Exchange Act: Legal and Regulatory Issues Remain ..	GGD-97-50	4-7-97
Treasury's Plan to Study Genuine and Counterfeit U.S. Currency Abroad ..	NSIAD-97-104	4-11-97
Bank Oversight: Few Cases of Tying Have Been Detected	GGD-97-58	5-8-97
Foreign Banks: Opportunities Exist to Enhance Supervision Programs as Implementation Proceeds	GGD-97-80	5-9-97
Four Financial Crises in the 1980s	GGD-97-96	5-21-97
Payments, Clearance, and Settlement: A Guide to the Systems, Risks, and Issues	GGD-97-73	6-20-97
International Financial Crises: Efforts to Anticipate, Avoid, and Resolve Sovereign Crises	GGD-NSIAD-97-168	7-7-97
Federal Reserve Banks: Internal Controls Over Cash at Atlanta, Los Angeles, and Philadelphia Banks	AIMD-97-127	8-28-97
Foreign Banks: Internal Control and Audit Weaknesses in U.S. Branches ..	GGD-97-181	9-29-97
OTC Derivatives: Additional Oversight Could Reduce Costly Sales Practice Disputes	GGD-98-5	10-2-97
Information on Private Banking and Its Vulnerability to Money Laundering	GGD-98-19R	10-30-97
Electronic Banking: Experiences Reported by Banks in Implementing On-line Banking	GGD-98-34	1-15-98
Regulatory Oversight of Offshore Private Banking Activities	GGD-98-154	6-29-98
Year 2000 Computing Crisis: Actions Needed on Electronic Data Exchanges	AIMD-98-124	7-1-98
Experience With Electronic Check Presentment	GGD-98-145	7-14-98
Risk-Based Capital: Regulatory and Industry Approaches to Capital and Risk	GGD-98-153	7-20-98
High-Loan-To-Value Lending: Information on Loans Exceeding Home Value	GGD-98-169	8-13-98
Live Loan Checks: Information on Unsolicited Consumer Loans for Preapproved Borrowers	GGD-98-176	8-14-98
Year 2000 Computing Crisis: Federal Reserve Is Acting to Ensure Financial Institutions Are Fixing Systems But Challenges Remain ..	AIMD-98-248	9-17-98
Federal Reserve Banks: Areas for Improvements in Computer Controls ..	AIMD-99-5	10-14-98
The Results Act: Observations on the Federal Reserve's 1998-99 Biennial Performance Plan	GGD-99-9R	11-9-98
Regulatory Burden: Some Agencies' Claims Regarding Lack of Rulemaking Discretion Have Merit	GGD-99-20	1-18-99
Year 2000 Computing Crisis: Federal Reserve Has Established Effective Year 2000 Management Controls for Internal Systems Conversion	AIMD-99-78	4-9-99
Year 2000: Financial Institution and Regulatory Efforts to Address International Risks	GGD-99-62	4-27-99
Electronic Banking: Enhancing Federal Oversight of Internet Banking Activities	GGD-99-91	7-16-99
Federal Reserve Banks: Areas for Improvement in Computer Controls ..	AIMD-99-245	8-13-99
Federal Reserve Board: Merger Process Needs Guidelines for Community Reinvestment Issues	GGD-99-180	9-24-99
International Finance: Actions Taken to Reform Financial Sectors in Asian Emerging Markets	GGD-99-157	9-28-99
Long Term Capital Management: Regulators Need to Focus Greater Attention on Systemic Risks	GGD-00-3	10-29-99
Large Bank Mergers: Fair Lending Review Could be Enhanced With Better Coordination	GGD-00-16	11-3-99

Table C.2

Continued

Report	Number	Date issued
Financial Regulatory Coordination: The Role and Functioning of the President's Working Group	GGD-00-46	1-21-00
Risk-Focused Bank Examinations: Regulators of Large Banking Organizations Face Challenges	GGD-00-48	1-24-00
Responses to Questions Concerning Long-Term Capital Management and Related Events	GGD-00-67R	2-23-00
Financial Impact of \$1 Coin	GGD-00-111R	4-7-00
Commodity Exchange Act: Issues Related to the Regulation of Electronic Trading Systems	GGD-00-99	5-5-00
Federal Reserve Banks: Areas for Improvement in Computer Controls ..	AIHMD-00-138	5-18-00
CLF Lending to Credit Unions Before Year 2000 Date Change	GGD-00-143R	5-23-00
Mutual Fund Fees: Additional Disclosure Could Encourage Price Competition	GGD-00-126	6-7-00
Banking Taxation: Implications of Proposed Revisions Governing S-Corporations on Community Banks	GGD-00-159	6-23-00
Automated Teller Machines: Issues Related to Real-time Fee Disclosure ..	AIMD-00-224	7-11-00
Insurance Regulation: Scandal Highlights Need for Strengthened Regulatory Oversight	GGD-00-198	9-19-00
Electronic Signature Systems	GAO-01-129R	11-8-00
Federal Reserve System: Mandated Report on Potential Conflicts of Interest	GAO-01-160	11-13-00

Table C.3

Completed OIG Audit Reports Relating to the Federal Reserve System, 2000

Report	Number	Month issued
Century Date Change Activities	A9713	March
Annual Thrift Plan Audit	A0001	March
e-Gov Congressional Initiative	A0003	March
Peoplesoft Control Self-Assessment	A9905	March
Audit of the FFIEC's Financial Statements (years ended 12-31-98 and 12-31-99)	A9906	April
Audit of the Board's Financial Statements (years ended 12-31-98 and 12-31-99)	A9906BD	April
Systemwide Review of ISM Compliance	P0011	June
Review of the Board's Frequent Flyer Policy	A9903	June
Publications Review	R9902	September
Review of the Board's Participation in PDD-63	A0002	September
Review of the Board's Retirement Plan Data Conversion	A0006	December

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 nongovern-

mental agencies to promote economy and efficiency and to detect and prevent fraud and abuse in activities administered or financed by the Board. The OIG keeps the Congress and the Chairman of the Board fully informed about serious abuses and deficiencies and about the status of any corrective actions.

During 2000, the OIG completed eleven audits, reviews, and assessments (table C.3) and conducted a number of follow-up reviews to evaluate action taken on earlier recommendations. In addition, the OIG closed thirteen 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, 2000 and 2001

Thousands of dollars except as noted

District	2000 (estimated)	2001 (budgeted)	Change	
			Amount	Percent
Boston	124,720	144,041	19,321	15.5
New York	448,572	484,358	35,787	8.0
Philadelphia	118,499	121,597	3,098	2.6
Cleveland	130,515	131,778	1,262	1.0
Richmond	185,498	188,288	2,790	1.5
Atlanta	270,542	297,629	27,087	10.0
Chicago	231,029	226,869	-4,160	-1.8
St. Louis	130,048	123,780	-6,268	-4.8
Minneapolis	115,978	138,828	22,850	19.7
Kansas City	143,418	150,806	7,388	5.2
Dallas	143,997	144,597	600	.4
San Francisco	248,236	273,246	25,010	10.1
Total, all Districts	2,291,051	2,425,817	134,766	5.9
<i>Special project</i>				
Check standardization	6,735	16,392	9,657	143.4
Total	2,297,786	2,442,209	144,423	6.3

NOTE. Excludes capital outlays. Includes expenses budgeted by Federal Reserve Information Technology (FRIT) and the System's Office of Employee Benefits (OEB). (For more detail on FRIT and OEB, see text note 2, chapter 3.)

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, 2000 and 2001

Average number of personnel except as noted

District	2000 (estimated)	2001 (budgeted)	Change	
			Amount	Percent
Boston	1,287	1,285	-3	-.2
New York	3,570	3,431	-139	-3.9
Philadelphia	1,272	1,287	15	1.2
Cleveland	1,340	1,392	52	3.9
Richmond	2,186	2,205	19	.9
Atlanta	2,644	2,666	22	.8
Chicago	2,134	2,111	-23	-1.1
St. Louis	1,324	1,318	-6	-.5
Minneapolis	1,265	1,289	24	1.9
Kansas City	1,602	1,678	76	4.7
Dallas	1,608	1,600	-8	-.5
San Francisco	2,489	2,499	10	.4
Total, all Districts	22,721	23,760	38	.2
Federal Reserve Information Technology (FRIT)	668	698	30	4.5
Total	23,389	23,458	68	.3

NOTE. See note to table D.1. See text note 4, chapter 3, for definition of average number of personnel.

*Table D.3*Budget Performance of the Federal Reserve Banks,
Operating Expenses, by District, 2000

Thousands of dollars except as noted

District	2000 (budgeted)	2000 (estimated)	Change	
			Amount	Percent
Boston	125,597	124,720	-876	-.7
New York	462,234	448,572	-13,663	-3.0
Philadelphia	119,350	118,499	-851	-.7
Cleveland	132,514	130,515	-1,999	-1.5
Richmond	181,017	185,498	4,481	2.5
Atlanta	270,313	270,542	228	.1
Chicago	235,202	231,029	-4,173	-1.8
St. Louis	129,353	130,048	695	.5
Minneapolis	117,876	115,978	-1,899	-1.6
Kansas City	143,542	143,418	-124	-.1
Dallas	143,654	143,997	343	.2
San Francisco	251,258	248,236	-3,022	-1.2
Total, all Districts	2,311,910	2,291,051	-20,860	-.9
Special project	13,995	6,735	-7,260	-51.9
Total	2,325,905	2,297,786	-28,119	-1.2

NOTE. See note to table D.1.

Table D.4

Budget Performance of the Federal Reserve Banks,
Employment, by District, 2000

Average number of personnel except as noted

District	2000 (budgeted)	2000 (estimated)	Change	
			Amount	Percent
Boston	1,308	1,287	-21	-1.6
New York	3,654	3,570	-84	-2.3
Philadelphia	1,287	1,272	-16	-1.2
Cleveland	1,381	1,340	-41	-3.0
Richmond	2,195	2,186	-9	-.4
Atlanta	2,762	2,644	-117	-4.2
Chicago	2,163	2,134	-28	-1.3
St. Louis	1,324	1,324	1	.1
Minneapolis	1,270	1,265	-5	-.4
Kansas City	1,614	1,602	-12	-.8
Dallas	1,635	1,608	-27	-1.7
San Francisco	2,515	2,489	-26	-1.0
Total, all Districts	23,107	22,721	-386	-1.7
Federal Reserve Information Technology	644	659	15	2.3
Special project	0	9	9	...
Total	23,571	23,389	-362	-1.5

NOTE. See note to table D.1. See text note 4, chapter 3, for definition of average number of personnel. . . . Not applicable.

Table D.5

Salary Administration Expenses of the Federal Reserve Banks for Officers and Employees, by District, 2001

Thousands of dollars except as noted

District	Merit	Promotions and reclassifications	Market adjustments	Cash awards	Incentive payments	Retention payments	Total	
							Amount	As a share of total personnel expense (percent)
Boston	2,558	914	85	490	970	0	5,018	6.9
New York	10,224	2,905	1,350	3,506	1,893	120	19,997	8.2
Philadelphia	2,297	454	299	774	472	0	4,295	6.6
Cleveland	1,943	238	227	593	481	45	3,528	5.6
Richmond	4,017	1,150	835	1,370	697	0	8,070	7.7
Atlanta	5,029	1,055	543	2,072	329	155	9,183	7.3
Chicago	4,393	1,600	500	1,359	913	38	8,804	7.6
St. Louis	2,535	324	114	854	326	177	4,329	7.1
Minneapolis	2,561	309	125	778	306	17	4,097	6.8
Kansas City	3,168	998	462	1,131	584	60	6,405	7.9
Dallas	2,840	240	32	979	144	53	4,288	5.7
San Francisco	5,340	782	577	1,902	676	1,424	10,700	7.2
Total, all Districts ..	46,905	10,969	5,149	15,808	7,791	2,089	88,713	7.0
Federal Reserve Information Technology	2,022	230	0	243	652	1,090	4,237	8.2
Total	48,928	11,200	5,149	16,052	8,443	3,179	92,950	7.0

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 "hot market" jobs or positions critical to the success of the Bank.

Table D.6

Capital Outlays of the Federal Reserve Banks, by District, 2000 and 2001

Thousands of dollars except as noted

District	2000 (estimated)	2001 (budgeted)	Change	
			Amount	Percent
Boston	18,692	12,025	-6,667	-35.7
New York	50,759	53,766	3,007	5.9
Philadelphia	10,259	7,037	-3,222	-31.4
Cleveland	40,171	17,726	-22,444	-55.9
Richmond	20,779	22,880	2,101	10.1
Atlanta	132,367	85,608	-46,758	-35.3
Chicago	22,346	46,590	24,244	108.5
St. Louis	13,292	20,449	7,158	53.9
Minneapolis	4,081	4,012	-69	-1.7
Kansas City	16,766	16,258	-508	-3.0
Dallas	38,671	10,431	-28,240	-73.0
San Francisco	43,257	26,252	-17,005	-39.3
Total, all Districts	411,438	323,034	-88,404	-21.5
Federal Reserve Information Technology	55,917	38,272	-17,645	-31.6
Total	467,355	361,306	-106,049	-22.7

Table D.7

Capital Outlays of the Federal Reserve Banks, by Asset Classification, 2000 and 2001

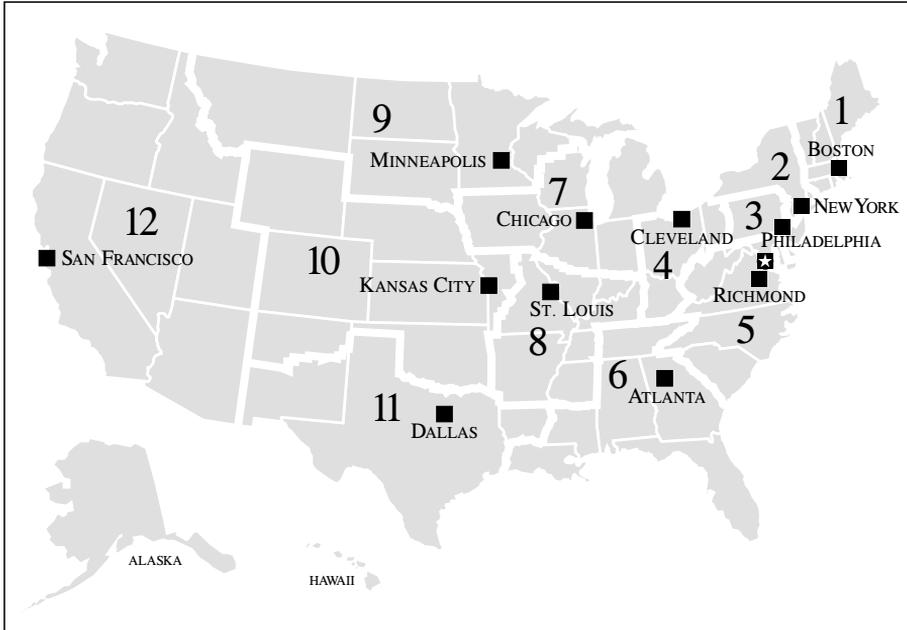
Thousands of dollars except as noted

Asset classification	2000 (estimated)	2001 (budgeted)	Change	
			Amount	Percent
Equipment	142,087	129,489	-12,598	-8.9
Furniture, furnishings, and fixtures	26,888	34,503	7,615	28.3
Land and other real estate	36,006	11,956	-24,050	-66.8
Building	164,708	113,571	-51,137	-31.0
Building machinery and equipment	20,867	24,745	3,879	18.6
Leasehold improvements	4,176	8,064	3,889	93.1
Software	72,624	38,977	-33,647	-46.3
Total	467,355	361,306	-106,049	-22.7

NOTE. Includes outlays for Federal Reserve Information Technology.

*Maps of the
Federal Reserve System*

The Federal Reserve System



LEGEND

Both pages

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

Facing page

- Federal Reserve Branch city
- Branch boundary

NOTE

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

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

The System serves commonwealths and territories as follows: The New York

Bank serves the Commonwealth of Puerto Rico and the U.S. Virgin Islands; the San Francisco Bank serves American Samoa, Guam, and the Commonwealth of the Northern Mariana Islands. The maps show the boundaries within the System as of year-end 2000.

